

December 24 | 2018

## Weekly | 2018 | Week 51

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## | CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Thursday	27-Dec-18	9:00	CZ	Businecc / Consumer Confidence, Dec'18	N/A	N/A
	27-Dec-18	9:00	SP	Retail Sales, Nov'18, y/y (SA)	1.2%	N/A
Friday	28-Dec-18	9:00	SPA	(Final) 3Q18 GDP, q/q	0.6%	N/A
	28-Dec-18	9:00	SPA	(Preliminary) HICP, Dec'18, y/y	1.6%	N/A
	28-Dec-18	14:00	GER	(Preliminary) HICP, Dec'18, y/y	1.9%	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

"THERE IS MILLENARIAN OVERREACH AND THEN THERE IS THIS ↗ ?" [TWITTER]

## WEEK AHEAD

Light week ahead of us.

In the Czech Republic, only the December confidence data will be released, and although the market expectation is not available, it's safe to assume that both consumer and business confidence will show worsening.

In Eurozone, German and Spanish preliminary headline inflation for December will be released. In both countries the headline inflation is to slow, reflecting the energy price drops due to declines in oil prices in November – December.

Merry Christmas!

## WEEK BEHIND

Producer and import prices show no signs of future inflation in pipeline

CNB stays put, but not unanimously so

IFO index raises the odds of recession in Germany

EMU consumer confidence falls to lowest since Feb'17

## FX

EURCZK rose back above 25.85 on renewed market turmoil.

Honestly, with stock market sell-off and SP500 now 17% off peak (and 7% in December alone), I would've thought 26 would be broken.

## FI

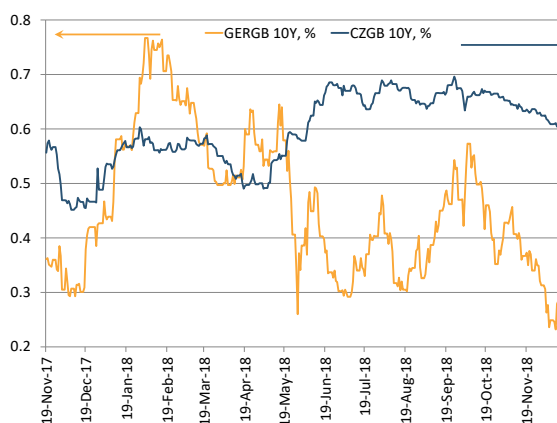
Turmoil kept the German 10Y yields low,...

...and sent the Czech ones below 2% for the first time since early June.

**EURCZK RISE BACK TO 25.85 ON RENEWED MARKET TURMOIL**

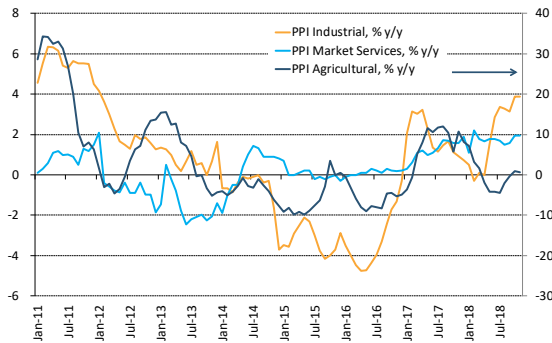


**TURMOIL KEEPS GER 10Y YIELDS LOW, SENDS CZ 10Y BELOW 2%**

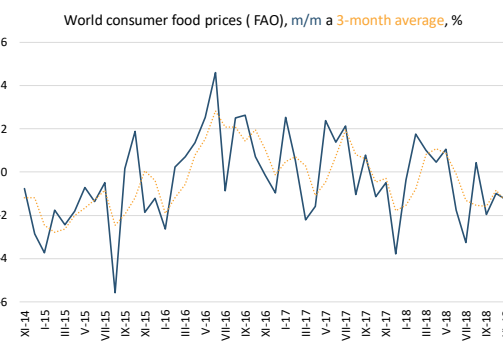
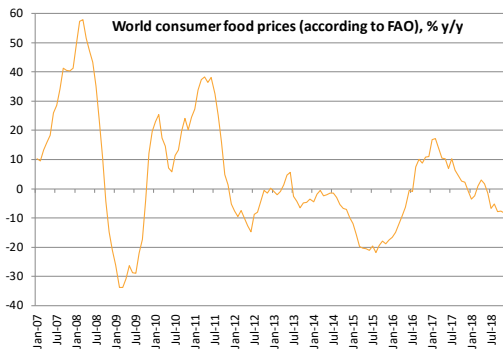


**CZECH ECONOMY**

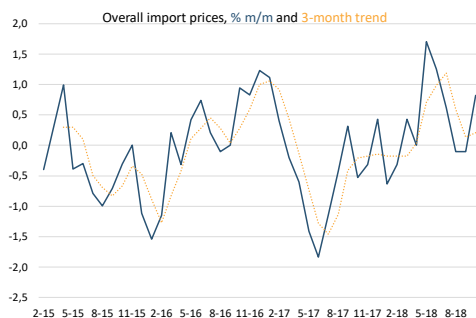
**PPI REMAINED STABLE IN NOVEMBER...**



**...AND IS ABOUT TO FALL AS FOOD, FUEL PRICES FELL.**



**IMPORT PRICES IN A SHORT-LIVED RETURN TO GROWTH IN OCTOBER**



**Growth rate of Czech producer prices remained stable in November while import prices returned to growth in October. Not for long...**

Only the growth of agricultural producers' prices decelerated in November, but even that was just imperceptibly so: from October's 0.9% y/y to November's 0.7% y/y, so hardly worth mentioning. For prices of market services and for industrial producers, annual growth remained unchanged at 2% and 3.9%, respectively. In monthly data, the only semi-interesting fact is the first decline since February of industrial producers' prices, but a) it was only a small one (-0.1% m/m) and b) this often happens in November. What's much more important is that, going forward, falling oil prices (22% in CZK terms in November, not yet reflected in PPI, additional 5% so far in December) and falling global food prices (worldwide -8.5% y/y) mean PPI will decelerate.

**Import prices returned to growth again in October**, reflecting mainly higher import prices of mineral fuels (+4.5% m/m), of chemicals (+1.2%) and of tobacco (+1.3% m/m). But this will be short-lived. See, import prices of mineral fuels are up 29% year-to-date, but considering the fall of oil prices in last two months, the picture will be different once import price data for November are released in January. The expected renewed decline of import prices will also be due to CZK being slightly stronger now (25.7) than a month ago (though it is still much weaker than what CNB expected in May...).

Put together: there are no significant inflationary pressures in the producers' sector. And whatever pressures there are will be less potent soon. In other words, in purely inflationary framework, the CNB shouldn't even think about further tightening of the policy.

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**But it did, in December – sort of.**

Although in the end the last week's CNB meeting produced no change in the interest rates (so 2-week repo is at 1.75%), it was not unanimously so: two members of the Board voted for a hike (who these two individuals were was not released, it will be released in the minutes).

That was surprising for me since statement ↗ released after the meeting was filled to the brim with what I felt were just anti-inflationary risks.

1] The external environment was seen as weaker: *“the outlook for foreign variables has been revised downwards. The producer price forecast has been lowered substantially, especially for next year. The forecast for euro area consumer prices is slightly lower for next year, as is the outlook for foreign economic activity and interest rates.”*

2] So was the outlook for energy prices: *“the market outlook for the Brent crude oil price is markedly lower over the next two years.”*

3] Lower domestic inflation is also by definition anti-inflationary risk to the forecast: *“Domestic inflation declined over the last three months, reaching the 2% target in November. It was lower than forecasted, mainly as a result of an unexpected fade-out of food price growth.”*

4] Growth was weaker than expected, with household demand and net exports responsible for the deviation from the forecast.

5] Growth of employment was weaker than predicted.

6] And although wages continued to grow solidly, the growth in private sector also lagged the forecast...

...forecast (from early November) which sees no rate hike until early 2020. And yet, two Board members found it appropriate to vote for a hike. Must've been someone who didn't read the forecast or can't understand it...I have my guess ;) Clearly, the obsession with CZK – which was some 1% weaker than forecast – stops some at CNB Board from connecting anti-inflationary dots.

If one realizes that a] 50% of inflation is in housing

(rents, utilities) that is bound to slow and b) that weakness in Eurozone is more pervasive than thought originally (see below), one has to wonder from where is it that the economists (interviewed by the local daily ihned.cz ↗ ) get their confidence that CNB will hike 1-3 times next year. I'd guess it will not - and if Germany falls into recession, as it might, we could see a cut next year instead.

## | EUROZONE ECONOMY

### December German IFO makes technical recession in Germany more likely.

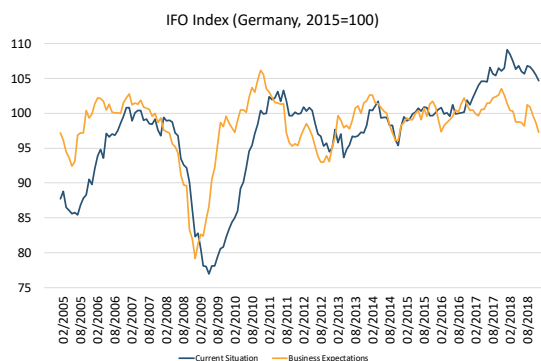
Although nobody seems to know why, the sentiment in Germany fell further in December: IFO index fell to the lowest level (101 pts.) in exactly 2 years (December 2016: 100,8). Even worse, the expectation component of the index fell lowest (97.3) since November 2014. And what's making all of this even bleaker is that both manufacturing and services fell, so it looks like a broad-based weakness, not one confined to manufacturing, as it may have looked few months back. The only sector that continued to power ahead was construction, which is the same as, for instance, here.

German December's IFO thus further increases the probability of another small q/q contraction in Germany in 4Q18 - which would mean a technical recession (2 consecutive declines in GDP).

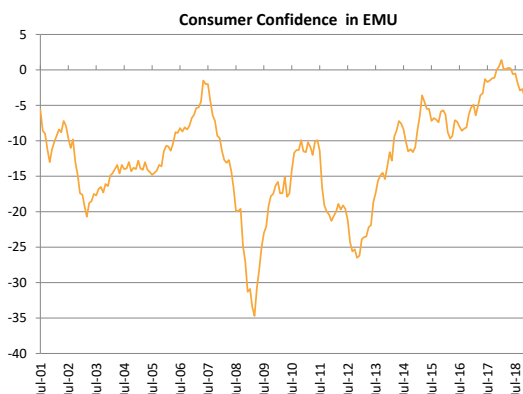
### Eurozone consumer confidence shows even consumers are becoming more worried.

Although the confidence of consumers is still high above the long-term average, the trend in last months is clear: worsening. At this rate, it'll take three, four months to get from December's preliminary figure of -6.2 pts. to the long-term average of -12 pts. And currently, with Brexit, Italy, stock market turmoil and Germany headed possibly for recession, it is hard to see why consumer morale should not head lower...

### GERMAN IFO SHOWS ECONOMY NOT RECOVERING IN 4Q18



### CONSUMER CONFIDENCE CONTINUES TO FALL







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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.020	2.080	2.115	1.930	1.863	1.870	
	-1M	2.010	2.070	2.385	2.475	2.458	2.450	
	-3M	1.560	1.680	2.230	2.410	2.417	2.428	
	-6M	0.930	1.010	1.435	1.810	1.887	1.980	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.624	-0.450	-0.317	-0.142	0.062	0.110	
	-1M	-0.847	-0.783	-0.745	-0.636	-0.443	-0.376	
	-3M	-0.717	-0.814	-0.632	-0.554	-0.320	-0.227	
	-6M	-0.380	-0.479	-0.322	-0.238	0.021	0.221	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.491	1.580	1.662	1.788	1.925	1.980	
	-1M	1.538	1.655	1.717	1.839	2.015	2.074	
	-3M	1.513	1.518	1.750	1.856	2.097	2.201	
	-6M	1.055	1.139	1.407	1.572	1.908	2.201	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.853	4.289	322.15	4.637	6.049	1.136	
	-1M	26.000	4.299	321.64	4.662	6.044	1.138	
	-3M	25.601	4.307	324.24	4.656	7.395	1.175	
	-6M	25.869	4.327	326.32	4.670	5.482	1.160	

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

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