Weekly | 2018 | Week 23

MARTIN LOBOTKA, (+420) 777 027 165, MLobotka@42fs.com, Research@42fs.com

CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	11-Jun	9:00	CZ	CPI, May'18, y/y	2.0%	1.9%
	11-Jun	10:00	ITA	Industrial production, Apr'18, y/y WDA	3.6%	N/A
Wednesday	13-Jun	11:00	EMU	Industrial production, Apr'18, y/y WDA	2.7%	N/A
Thursday	14-Jun	13:45	EMU	ECB rate-setting meeting	no change	no change
Friday	15-Jun	11:00	EMU	(Final) Core/Headline HICP, May'18	1.1% / 1.9%	N/A
	15-Jun	11:00	EMU	Trade balance, SA, Apr'18, EUR bn.	20	N/A

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

JUNE 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2018-2021**	6-Jun	8-Jun	23-Feb-21	CZK 4 bn. max	0.75%
CZGB 2014-2025**	6-Jun	8-Jun	17-Sep-25	CZK 4 bn. max	2.40%
CZGB 2018-2029**	6-Jun	8-Jun	23-Jul-29	CZK 4 bn. max	2.75%
SPP 797	7-Jun	8-Jun	7-Dec-18	CZK 0-5 bn.	N/A
CZGB 2007-2022**	13-Jun	15-Jun	12-Sep-22	CZK 4 bn. max	4.70%
CZGB 2017-2027**	13-Jun	15-Jun	10-Feb-27	CZK 4 bn. max	0.25%
CZGB 2015-2030**	13-Jun	15-Jun	15-May-30	CZK 4 bn. max	0.95%
SPP 798	14-Jun	15-Jun	14-Dec-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	20-Jun	22-Jun	23-Feb-21	CZK 4 bn. max	0.75%
CZGB 2013-2028**	20-Jun	22-Jun	25-Aug-28	CZK 4 bn. max	2.50%
CZGB 2017-2033**	20-Jun	22-Jun	13-Oct-33	CZK 4 bn. max	2.00%
SPP 799	21-Jun	22-Jun	21-Dec-18	CZK 0-5 bn.	N/A
SPP 800	28-Jun	29-Jun	28-Dec-18	CZK 0-5 bn.	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.

THOUGHT OF THE WEEK

"MERGING COMMERZBANK AND DB IS LIKE TYING TWO COMPLETE DRUNKS TOGETHER HOPING THEY'LL BE MORE STABLE THAT WAY. ↗"

WEEK AHEAD

In the Czech Republic, May inflation is the only release this week and the most important one this month.

After the deep decline in 1Q18, inflation returned to 2% in 2Q18 and May figure should just confirm that. What is most important however is the monthly dynamics of the core inflation: there has been an acceleration in previous two months, driven to a good extent by real estate prices, so it is crucial to see whether this continued midway through the 2nd quarter. Combined with recent weakness in CZK, this is an important release for CNB. Upside surprise here and we might get quicker hike.

In the Eurozone, ECB meeting is No.1 event. Judging from the last week's statements of ECB chief economist Praet and Bundesbank's Weidmann ↗ and because this is the last meeting of ECB before summer, I expect the heated discussion about the end of QE here. On the one hand, hawks will say that extraordinary measures were for extraordinary times (fighting deflation) and since situation's normalized, they should be exited. Plus, technically, headline inflation (which is what ECB targets) is close to target. Doves will counter that the fact that core inflation is well below the ECB target makes the headline unsustainable. And that, thus, end of QE should be postponed. I am slightly more inclined to believe hawks will carry the day…And that EUR will get some boost.

WEEK BEHIND

▌ CZ RETAIL: households still going at full speed ▶ as wages grow strongly ▶

▌ CZ INDUSTRY: big disappointment in April, weakness continues ▶

▌ GER INDUSTRY: weakness continues, as evident in April fall of orders ▶ and of production ▶

| FX

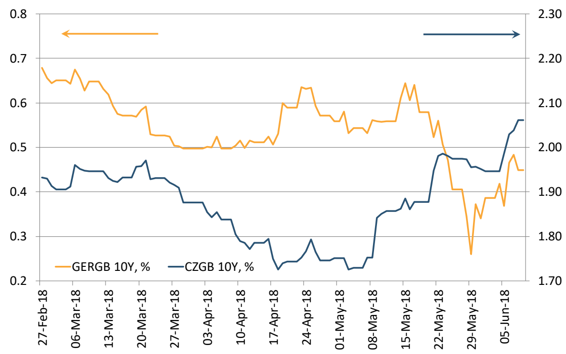
EURCZK between 25.60-25.80, no clear trend.

EURCZK fell to 25.60 in first half of the week, then rebounded back to 25.80.

Strong retail / wage data and hawkish comments from Mojmir Hampl didn't really help to keep CZK stronger. Hampl, previously a dove advocating later exit from the interventions in early 2017, now turned one of the biggest hawks (consistency out of window…), saying in interview ↗ last week that rates should have already been increased above 1% and that in current phase of the cycle they should be between 2% and 3%. He's thus joined Rusnok in verbally intervening against the weak CZK – to no avail.

| FI

German yields rose as QE wind-down hopes increased



Yields of German Bunds headed higher on QE end speculations.

Praet & Weidmann fanned the hopes of early QE wind-down ↗ last week, sending euro higher and German Bund prices down. For the first time in two weeks, German 10Y yields touched 50 bps.

The data released last week, on the other hand, were decisively against Praet - Weidmann scenario: weak April industry, weak April retail speak decisively against fast QE wind-down. This has also prevented the 10Y yields from going above 50 bps.

Czech yields continued to rise, with 10Y rising above 2%. This was probably consequence of strong domestic data (wages, retail).

| CZECH ECONOMY

Households are still going full throttle. And there's good reason why.

Core retail sales, i.e. sales without cars, fuel and food, **rose 9.4% y/y (WDA, real) in April**, in line with the very high consumer confidence and very high wage growth. See, as we reported earlier, the confidence of consumers was at 10 pts. in April, i.e. at the all-time high at the time (which was then surpassed in May, when confidence rose to 11.3 pts.).

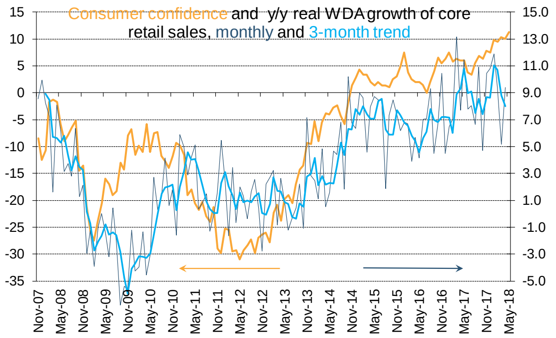
Last week, Statistical office released the **1Q18 wage growth**, and it **was stellar**: nominal wage growth clocked 8.6% y/y, fastest since 1Q08 (9.9%) and fourth fastest growth since 2001, real wage growth was 6.6% y/y, fastest since 1Q03. The growth was mainly driven by enormous increase in wages in public sector (see previous Weekly ↗ for the reflection of this in budget numbers): public administration and education sectors, for instance, saw 12.6% and 12.5% nominal growth, respectively. Private sector growth was also strong, but slower than the public sector one: between 7% and 8%.

Returning to *total* retail sales, food sales fell precipitously to 0% y/y, but that is only transient, a reflection of Easter. Surprisingly, pricier fuel didn't discourage the motorists: fuel retail sales grew 7% y/y (real, WDA). And, also surprisingly, car sales continued to contract y/y – after 4.2% y/y fall in March, they fell 3.5% y/y in April. Considering the fundaments described above, this last thing makes ZERO sense.

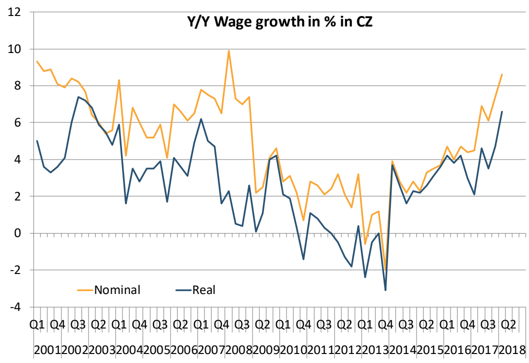
Industrial production disappointed big time in April.

Production fell 0.9% m/m (SA), having thus grown only in March (+0.6% m/m) this year (it stagnated in January and fell 1.7% m/m in February). Although PMI did foretell the worsening of industry, this was actually much weaker than what PMI

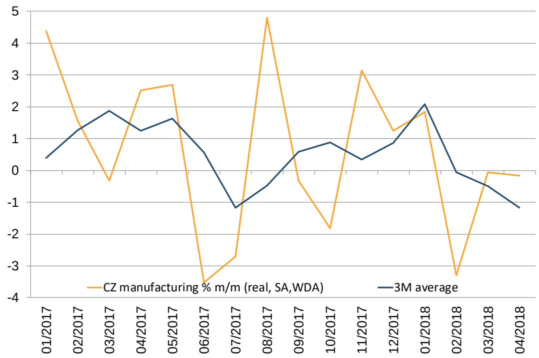
RETAIL SALES GROW STRONGLY…



…AS WAGES GROW STRONGLY.



MANUFACTURING FELL FOR THE THIRD TIME IN A ROW IN APRIL.



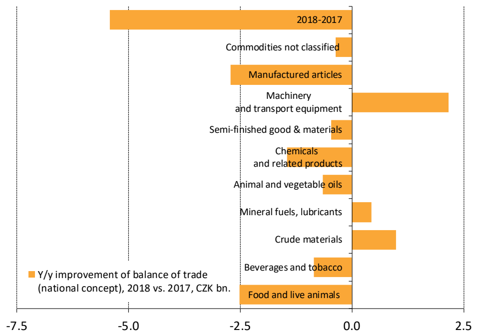
suggested – PMI pointed at around 8% y/y growth but the reality was weaker, at 5.5% y/y. Manufacturing did even worse than the overall industry: it fell third time in a row, 0.2% m/m (after -0.1% m/m in March and -3.3% m/m in February). And, in light of weaker May'18 PMI, IFO readings in Germany I don't expect quick turnaround in either May or June.

Trade balance is slightly worse this year, but not so much as one could've expected based on the strength of the domestic demand.

The surplus in the first four months of this year was just CZK 5.4 bn. lower than in the first four months of 2017 (CZK 79 bn.), a relatively small difference considering the strength of the aggregate domestic demand.

Most of the y/y worsening came from manufactured articles, a natural development considering that these are goods satisfying the domestic demand, especially that of households. What is a bit surprising is the fact that mineral fuels' deficit shrank by just CZK 0.4 bn. to minus CZK 40.968 bn.: with oil prices and overall economic growth, I would've expected bigger worsening. Finally, what was also surprising was the fact that surplus in trade with machinery and vehicles improved: with export weakness and import strength, I would've expected this particular surplus to decrease.

TRADE BALANCE SLIGHTLY WORSE THIS YEAR THAN NEXT

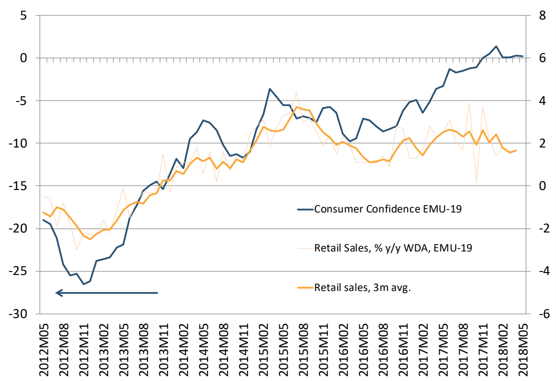


| EUROZONE ECONOMY

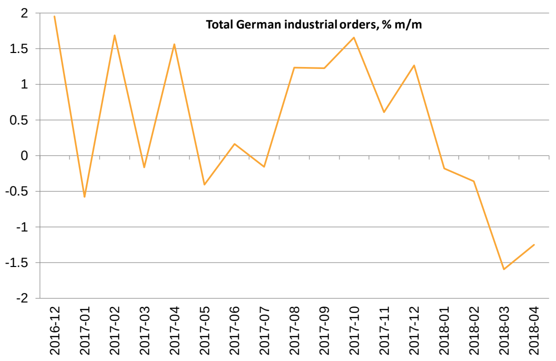
Defying the upbeat tone of ECB's Praet and Weidmann assessments of last week (see above), April retail sales came out very weak.

April rise of 0.1% m/m came after 0.4% in March and 0.3% in February. Annual growth remained at meagre 1.7% y/y after 1.5% in March and 1.8% in February. Now, these are all levels incongruous with the very high levels of reported consumer confidence. This disconnect has been around for two years now and so it is becoming increasingly hard to expect it to close anytime soon. Not that the

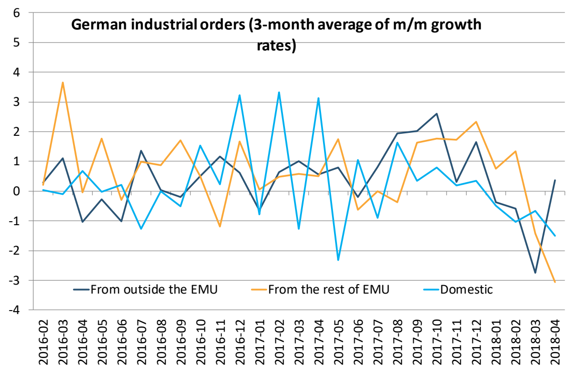
APRIL EUROZONE RETAIL GROWTH STILL MORIBUND



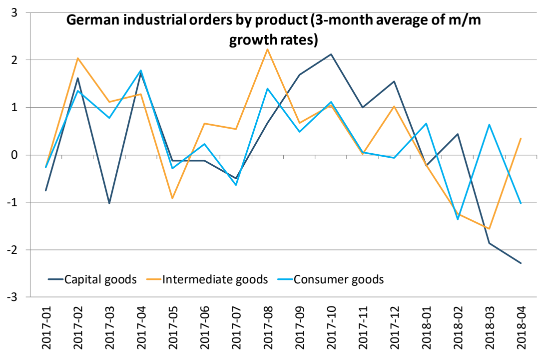
GERMAN INDUSTRIAL ORDERS FELL FOR THE 4TH TIME THIS YEAR



GEOGRAPHICALLY, THE YTD WEAKNESS IS EQUALLY SPREAD



STRUCTURALLY, WEAKNESS IS CONCENTRATED IN CAPITAL GOODS ORDERS.



weakness of retail sales doesn't make sense to me: unemployment improves only modestly (0.7 pp / year as of recent) and wage growth is very weak in Eurozone. But I am puzzled as to why households are so optimistic.

For ECB, such a weak growth should mean zero thinking about ending the QE anytime soon. But, as I said repeatedly, there is high probability that politics will trump monetary policy. And that QE will end this year as a consequence.

And, on Thursday last week, another blow to Praet & Weidmann optimism: German industrial orders fell fourth time in a row. Still a soft patch, bros?

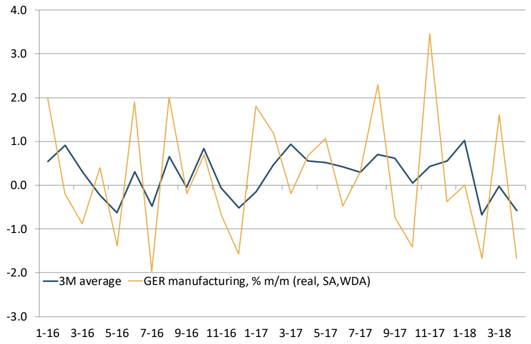
Having contracted 1.6% m/m in March, orders fell another 1.3% m/m in April for the cumulative decline of 3.5% this year. The April "semi-hard" orders data thus confirm what the April / May soft indicators like PMI or IFO suggested: that the weakness isn't confined to the 1st quarter. Looking at the structure, year-to-date weakness is geographically due pretty much equally to domestic (German), intra-Eurozone and extra-Eurozone demand (though there was rebound in April for orders from outside the Euro area). As regards product structure, the weakness is primarily due to capital goods.

It is not easy to decipher what happened – threat of trade wars, rise of political uncertainty in the Euro area must have played a role, but since these came somewhat late in 1H18 they are unlikely to have been the only reason.

Be it as it may, it is another thing (together with weak household demand growth and low core inflation) speaking against tighter Euro area monetary policy.

In a separate release, industrial production in Germany confirmed the weakness is real. Production fell 1% m/m in April and manufacturing component thereof fell 1.7% m/m; the contraction in

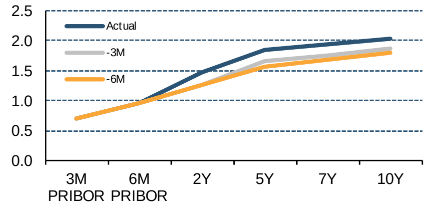
GERMAN MANUFACTURING FELL 2% CUMULATIVELY IN LAST THREE MONTHS.



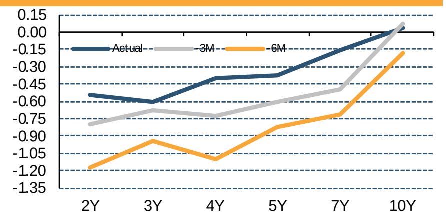
manufacturing over February-April period was almost 2%. Not good. And with weakness of orders continuing this looks unlikely to change come May or June.

| Markets ‡

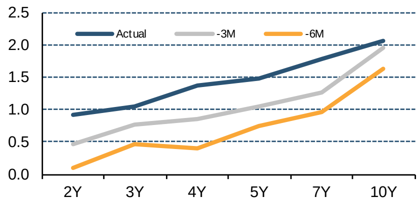
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.463	1.855	1.933	2.023
	-1M	0.709	0.969	1.310	1.713	1.808	1.905
	-3M	0.709	0.969	1.270	1.655	1.758	1.880
	-6M	0.709	0.969	1.275	1.575	1.675	1.810



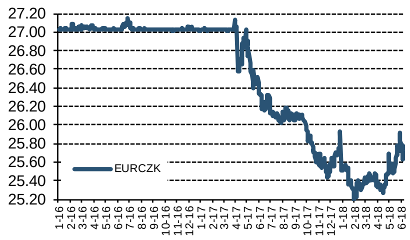
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.549	-0.604	-0.401	-0.377	-0.155	0.039
	-1M	-0.577	-0.661	-0.599	-0.450	-0.219	-0.063
	-3M	-0.800	-0.674	-0.723	-0.601	-0.495	0.067
	-6M	-1.175	-0.949	-1.097	-0.828	-0.715	-0.181



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	0.914	1.035	1.359	1.478	1.778	2.061
	-1M	0.733	0.824	1.018	1.263	1.589	1.842
	-3M	0.470	0.770	0.848	1.054	1.263	1.947
	-6M	0.100	0.463	0.408	0.747	0.960	1.629



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.752	4.278	319.75	4.659	5.270	1.177
	-1M	25.575	4.263	315.31	4.646	5.084	1.185
	-3M	25.452	4.194	311.73	4.659	4.693	1.231
	-6M	25.560	4.197	313.92	4.633	4.516	1.177



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

| Contacts

Martin Lobotka, Analyst (+420) 777 027 165, MLobotka@42fs.com

Research Research@42fs.com

Available at Thomson Reuters Eikon Messenger

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