

December 25 | 2017

Weekly | 2017 | Week 52

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Wednesday	27-Dec	9:00	CZ	Consumer / Business Confidence, Dec'17	N/A	N/A
	27-Dec	9:00	SPA	Retail sales, Nov'17, y/y	2.4%	N/A
Friday	29-Dec	9:00	SPA	(Preliminary) HICP, Dec'17, y/y	1.5%	N/A
	29-Dec	14:00	GER	(Preliminary) HICP, Dec'17, y/y	1.4%	N/A

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

DECEMBER 2017 AUCTIONS

NOTHING SCHEDULED UNTIL THE END OF YEAR.

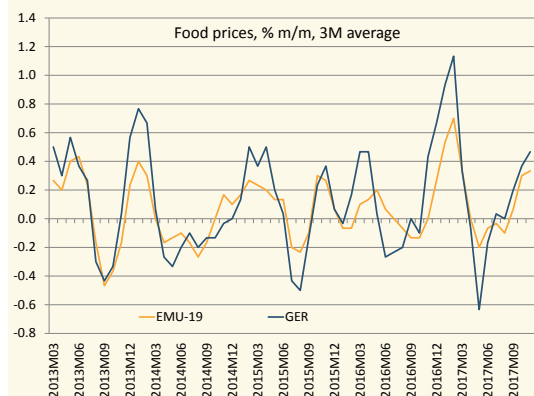
THOUGHT OF THE WEEK

“GETTING DRUNK STEALS HAPPINESS FROM TOMORROW. BUT, FOR MOST PEOPLE, TOMORROW IS GOING TO SUCK ANYWAY.”

WEEK AHEAD

Very light week ahead.

In Eurozone, the first December inflation data (preliminary one from Germany and Spain) will confirm there is no such thing as inflation pressures anywhere in the Eurozone (and nothing like that is in making either). There will be some base effect from food prices as well in next three months as food price growth will not be as fast as this time 12 months ago.

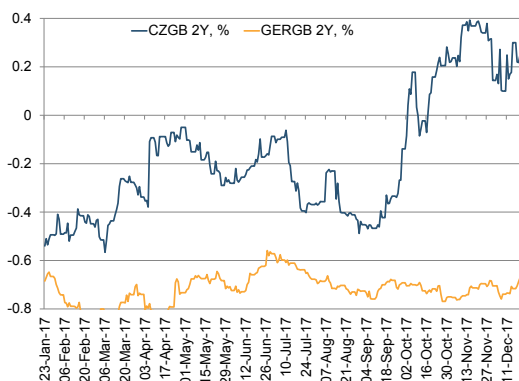
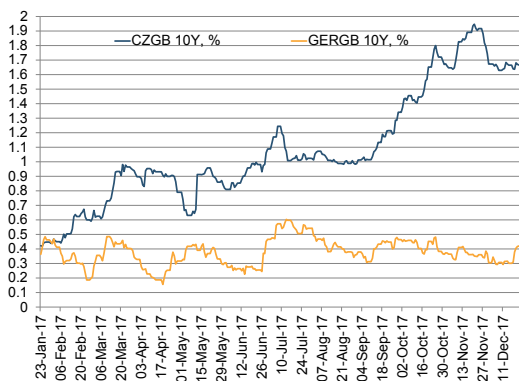


In Czech Republic, consumer / business confidence for December will be released. Nothing but optimism should be seen there (though industry could cheer up finally on paper now that it is cheerful on the ground).

EURCZK TESTS 25.80 AFTER DOVISH CNB MEETING



CZECH YIELDS STABLE DESPITE BUNDS' SELL-OFF



WEEK BEHIND

CNB meeting a dovish affair, reaffirming slow tempo of hikes in 2018 ▶

CZ import, producer prices confirm disinflation ahead ▶

Eurozone soft indicators sky-high, but inflation remains very low ▶

| FX

EURCZK weakened further to within a hair of 25.80 after CNB's dovish meeting.

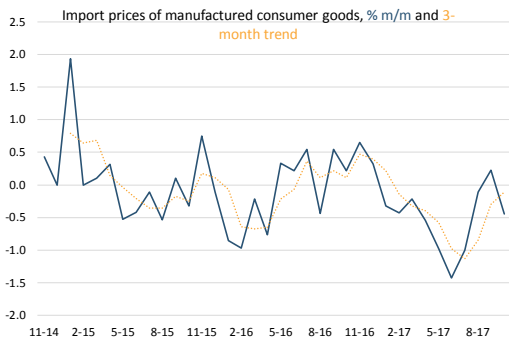
And this, I think, is just the beginning of things to come once market sees CNB's inflation threat of 2017 was just as real as Santa Claus ↗.

| FI

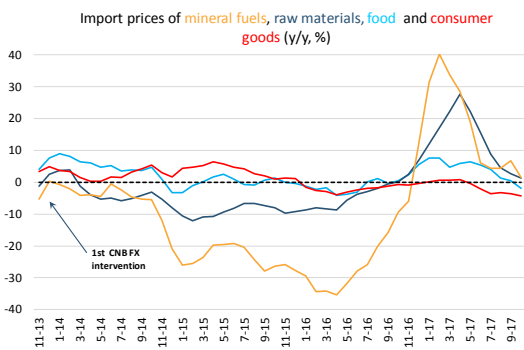
Czech yields were stable despite German yields having headed higher.

The jump in German yields was due to two things: first, the release of the outlook for issuance in 2018 and the passage of tax reform in the US. None of these events impacted Czech yields, however.

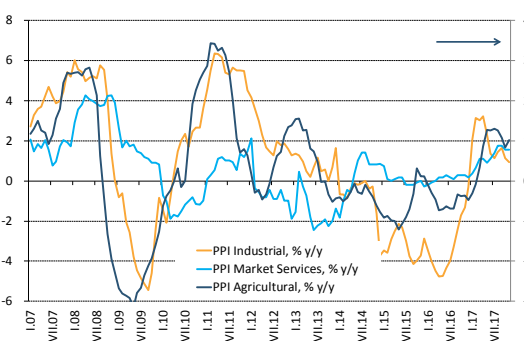
IMPORT PRICES OF CONSUMER GOODS FELL AGAIN M/M IN OCTOBER



FOOD PRICES IN A FIRST Y/Y FALL SINCE SEPTEMBER 2016, AND OTHER SECTORS ARE SLOWING TOO.



PRODUCER PRICES STABILIZE EXPECT FOOD PRICES...



CZECH ECONOMY

Another evidence came out last week that the ‘inflation threat’ CNB responded to with two hikes this year was about as real as the ‘deflation threat’ back in 2013...

I explained in greater detail in the recent Special report what really drove inflation higher this year, and how CNB (again) responded to a myth. The import prices for October confirm the view expounded therein.

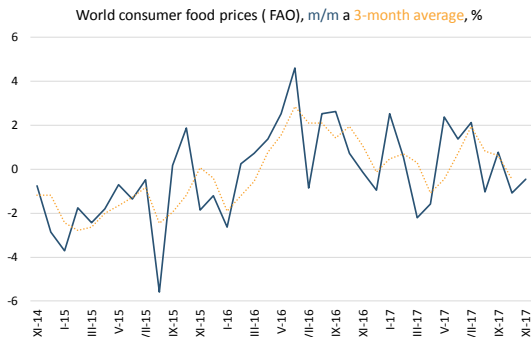
To wit: the import prices of the manufactured consumer goods fell again in October, having recorded just one month this year in which they haven’t done so. Hence it comes as no surprise that these prices are 4.2% lower than they were a year ago, 4.2% being their largest annual drop since June 2011.

And it’s not just the manufactured consumer goods that are being imported at lower prices than this time last year. Food prices – one of the 2 major components behind the rise of monetary-policy inflation in last twelve months (the other being imputed rents) – fell for the time (y/y) since September 2016, thereby (again) confirming my view that there will be a powerful base effect in CPI the coming months. Finally, the growth rate of import prices slowed in all other segments too (see picture to the left).

Producer prices also don’t hint at inflation pressures ahead. Those of industrial producers slowed their annual growth to just 0.9% y/y, the slowest since December of 2016, while the growth of prices of market services stabilized at 1.6%. The only sector where the annual growth of producer prices accelerated were food prices, mainly due to much, much higher prices of eggs (68.3% y/y). However, considering the monthly dynamics of the world food prices (they fell 1.5% over October and November), this will not last - and negative base effect in both producer and consumer prices is all but assured for the coming months.

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...BUT THEIR MONTHLY DYNAMICS SUGGEST ANNUAL GROWTH IS NOW PEAKING



Last meeting of CNB was another dovish affair. But market continues to ignore it – at its own risk.

CNB didn't raise the rates though half of the analysts thought it would. Although I also thought that the political considerations will trump the absence of the need to hike, I was – thankfully – proven wrong.

In its statement, CNB basically said that there is no need to go faster than what the November forecast (which sees first hike in 2nd half of 2018) anticipates, this being due to the fact that none of the risks outlined in November – “*overboughtness*” of CZK and “*strength, composition and inertia of fundamental inflation pressures from the domestic economy*” – have materialized. CNB added “yet” after “materialized” but I cannot escape the feeling that CNB has just begun its retreat from ‘economy is generating inflation pressures’ narrative.

CNB thus also offered two scenarios in which it would deliver as fast a growth of repo rate as market now expects (3-4 hikes in 2018): either the speculators’ run for exit leads to much weaker CZK or domestic economy somehow miraculously generates enough demand inflation to enable CNB to hike.

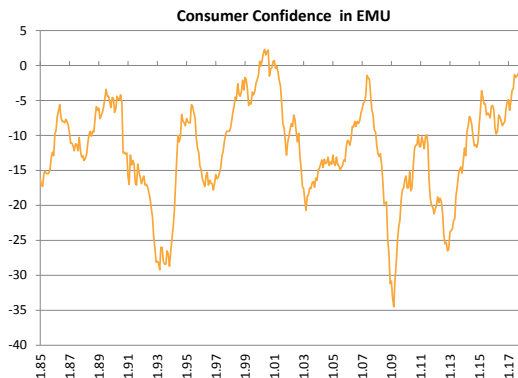
The latter is almost impossible: this is not how open Czech economy behaves (instead, strong demand → worse trade balance), foreign environment is anti-inflationary (see below) and most of the 2017 inflation increase was non-demand in nature anyway (see Special report).

The former is, on the other hand, a real possibility: as soon as (EURCZK) market realizes inflation is much less of a threat than the CNB’s rapid shift from deflation-fighting intervention to inflation-fighting hiking in 2017 might one to believe, it will take profit.

And EURCZK will head well above 26.

EUROZONE ECONOMY

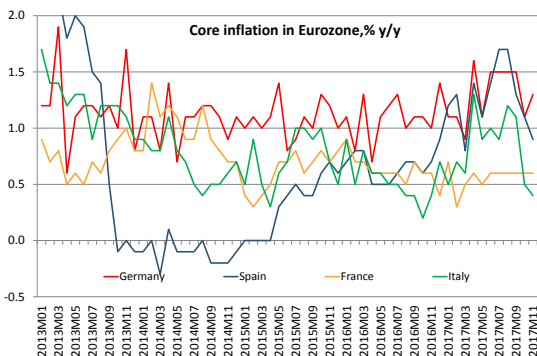
CONSUMER CONFIDENCE AS WELL AS...



...IFO REMAIN SKY HIGH, BUT..,



...NEITHER SHOWS UP IN INFLATION.



Soft indicators remain sky-high, but inflation low.

December consumer confidence climbed above zero for the first time since January 2001 – and to really illustrate how high it is it should suffice to say that there were only 9 months in the entire 33 years of history of the measurement when the confidence was higher (and that was in 2000 and early 2001). Consumers really are optimistic.

The same goes for German industry: although there was worsening of the expectations' component of the IFO index in December, the assessment of the current conditions remains close to all-time high (and the expectations are still highest since 2011). Too bad it doesn't show up in actual numbers from industry.

None of those soft indicators matter for inflation: final November inflation confirmed that core inflation remained below 1% and with no trend whatsoever. In all big economies, the core inflation is lower than it was 6 months ago and if it shows any trend it is downward (Italy, Spain). ECB is right in keeping policy loose.

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MARKETS ‡



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

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