Weekly | 2018 | Week 36

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

| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	10-Sep-18	9:00	CZ	CPI, Aug'18. y/y	2.4%	2.3%
Wednesday	12-Sep-18	9:00	SP	(Final) HICP, Aug'18. y/y	2.2%	N/A
	12-Sep-18	10:00	ITA	Industrial production,Jul'18, y/y (WDA)	1.6%	N/A
	12-Sep-18	11:00	EMU	Industrial production,Jul'18, y/y (WDA)	1.0%	N/A
Thursday	13-Sep-18	8:00	GER	(Final) HICP, Aug'18. y/y	1.9%	N/A
	13-Sep-18	8:45	FRA	(Final) HICP, Aug'18. y/y	2.6%	N/A
	13-Sep-18	10:00	CZ	Current Account, Jul'18, CZK bn,	-26.0	-19.6
	13-Sep-18	13:45	EMU	ECB Rate-setting meeting	no change	no change
Friday	14-Sep-18	11"00	EMU	Trade Balance, Jul'18, EUR bn.	16.2	N/A

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

| SEPTEMBER 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2007-2022**	5-Sep-18	7-Sep-18	12-Sep-22	CZK 3 bn. max	4.70%
CZGB 2018-2029**	5-Sep-18	7-Sep-18	23-Jul-29	CZK 5 bn. max	2.75%
SPP 800	13-Sep-18	14-Sep-18	14-Dec-18	CZK 0-5 bn.	N/A
SPP 801	20-Sep-18	21-Sep-18	21-Dec-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	19-Sep-18	21-Sep-18	23-Feb-21	CZK 3 bn. max	0.75%
CZGB 2014-2025**	19-Sep-18	21-Sep-18	17-Sep-25	CZK 3 bn. max	2.40%

* 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

"MUSK IS THE COMBINATION OF JOHN LAW AND "PHINEAS T. BARNUM".

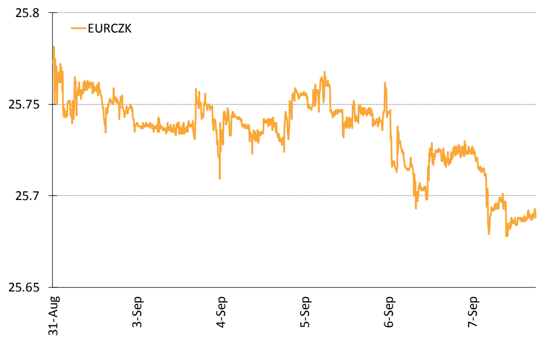
WEEK AHEAD

Inflation in Czech Republic the only thing worth looking at this week.

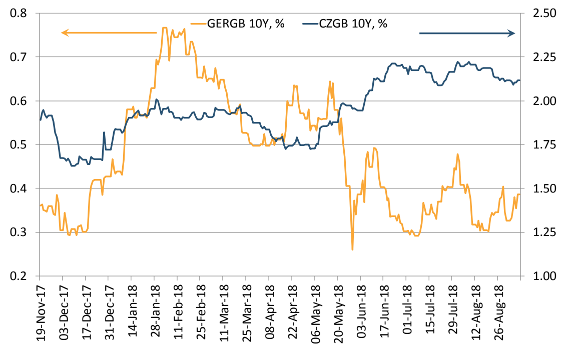
The key thing here is to remember that in July core inflation shot up dramatically (see page 5 here ↗) as prices of vacations increased at double the usual monthly rate. I can't explain that as the usual seasonality was 12% m/m, so we shall look into whether CSO didn't adjust that reading downward.

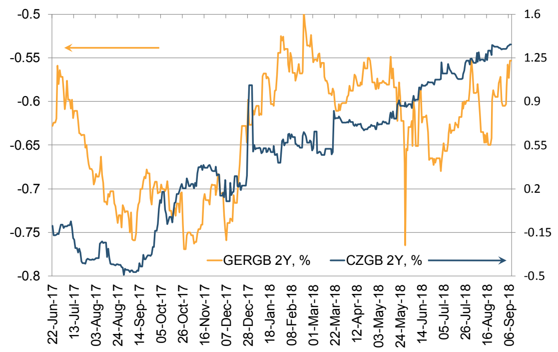
In Eurozone, most important event is by far the ECB meeting. Even if there are no changes to the setting of the monetary policy to be expected. There are two areas of interest at the press conference after the meeting: first, what does ECB think about persistently low inflation that doesn't seem to be moving anywhere, and whether that can have any bearing on its decision to scrap the QE at the end of this year, and, second, whether Italy is of any concern. On the former, there could be some answers, on the latter, I am less sure, Draghi being Italian.

EURCZK FALLS SLIGHTLY TO UNDER 25.70



TINY CHANGES IN THE GER/CZ BOND MARKETS LAST WEEK





WEEK BEHIND

CZ: industry fell despite electricity production surge ▶ …

…and PMI suggests it won't quicken in 2H18 ▶

CZ: wages still through the roof, and still primarily because of government ▶

CZ: Retail sales in a solid y/y growth, but monthly dynamics muted ▶

GER: Industry remains in a soft patch, unlikely to accelerate soon ▶

EMU: Final 2Q18 GDP data shows net exports key to faster growth ▶

| FX

CZK strengthened marginally to under 25.70 in the 2nd half of last week.

| FI

Nothing happened in either German or Czech government bond markets.

Both ends of the German government bond yield curve rose about 5 bps. Czech curve did the same.

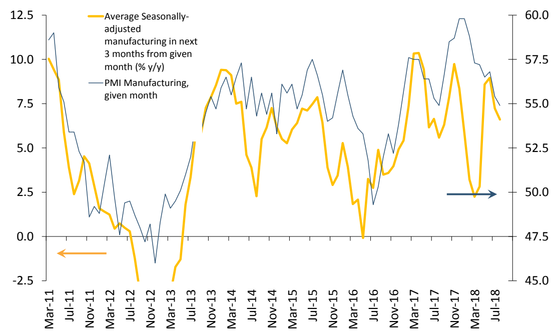
| CZECH ECONOMY

Although still at levels consistent with solid growth, Czech manufacturing PMI retreated further to lowest level (54.9) since August 2017.

This was not only true of the entire index, but also of the actual output component thereof. Of even more importance, clearly, are new orders. Here, the new export orders rose from July's 20-month low, but only slightly so. Domestic orders were robust, though, as reported by the data compiler, Markit, "slightly less regular", whatever that means. As regards inflation, input one was reported largest since November 2017 as exchange rate and higher prices of raw materials fed into production. On the output side of things, situation was not as dramatic, with sub-index of output prices weakest in last three months.

Put together, it appears that although **industry will continue to grow, it won't provide any boost to GDP beyond what we saw in last two quarters**. Just the contrary is likely: the current level of PMI is consistent with about 5% annual growth of manufacturing going forward. With trade war, chaotic Brexit possibility, emerging markets' turmoil, it is then even more likely than not that actual growth in next twelve months will be even weaker.

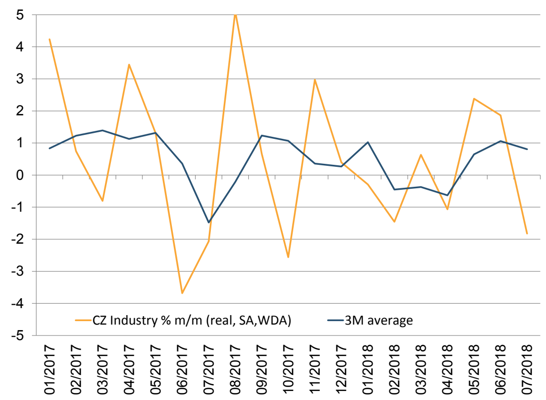
PMI SUGGEST 5% Y/Y GROWTH OF INDUSTRY AHEAD



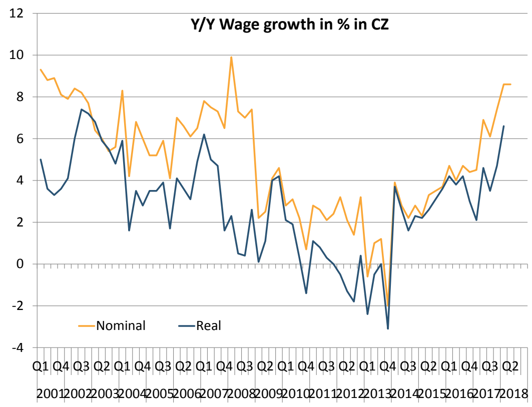
And July industry numbers certainly do justify that expectation.

The entire industry fell 1.8 % m/m in July and so did the manufacturing component thereof. Annual working-day adjusted (WDA) growth rate remained at 6.7%, mainly due to the strong production of electricity, gas, steam and air conditioning where annual increase was 23.3% (WDA). The annual increase of manufacturing was about 5% y/y, i.e. what current levels of PMI suggest. But, considering the weakness in Germany, this year's performance of Czech industry (and manufacturing component thereof) is surprising.

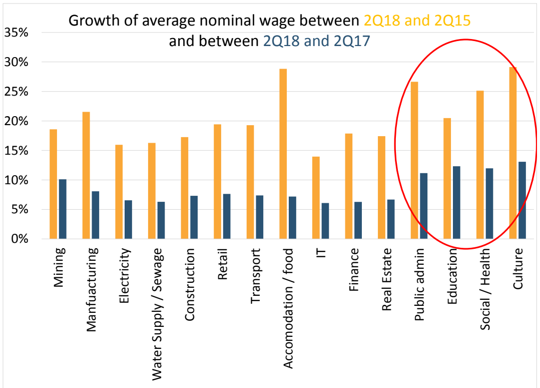
INDUSTRY FELL IN JULY DESPITE STRONG HELP FROM ELECTRICITY GENERATION



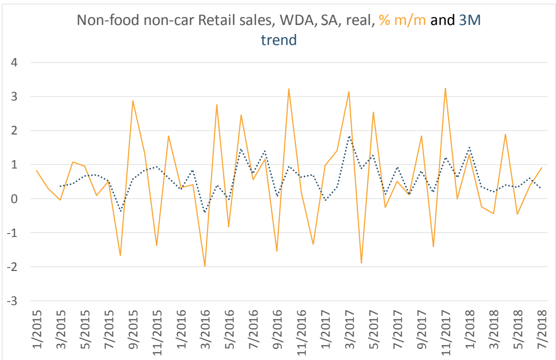
WAGES CONTINUE TO GROW STRONGLY,…



..AND PRIMARILY, AS IN LAST THREE YEARS, DUE TO STATE.



RETAIL SALES STILL AT 7% Y/Y, BUT MONTHLY DYNAMICS SUGGEST THIS WILL SLOW TO 4% SOON



Going forward, though, the overall situation is unlikely to improve. August release will probably show another strong electricity production (heat wave), which will help overall industrial production strong. But manufacturing looks unlikely to quicken: German industrial orders, as seen below, fell for the second time in July. Not a good omen for us.

Wages are still through the roof, with government in the driving seat of the wage rage.

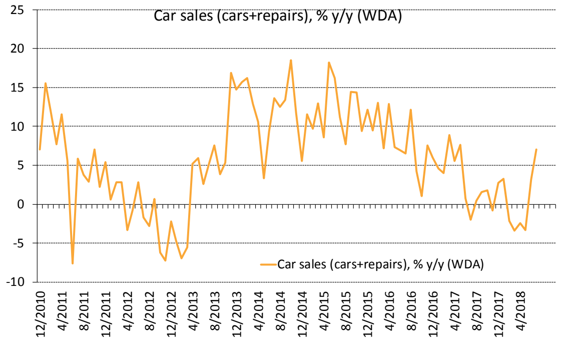
Average nominal wage rose 8.6% y/y in the 2Q18, coming close to CZK 32 ths. in the absolute numbers. What's even more impressive is that over last three years the average wage rose 21% - and since price level only increased by 6% over the same time, real wage grew 15%. Which is all nice except…

…except for the fact that it's been driven by public sector. Out of 19 NACE sectors, just 6 recorded larger than 20% growth of average wage in last three years. The winner is obviously hospitality (+29% y/y), a consequence of EET (as it became harder to hide sales, it became harder to pay people on the side). But out of next 5 NACE sectors, in four are the employees paid for predominantly by state: public administration and defense (average wage +26.6% in last three years), education (+20.5%), health and social care (+25.1%) and culture (+29%). And it obviously won't stop soon: the public sector wages are set to go up additional 10% next year, Andrej Babis promises average teacher's monthly pay of 45 ths. in four years etc.

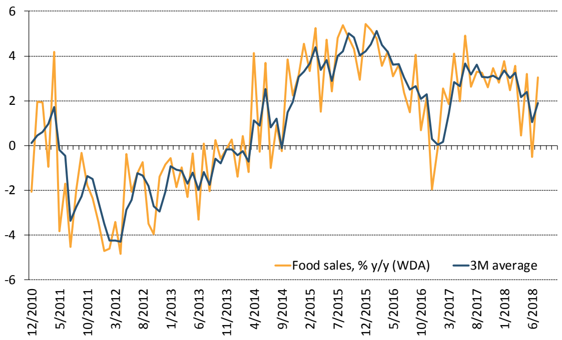
This obviously has negative fiscal implications, which will become very pronounced when (not if) the economy slows. But, equally importantly, it has a crowding out effect: the employment in the public sector is quickly becoming relatively more attractive to others. Which is, by the way, the way it was in Greece…

Retail sales maintained solid annual growth at the beginning of 2nd half, though the

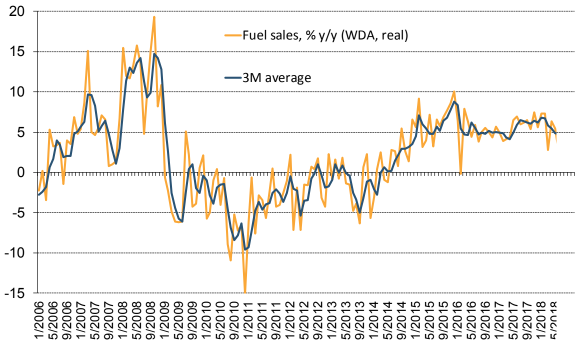
CAR SALES UP 7%, FINALLY



FOOD PRICES REVERSED JUNE Y/Y DECLINE, BUT LOST MOMENTUM THIS YEAR,…



…AS DID FUEL SALES.



best times of previous two years are over.

Core retail sales, i.e. without cars, fuel and food, grew solid 7.3% y/y (WDA, SA, real), but their monthly dynamics is much more subdued this year than what we saw in 2017 and 2nd half of 2016. This is probably, as I already mentioned before, the consequence of saturated labor market (unemployment can't fall further), low savings rate (can't fall much further) high wage growth (can't be much quicker as it already eats into companies' profitability rates). **The retail sales growth will soon (in the Fall) fall and then stabilize around 4 y/y.** Which is also the best it can grow next year – if nothing negative happens.

In other segments of the overall retail, car sales posted another small rise in July (0.6% m/m). Considering that June and July of 2017 saw big declines (in excess of 7% cumulatively) which subsequent months failed to reverse, I'd say we'll see rates of growth around July one (7%) throughout 2H18. Which is where car sales should be considering the state of the economy.

Food sales reversed their dip below zero from June and grew 3% y/y in July, but the loss of sales momentum this year, due to higher food prices, is clear, if not large.

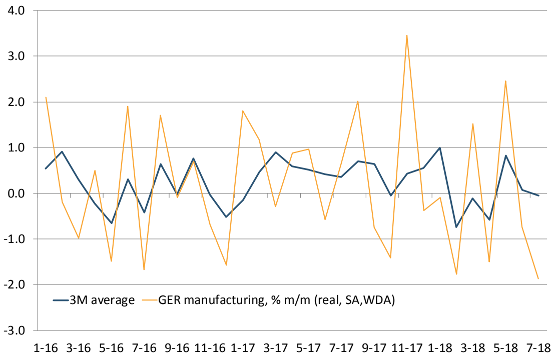
Finally, **fuel sales** also slowed down this year, and for the same reason as food ones (higher prices), but again, it's been small: from about 6.5% y/y growth at the beginning of 1st half to about 4% growth at the beginning of 2nd.

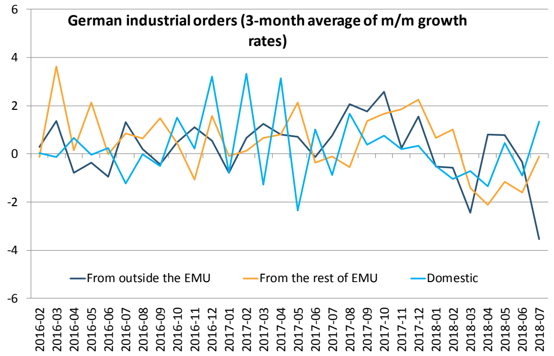
| EUROZONE ECONOMY

German industry remained soft at the beginning of 2Q18, with little hope of acceleration.

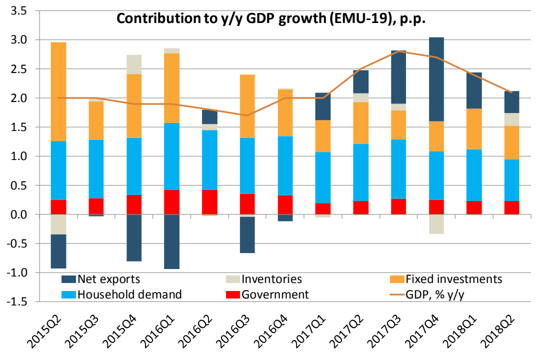
Industrial orders fell again in July, recording 6th down month in 2017. The fall of almost 0.95% m/m against June came after 3.9% monthly decline

German industrial weakness continues: manufacturing and orders fell for the second month





The loss of GDP growth momentum due to net exports.



in June and 2.6% monthly gain (the only one this year) in May. Orders are now 0.9% lower than in July 2017 and just 3.2% higher than in July 2015. Not very impressive, if you ask me.

The decline in orders in recent months, as well as in July alone, was driven by foreign non-Eurozone orders (-4% m/m in July, -5.6% m/m in June, -1.1% m/m), likely the reflection of Trump trade jihad and emerging markets slowdown.

The actual production also didn't fare too well in July, having fallen 1.1% m/m in July (after 0.6% m/m contraction in June). It fell in five out of 2018's seven months. Manufacturing was down even more, with almost 2% m/m contraction in July and 0.7% contraction in June. Structure-wise, all the major components fell, with capital goods and consumer durables both down 2.5% m/m. What helped was 0.9% gain in electricity, gas, steam and air-conditioning production. Industrial production is thus now just 1.2% higher than in July 2018; manufacturing just 0.8% y/y.

Put together, it does not look too likely we're going to see German industry accelerating to 5% growth rates any time soon. **The implication: expect weaker annual growth of CZ industry soon, too.**

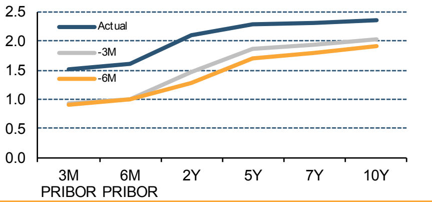
Final 2Q18 Eurozone GDP data didn't reveal anything we didn't know.

Quarterly growth was confirmed at +0.4% q/q, with pretty uneventful structure. The contribution of final domestic demand to q/q growth was in line with its contribution seen in 2017-1H18. Hence, only the fact that net exports' contribution was negative pushed the growth lower in 1H18 (and in 2Q18 in particular) than before.

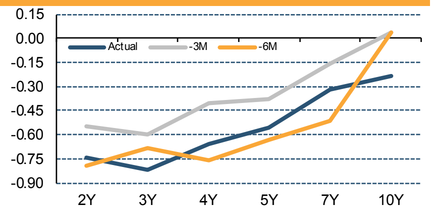
Annual growth was confirmed at 2.1%, with the same story. The contribution of domestic demand (government + firms + households) remained around 1.5 pp, in line with that seen in previous 5-6 quarters. What was different was the smallest contribution of net exports since 4Q16. In essence, the **data confirm that domestic demand is at its maximum and if growth is to quicken beyond that, it has to be due to net exports.** Which is unlikely to happen in coming quarters (Trump, Brexit, EM slowdown).

| Markets ‡

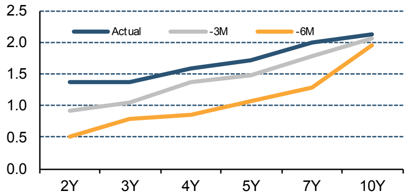
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	1.510	1.610	2.100	2.280	2.313	2.355
	-1M	1.450	1.540	1.930	2.165	2.193	2.220
	-3M	0.920	1.000	1.463	1.855	1.933	2.023
	-6M	0.910	0.990	1.290	1.710	1.795	1.915



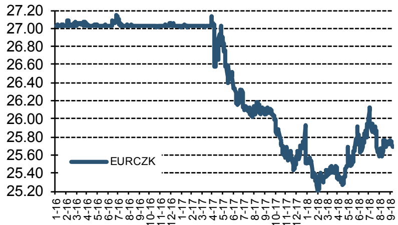
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.741	-0.816	-0.659	-0.561	-0.324	-0.237
	-1M	-0.634	-0.727	-0.620	-0.404	-0.173	0.003
	-3M	-0.549	-0.604	-0.401	-0.377	-0.155	0.039
	-6M	-0.794	-0.688	-0.757	-0.635	-0.517	0.033



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	1.359	1.377	1.584	1.719	1.989	2.118
	-1M	1.296	1.322	1.502	1.761	2.020	2.223
	-3M	0.914	1.035	1.359	1.478	1.778	2.061
	-6M	0.496	0.787	0.852	1.075	1.278	1.948



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.689	4.315	324.94	4.622	7.409	1.155
	-1M	25.597	4.263	319.53	4.640	6.133	1.161
	-3M	25.752	4.278	319.75	4.659	5.270	1.177
	-6M	25.416	4.204	311.86	4.657	4.712	1.231



‡ 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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