Weekly | 2018 | Week 24

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	18-Jun	9:00	CZ	PPI, May'18, y/y	1.0%	1.2%
	18-Jun	10:00	CZ	Export / Import prices, Apr'18, y/y	N/A	N/A
Tuesday	19-Jun	10:00	EMU	Current Account, SA, Apr'18, EUR bn.	N/A	N/A
Thursday	21-Jun	16:00	EMU	(Preliminary) Consumer confidence, Jun'18	-	N/A
Friday	22-Jun	8:45	FRA	(Final) GDP, 1Q18, q/q	0.2%	N/A
	22-Jun	9:30	EMU	(Preliminary) Manufacturing / Services PMI, Jun'18	55/53.8	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

"IF I WERE TO HIRE THERESA MAY FOR JOB, IT'D ONLY BE IF I WERE LOOKING FOR A TOP-CLASS PLATE SPINNER."

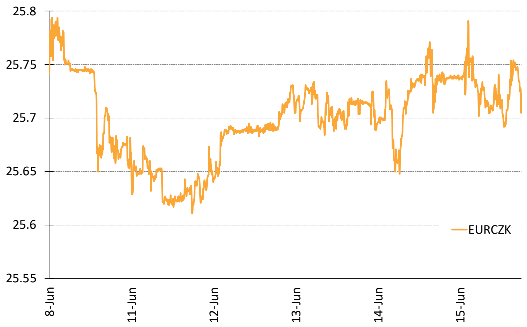
WEEK AHEAD

Compared to previous one, this is a fairly uneventful week.

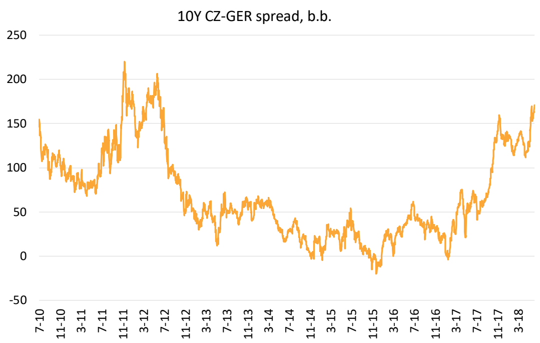
In the Czech Republic, import prices for April will be released and will likely be shown to have stopped falling as CZK stopped strengthening. That much appears to be reflected in higher April - May CPI.

In Eurozone, June soft indicators are the only important thing to monitor. Consumer confidence is less of an interest since it's shown pretty large disconnect to actual data in last two years or so. PMI, on the other hand, is interesting as it leads the actual growth fairly accurately.

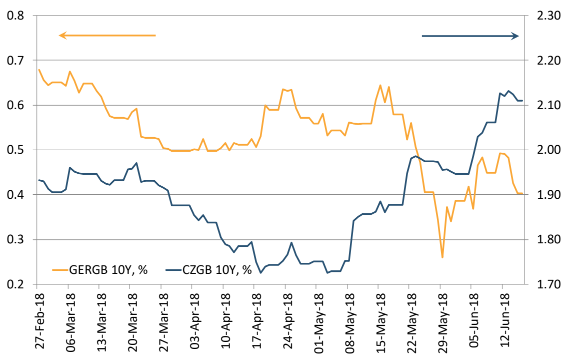
EURCZK BETWEEN 25.70-25.80, NO CLEAR TREND.



CZ-GER SPREAD WIDENED TO 6-YEAR HIGH…



….AS GERMAN BUND YIELDS FELL AFTER ECB MEETING



WEEK BEHIND

CZ INFLATION: return to 2% makes June hike likely, esp. in light of weak CZK ▶

FED: slightly hawkish meeting didn't produce any EURUSD move… ▶

ECB: …but sure as hell the ECB one did ▶

EUROZONE INDUSTRY: ongoing weakness confirmed in April ▶

| FX

EURCZK weakened to 25.80 at one point last week.

But it returned to 25.70 immediately afterwards. What's more important, then, is that the verbal interventions of central bankers ahead of the end-of-June meeting don't seem to have had much of an impact. See, last week Nidetzky ↗ and Benda ↗ joined Hampl and Rusnok in indicating that they'd vote for hike at June meeting (May forecast called for a hike only at the end of year). One of the reasons for this hawkishness is certainly the weak CZK, the other real estate prices↗.

Hence, the hike in June just got over 50% probability, with four bankers now almost openly in favor of tightening policy soon. Yet, CZK remained unmoved.

| FI

CZ-GER 10Y spread widened to a 6-year high of 171 bps. as…

…market was underwhelmed by ECB's plans (see below) and as CZ yields held steady on central bankers' hawkish comments. In other words, expected monetary policy divergence on display.

| CZECH ECONOMY

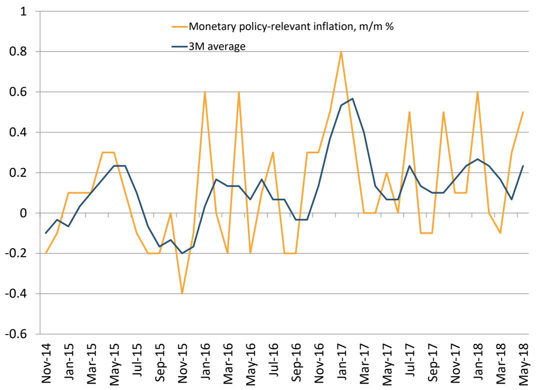
In May, Czech annual monetary-policy relevant inflation (MPRI) returned to January level (2.1%) & the monthly dynamics quickened to 0.5% m/m.

That is a bit more than I expected but the May monthly figure was influenced by two non-demand factors: 1) fastest monthly growth of fuel prices (4.1% m/m) since June 2016, and 2) return, after three months, to positive m/m growth of food prices (+0.7% m/m). MPRI itself, however, isn't accelerating: the three-month average of monthly changes has oscillated around 0.2% in last year or so.

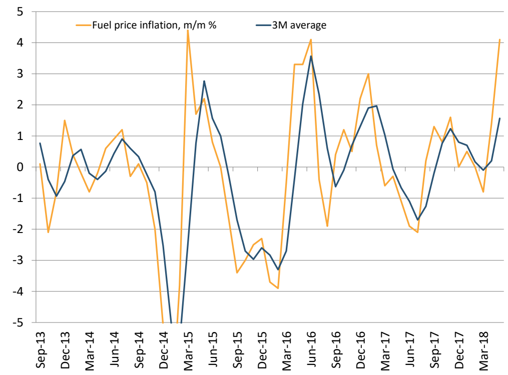
What's more of a concern for CNB, certainly, is the evolution of the demand inflation. See, partially as a result of fading disinflationary effect of the CZK (= the import prices no longer depress local price level, though, do not increase it either), monthly demand inflation growth quickened to around 0.25% m/m, i.e. around 3% annualized (even if actual y/y demand inflation was 1.9% in May, 0.2 pp above February low). Another reason for the quicker demand inflation are real estate prices (their growth led CNB to announce another round of restrictions on mortgages last week ↗ (DSTI ratio of no more than 45%, DTI ratio of no more than 9x etc.).

May MPRI was slightly above CNB's forecast of May, but, as could be inferred from what I wrote above, only due to food and fuel prices. But that didn't prevent, as mentioned above, Nidetzky ↗ from joining Hampl ↗, Rusnok and Mora in saying that rates should go up earlier than forecast. Although Eurozone is slowing, that there will be a hike has become a likely outcome for June meeting.

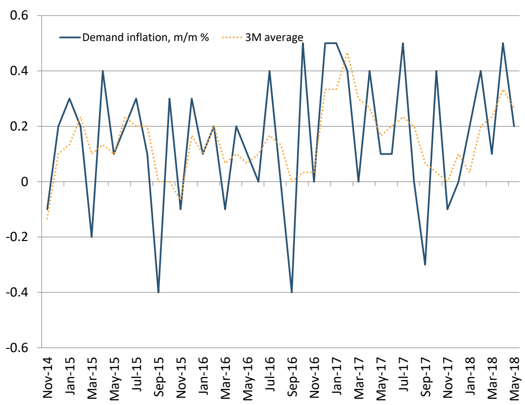
CZECH MPRI QUICKENS IN MAY…



…THOUGH PRIMARILY BECAUSE OF FUEL PRICES.



HOWEVER, THE RE-ACCELERATION OF DEMAND INFLATION IN LAST COUPLE OF MONTHS GIVES AMMO TO CNB HAWKS



| EUROZONE ECONOMY & FED

FED hiked the rates (+25 bps to 2%) and sent a moderately hawkish message.

In a new forecast that was released at the meeting ↗ FED's expectation shifted from the total of three hikes this year (median expectation of FED funds rate in March = 2.1%) to the total of four (median now being 2.4%). The total number of forecast hikes over 2018 and 2019 didn't change, so this was merely shift of one additional hike from 2019 to 2018. That doesn't mean much.

What does is the erasure from the statement ↗ of the assurance that rates will stay low for long:

"The Committee expects that economic conditions will evolve in a manner that will warrant further gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data." And like that, the assurance of low-for-long that originated in the great financial crisis is now fully gone.

To not make the overall statement too hawkish, FED inserted the important adjective before its "*2 percent inflation objective*" that it wants to achieve. That adjective, hitherto not present, is "*symmetrical*". This is clearly to indicate that FED won't panic if inflation gets above 2% -- and that it might leave it there for a while without doing anything.

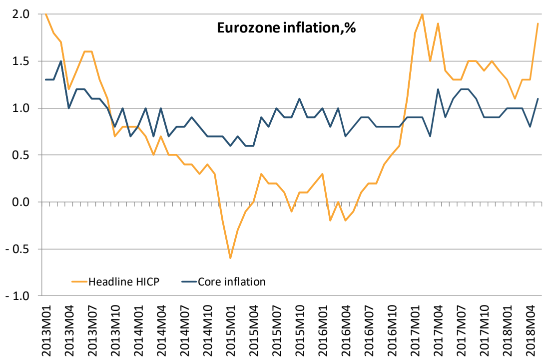
Euro/dollar didn't respond much (stayed a bit below 1.18) – and after careful reading of the statement, it makes sense.

But what it did after the ECB meeting the day after was a complete nonsense – to me, that is.

Apparently wrong-footed by ECB's meeting, EURUSD fell from 1.18 to 1.15 in what was the

EURUSD FELL MOST SINCE BREXIT AFTER ECB MEETING, MARKET APPARENTLY EXPECTED MORE FROM ECB.

EVEN THOUGH HOW IT COULD EXPECT ANYTHING MORE HAWKISH THAN WHAT ECB DID IS BEYOND ME, WITH CORE INFLATION LOW.



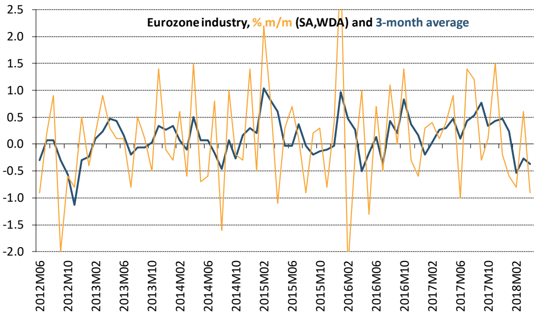
biggest one-day drop since Brexit referendum almost two years ago (BTW, does it feel like 2 years elapsed?). **What truly baffles me is how someone could have expected anything more hawkish from ECB than what ECB delivered.**

See, ECB did, in my eyes, more than it was reasonably expected to. It said that it would end the asset purchases after full 4 years at the end of December 2018, first cutting the net purchases in half in September (i.e., EUR 30 bn. / month from now until September, 15 bn. for the last three months of 2018) and then ceasing to purchase altogether at the end of December. It did of course qualify this by saying that this is subject to "*incoming data confirming our medium-term inflation outlook*" but I don't think they mean it any seriously: it is there so that the backdoor isn't slammed shut (or, one could say, to not irreversibly pre-commit).

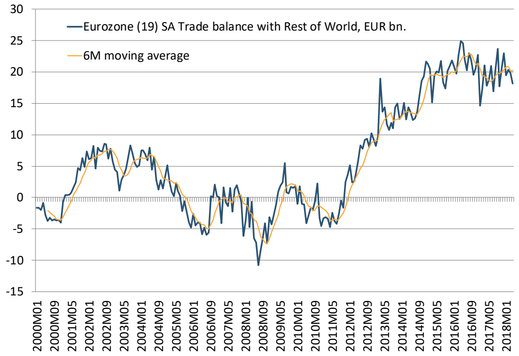
ECB said that the headline inflation (which is what it targets) is at its target, as if that were to justify the announcement of the end of QE. Yes, headline (1.9% in May) is at the ECB's target but only because of oil and food price increased recently (especially the former). ECB did acknowledge that, as it had to, when it said that underlying measures of inflation (=core inflation) remain muted. Though it did strike me that ECB said that "*they* (=underlying measures of inflation) *have been increasing from earlier lows*". Looking at the core inflation (final May data on which came out last week), all I see is oscillation around 1% in last years, with no trend whatsoever: core inflation, for instance, has stayed between 0.7 and 1.1% continuously in last three years. But, to be able to announce the end of QE, you need to see the glass half-full.

All of this is pretty hawkish, considering the core inflation or recent PMI. What, then, caused the EURUSD fall? I surmise it was the announcement that ECB expected the key interest rates "*to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained*

Eurozone industry remained weak in April …



…while Trade balance remained in large surplus.



adjustment path.“ **Frankly, with Italy in the background, loss of growth dynamics in 1H18, subdued core inflation, how anyone could have expected anything else than “low-rates-for-another-year” is above me.**

Anyway, the end of QE is near. In the end, politics trumped the monetary policy, just as I thought. The rise of oil prices offers the convenient justification for QE withdrawal (“see, headline inflation is on target”) even if convincing case for sustainability of return of inflation to the target cannot still be made. **ECB is essentially banking on core inflation rising to 2% by the time oil price effect fades away.** We’ll see.

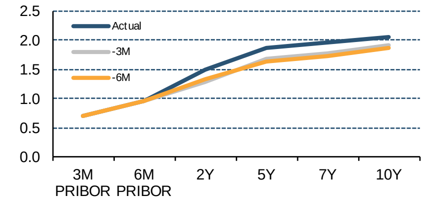
Data don’t offer much optimism in that respect. April Industrial production confirmed the loss of momentum that the leading indicators have been suggesting.

April industrial production reflected what the leading indicators have been telling us throughout 1H18: that industry lost momentum. Eurozone production fell 0.9% m/m in April, with the three-month average growth rate now -0.4% m/m in what is the longest spell of weakness since 2012. Manufacturing component fell 0.3% m/m for the average monthly “growth” rate in last three months of -0.5%. Since there wasn’t any improvement in PMI / IFO in May, it is safe to assume May or June growth won’t be anything that’d blow us away.

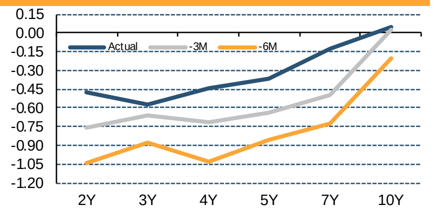
Separately, and much less importantly, the **trade balance** remained in large surplus, though weaker exports did lower it from about EUR 20 bn./month seen previously to EUR 18 bn. in April. But, as in any month since 2013, this is incomparable with what we’d seen before 2013.

| Markets ‡

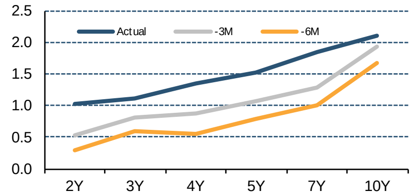
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.495	1.880	1.970	2.065
	-1M	0.709	0.969	1.365	1.810	1.895	1.990
	-3M	0.709	0.969	1.280	1.695	1.780	1.910
	-6M	0.709	0.969	1.340	1.645	1.740	1.870



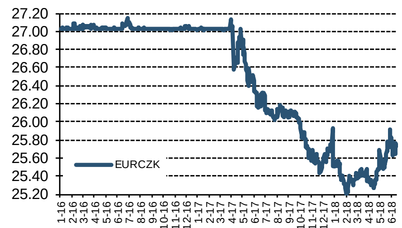
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.471	-0.571	-0.446	-0.368	-0.123	0.045
	-1M	-0.600	-0.666	-0.634	-0.508	-0.294	-0.129
	-3M	-0.760	-0.666	-0.719	-0.638	-0.502	0.022
	-6M	-1.040	-0.883	-1.032	-0.859	-0.732	-0.205



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	1.024	1.114	1.354	1.512	1.847	2.110
	-1M	0.765	0.884	1.082	1.302	1.601	1.861
	-3M	0.520	0.799	0.871	1.057	1.278	1.932
	-6M	0.300	0.601	0.547	0.786	1.008	1.665



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.729	4.286	322.52	4.664	5.495	1.161
	-1M	25.517	4.273	316.07	4.634	5.213	1.181
	-3M	25.417	4.217	310.93	4.670	4.819	1.229
	-6M	25.686	4.207	314.13	4.622	4.540	1.175



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

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