

July 30 | 2018

## Weekly | 2018 | Week 30

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## CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	30-Jul	10:00	SPA	(Flash) HICP, Jul'18	2.4%	N/A
	30-Jul	11:00	EMU	(Final) Economic Confidence, Jul'18	112.0	N/A
	30-Jul	14:00	GER	(Flash) HICP, Jul'18	2.1%	N/A
Tuesday	31-Jul	8:00	GER	Retail sales, Jun'18, y/y WDA	1.5%	N/A
	31-Jul	8:45	FRA	(Flash) HICP, Jul'18	2.4%	N/A
	31-Jul	9:00	SPA	(Preliminary) GDP, 2Q18, q/q	0.7%	N/A
	31-Jul	11:00	EMU	Unemployment, Jun'18	8.3%	N/A
	31-Jul	11:00	EMU	(Flash) Headline / Core HICP, Jul'18	2%/1%	N/A
	31-Jul	11:00	ITA	(Flash) HICP, Jul'18	1.4%	N/A
	31-Jul	11:00	EMU	(Preliminary) GDP, 2Q18, q/q	0.4%	N/A
Wednesday	1-Aug	9:30	CZ	Manufacturing PML, Jul'18	56.4	N/A
	1-Aug	10:00	EMU	(Final) Manufacturing PML, Jul'18	55.1	N/A
	Thursday	2-Aug	13:00	CZ	CNB rate-setting meeting, 2W repo rate	1.25%
Friday		3-Aug	10:00	EMU	(Final) Services PML, Jul'18	54.4
	3-Aug	11:00	EMU	Retail Sales, Jun'18, y/y	1.4%	N/A

\* LOCAL TIME IS CET

\*\* (REUTERS/ BLOOMBERG) POLL

## AUGUST 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2011-2023**	8-Aug	10-Aug	18-Apr-23	CZK 4 bn. max	VAR
CZGB 2014-2025**	8-Aug	10-Aug	17-Sep-25	CZK 4 bn. max	2.40%
SPP 799	9-Aug	10-Aug	9-Nov-18	CZK 0-5 bn.	N/A
CZGB 2014-2027**	22-Aug	24-Aug	19-Nov-27	CZK 4 bn. max	VAR
CZGB 2018-2029**	22-Aug	24-Aug	23-Jul-29	CZK 4 bn. max	2.75%

\* 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

“MAKING SURE NO ONE CAN HOLD ME ACCOUNTABLE FOR MY MESS ↗”

## WEEK AHEAD

**Data-heavy week ahead of us in Eurozone.**

**Most importantly, preliminary 2Q18 GDP growth data will be released.** The expectation is for 0.4% q/q growth, but French numbers ↗ (out last week) suggest the risk is to the downside. Monthly data suggest that too: retail sales fell 0.1% m/m in April and stagnated in May, so unless June was extraordinarily good household demand didn't contribute much. Industry was also fairly weak, though it grew somewhat in April-May. Key question thus is what happened to fixed investments – here, with uncertainty regarding Brexit and trade war having increased further in 2Q18, I wouldn't be surprised if investments stalled in Germany. But no matter: even if 0.4% q/q is what it indeed was in 2Q18, it would be far from inflationary.

Lack of inflationary pressures will, after all, be confirmed by **July preliminary inflation data** to be released tomorrow. Core inflation likely remained around 1% in July, i.e. just like in last 4 years. No news there.

**In Czech Republic, CNB will hike the rate to 1.25%.** This is what Benda ↗ and Hampl ↗ suggested in interviews last week. The reasons are clear, despite all this talk about wage growth being > productivity etc.: weak CZK and house prices. Nothing else really matters to CNB Board now. Plus, there'll be new forecast, and that alone increases probability to close to 1.

## WEEK BEHIND

**CZ: confidence decreased marginally in July** ▶

**ECB meeting: a non-event, as expected** ▶

**French 2Q18 GDP: Eurozone 2Q18 growth nothing to write home about** ▶

**EMU: consumer confidence still high, but slowly declining** ▶

**EMU: leading indicators suggest economy started 2H18 on a weak note** ▶

## | FX

**EURCZK fell to 25.60, lowest since June...**

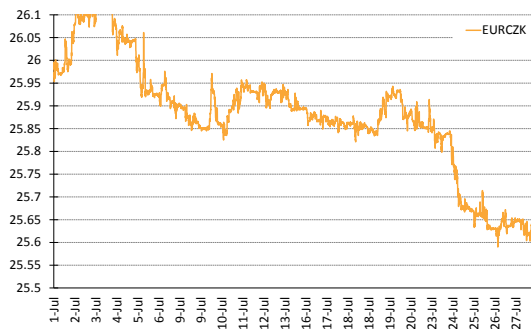
...as interviews from CNB Board members appeared ↗↗ that made it clear to the market that this week will bring another hike from CNB.

## | FI

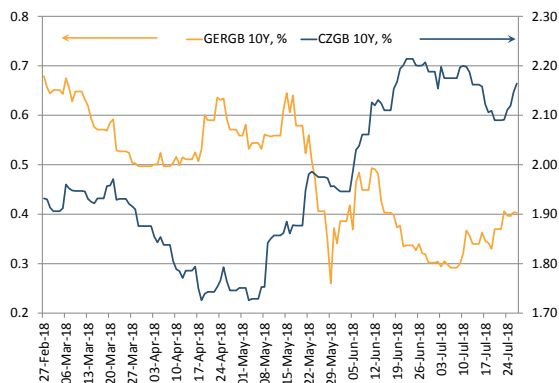
**Yields responded to the increased probability of CNB hike as well...**

...with 10Y rising towards 2.20% even if their German counterparts remained essentially unchanged.

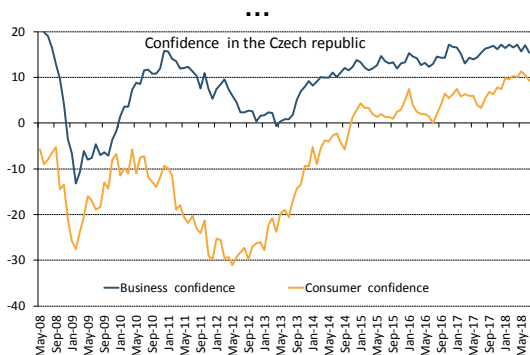
**EURCZK FALLS TOWARDS 25.60 AND...**



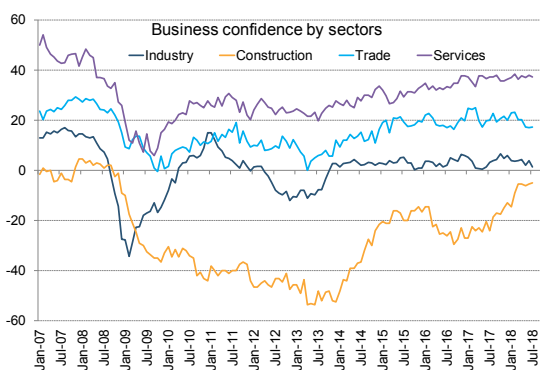
**...YIELDS RISE AS CBANKERS' COMMENTS MAKE AUGUST HIKE MUCH MORE LIKELY.**



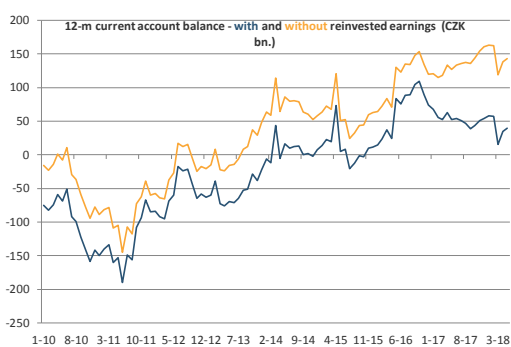
**CONFIDENCE WORSENE MARGINALLY**



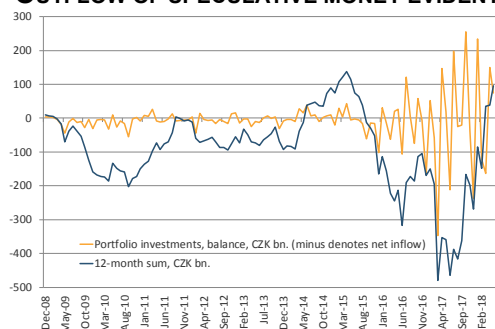
**...WITH TRADE AND INDUSTRY ACCOUNTING FOR MOST OF THE DECREASE IN JULY.**



**CURRENT ACCOUNT REMAINS IN SURPLUS**



**OUTFLOW OF SPECULATIVE MONEY EVIDENT**



**CZECH ECONOMY**

**Czech confidence worsened marginally in July in both consumer and business sector, but remained high in general.**

**For consumers**, confidence slid to 9.3 pts., lowest this year but still very high from the historical perspective – this is thus the same development we saw in July in Eurozone (below). And it is natural. See, consumers still don't have anything to fear: trade war & rising probability of chaotic Brexit and its potentially disruptive effect on Eurozone (via financial sector) are remote to them whereas rising nominal wages (supplemented by falling savings rate), non-existent unemployment and low inflation are all very tangible.

**For businesses**, these are significantly closer events. That is likely why we saw confidence in trade and industry decrease further in July, having reached its lowest in little over a year. Overall, whereas consumer confidence fell 1.2 pts between June and July, business one fell 1.6 pts (from 17 to 15.4). But, as said, consumer confidence is still close to historical highs whereas business one never recovered to pre-crisis levels.

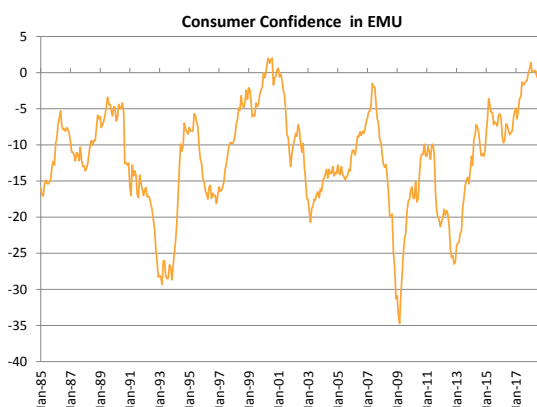
July confidence data are in my view thus yet another confirmation that this cycle has matured.

**Czech current account remained in a healthy 12-month surplus in June.**

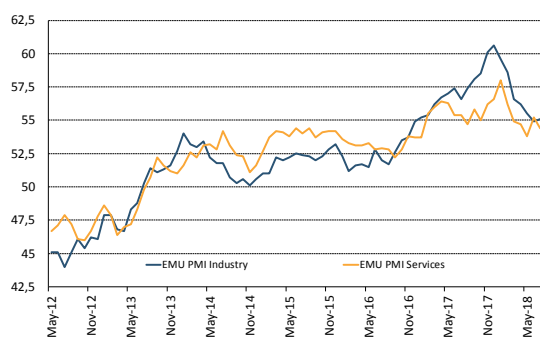
Although the headline 12-month current account surplus was lower (CZK 39.56 bn.) than in almost all months in last two years, the one without reinvested earnings (reinvested earnings don't have FX impact – they are an outflow in accounting logic, but one that doesn't result in actual cash flow) was almost CZK 150 bn., i.e. one of the highest 12-month surpluses ever.

What's evident in both portfolio and other investments' balance is the net outflow of money from Czech economy in last 12 months – since the

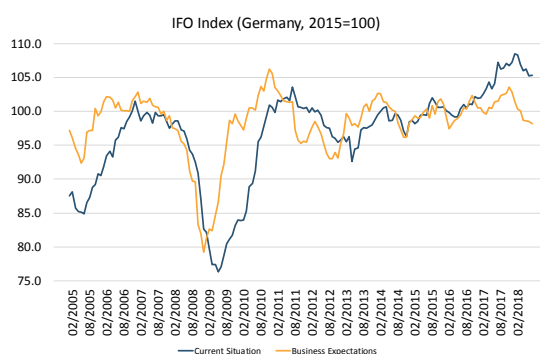
**CONSUMER CONFIDENCE CONTINUES TO SLOWLY WORSEN IN EUROZONE**



**PMI STAGNATED AT THE BEGINNING OF 2<sup>ND</sup> HALF...**



**...AND SO DID GERMAN IFO.**



end of interventions, money has been leaving the country. Approximately CZK 100 bn. of portfolio investments left the country in last twelve months, a sizeable sum, yes, but one still dwarfed by what came into the economy in the last 4-5 months prior to the intervention exit in April 2017. In other words, CZK continues to remain vulnerable to mood shifts.

**| EUROZONE ECONOMY**

**■ Eurozone confidence remained high in July...**

...though it did fall further from the peak of 1 pt. seen back in January. The July reading of -1 pt. remains one of the highest ever: except for few months in 2000 and 2001, there weren't any months since 1985 when confidence would be this high. And all that despite trade war fears and pricier oil. Pretty good, considering. That said, though, it is more likely that the worsening trend will continue.

**■ Eurozone leading indicator No.1, i.e. PMI, didn't improve at all at the beginning of the 2<sup>nd</sup> half.**

Service PMI returned below 55 in July (54.4) while manufacturing PMI remained essentially flat at 55.1 (vs. June 54.9). The overall PMI fell to a 2-month low of 54.3 (as against 54.9 in June), the 2<sup>nd</sup> lowest reading since November 2016 (only May'18 was slightly lower).

What's more worrisome, however, for the next two-three months is the fact that new orders growth was slowest since October 2016 - - not exactly a good omen for the actual production for the coming quarter. In manufacturing, this was blamed on weak growth of new export orders, which in turn might reflect worsening atmosphere in the world trade. On the positive note, hiring continued unabated according to the survey participants, although how long this will last if general growth momentum doesn't pick up is questionable – and I'd say it is only a matter of time before hiring slows as well. After all, the unemployment rate, although still improving, saw the annual rate at which it does so slow in the first half of 2018 as against 2017.

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**Regarding outlook, morale in manufacturing improved** as against June (but then again, in June it was at 31-month low), **but it fell to lowest since November 2016 in dominant service sector.**

In a related development, **German IFO index also worsened marginally in July**, decreasing from 101.8 in June to 101.7 in July. This thus makes it over 3 pts. lower than what it was at the end of last year.

Breaking it down into components, it was understandably the expectations' one that dragged the index down: the expectations are now lowest since March 2016, with looming trade war with US certainly having played a large role here. The current situation assessment improved marginally from June 105.2 to 105.3 pts.

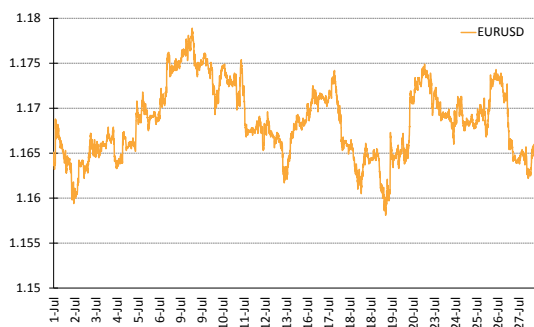
**Altogether, it thus seems that the growth of the Eurozone economy didn't gain speed at the beginning of 2<sup>nd</sup> half of the year and that GDP growth to be expected in 2H18 looks very unlikely to be stronger than 0.3-0.4% q/q.** Inflationary implications thereof are clear: ECB won't see sustainable increase in annual core inflation anytime soon.

**Speaking of which – it held a meeting last week. Not much was expected from it and ECB didn't disappoint in that respect: not much was learned.**

Right off the bat, Draghi said that those things that interested analysts most (=reinvestment policy after the end of asset purchases and interest rate guidance) weren't discussed at the meeting, and, that it wasn't even discussed when they will be discussed. Asked whether he could clarify what "through the summer" means when referring to how long rates will stay unchanged, Draghi offered a lecture on term structure of interest rates...

In the assessment of the economy, Draghi and Co. tried to keep the calm face regarding the fear of the trade war, saying merely that so far not much has been seen (tariffs imposed hitherto are negligible)

**EURUSD FALLS AFTER ECB MEETING, THOUGH THERE WASN'T ANY REASON WHY**



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and that they will wait for something concrete happens before commenting on / responding to it. Regarding inflation, it was just “yes, headline inflation is on target, but that is not sustainable since core one is under 1%”.

All in all, nothing important. Regardless, EURUSD saw this as another reason to head lower (1.1650). That is firmly in line with my expectations of EURUSD going nowhere from 1.15-1.18 range in 2H18.

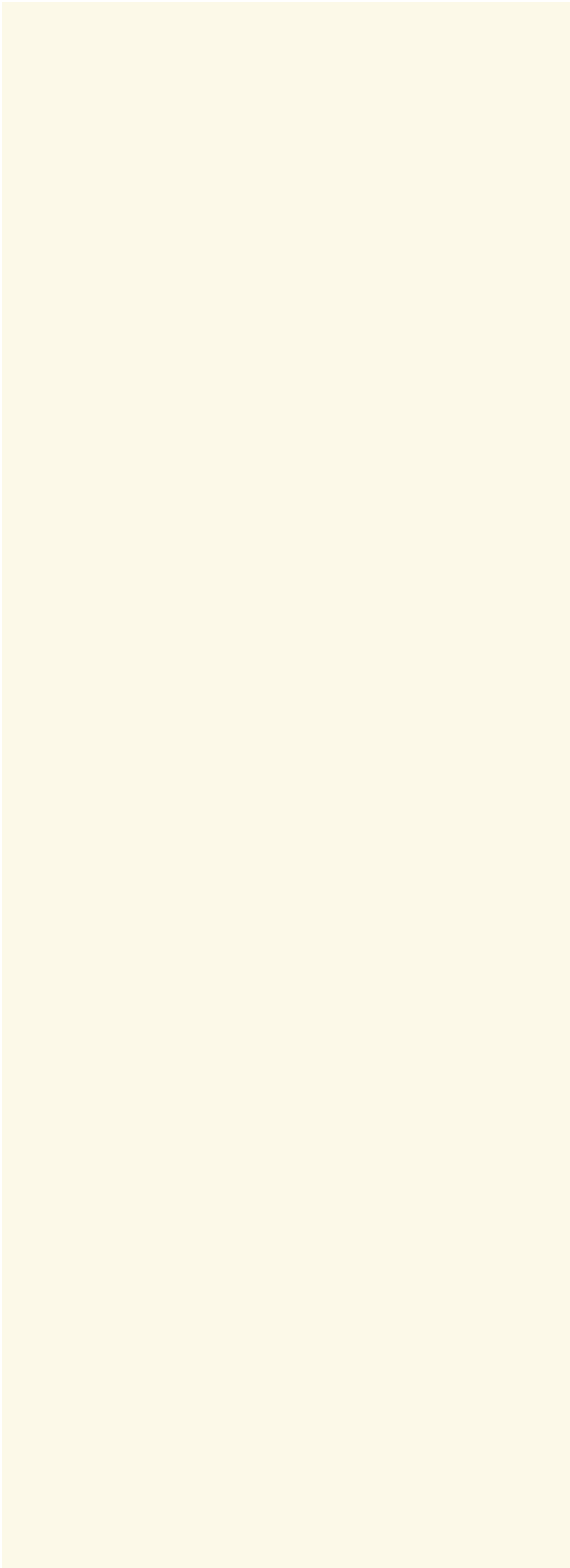
**French 2Q18 GDP gave first firm indication that 2<sup>nd</sup> quarter was weak in Eurozone.**

The economy grew just 0.2% q/q in the previous quarter, just like in 1Q18.

Structure wasn't too surprising: household demand remained weak (another reason why expecting increase in demand inflation soon is unreasonable), having decreased by 0.1% after growing just 0.2% q/q in first quarter. Compensating for this weakness was gross fixed capital formation (=fixed investments) which increased 0.7% q/q after 0.1% q/q in 1Q18. Put together, domestic demand added 0.2 pp to growth, just like in 1Q18.

**Net exports, then, were a drag on growth** (-0.3 pp.) due to faster growth of imports compared with that of exports; on a positive note, exports made up for the fall in 1Q18 but even despite their growth in 2Q18 the overall rise in the first half was pretty much zero. Finally, inventories offset the negative trade contribution by +0.3 pp contribution to quarterly growth.

Takeaway: **weak household demand puts ECB expectations of sustainability of inflation at risk.** To me, “*stability of ECB rates throughout the summer 2019*” means Fall 2019 is the very earliest we can see anything remotely resembling hike in Eurozone.



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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	1.200	1.290	1.875	2.120	2.122	2.140	
	-1M	0.930	1.020	1.510	1.875	1.954	2.030	
	-3M	0.900	0.990	1.225	1.603	1.688	1.793	
	-6M	0.780	0.870	1.380	1.805	1.905	2.010	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.649	-0.711	-0.610	-0.491	-0.172	0.024	
	-1M	-0.435	-0.519	-0.377	-0.287	-0.035	0.171	
	-3M	-0.523	-0.596	-0.549	-0.419	-0.193	-0.047	
	-6M	-0.971	-0.888	-0.720	-0.752	-0.621	-0.054	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.226	1.287	1.468	1.629	1.950	2.164	
	-1M	1.075	1.169	1.425	1.588	1.919	2.201	
	-3M	0.702	0.782	0.956	1.184	1.495	1.746	
	-6M	0.409	0.701	1.003	1.053	1.284	1.956	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.643	4.285	322.49	4.625	5.653	1.166	
	-1M	25.944	4.352	327.61	4.653	5.343	1.155	
	-3M	25.471	4.207	312.78	4.663	4.908	1.213	
	-6M	25.318	4.132	309.34	4.662	4.664	1.243	

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

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AVAILABLE AT THOMSON REUTERS EIKON MESSENGER

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