Weekly | 2018 | Week 39

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	1-Oct-18	8:00	GER	Retail sales, Aug'18, y/y	1.6%	N/A
	1-Oct-18	9:00	SPA	Retail sales, Aug'18, y/y	0.4%	N/A
	1-Oct-18	9:30	CZ	PMI, Sep'18	54.4	N/A
	1-Oct-18	10:00	EMU	Unemployment rate, Aug'18	8.1%	N/A
Tuesday	2-Oct-18	9:00	CZ	(Final) GDP, 2Q18, q/q	0.7%	0.7%
Wednesday	3-Oct-18	10:00	EMU	(Final) Service PMI, Sep'18	54.7	N/A
	3-Oct-18	11:00	EMU	Retail sales, Aug'18, y/y	1.7%	N/A
Friday	5-Oct-18	8:00	GER	Industrial orders, Aug'18, y/y (WDA)	-3.0%	N/A
	5-Oct-18	9:00	SPA	Industrial output, Aug'18, y/y (SA)	0.5%	N/A
	5-Oct-18	10:00	ITA	Retail sales, Aug'18, y/y	0.2%	N/A

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

OCTOBER 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2018-2029**	10-Oct-18	12-Oct-18	23-Jul-29	CZK 5 bn. max	2.75%
CZGB 2017-2033**	10-Oct-18	12-Oct-18	13-Oct-33	CZK 3 bn. max	2.00%
CZGB 2018-2021**	24-Oct-18	26-Oct-18	23-Feb-21	CZK 3 bn. max	0.75%
CZGB 2014-2025**	24-Oct-18	26-Oct-18	17-Sep-25	CZK 5 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

YOU KNOW U.S. IS NOT A FIRST-WORLD COUNTRY WHEN ORDINARY JOE CAN NAME A SUPREME COURT JUDGE NOMINEE.

WEEK AHEAD

Czech PMI and final 2Q18 GDP data to be released this week.

The latter release is pretty unimportant for the markets, but I am curious whether the all-time low of household savings rate from 1Q18 was broken in 2Q18 (households savings rate and non-financial firms' profitability are the two most important new data pieces in final GDP releases). I think it was not.

In Eurozone, retail and industrial data for some big economies are to be published. For retail sales, Eurozone August growth was very likely very slow, so nothing to change my view that we're long away from sustainable inflation. Industrial orders in Germany and Spanish actual production will likely confirm the ongoing soft patch in Euro-area industry.

WEEK BEHIND

CZ: confidence unchanged in September ▶

CNB: hike, but hawks underwhelmed by the presser ▶

EMU: IFO unchanged on August ▶ as was core inflation ▶

| FX

CZK weakened back towards 25.80 last week…

…as market found the CNB's statements / press conference to be a little too much on the dovish side. My view is that if CZK stays this weak, new forecast in November will have higher expected interest rate path than the previous one. Which CNB will act on by tightening which then will send EURCZK lower. But, as said previously, the strengthening towards 25 is unlikely as profit-taking among the intervention speculators takes place.

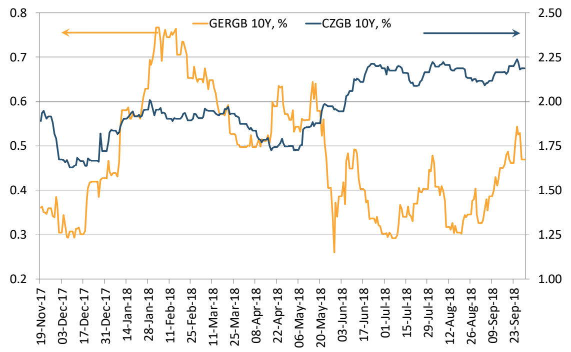
EURCZK FELL FURTHER AS MARKET UNDERWHELMED BY CNB PRESSER / STATEMENT

| FI

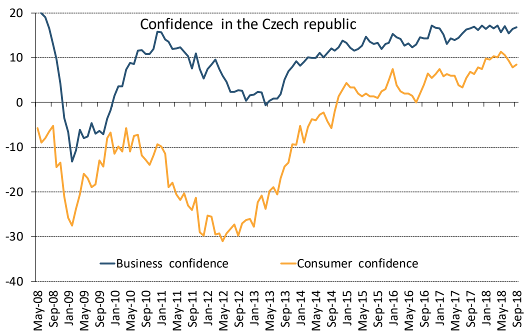
Italy projected budget deficit and another low core inflation reading pushed German 10Y back below 50 bps.

Italy 10Y yields rose to highest since early June as government presented a larger-than-expected budget deficit of 2.4%, defying Brussels' target of 2% and calling it "budget for change". Combined with low core inflation reading form Eurozone, money flew to German government paper. I don't think the pressure on German yields will stop soon: Italy seems hell-bent on going against Brussels. Not that Brussels will do anything now: EU prefers to let bond markets rein in Italy. But the latent nervousness will keep German yields from rising. That, and low inflation that will continue.

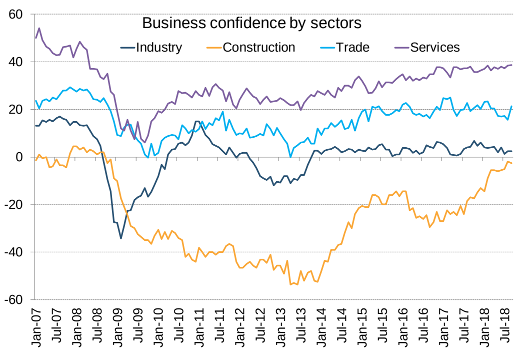
GERMAN 10YS BACK BELOW 50 BPS ON ITALY BUDGET, LOW CORE INFLATION



CONFIDENCE DIDN'T CHANGE MUCH IN SEPTEMBER



THE ONLY MEANINGFUL CHANGE WAS IN TRADE



| CZECH ECONOMY

September confidence of consumers didn't change almost at all while business one rose back to June level.

For consumer confidence, change as compared with August was small (+0.7 pts.) and thus left the confidence near this year's (August) low of 8.5 pts. Looking at the structure of the index, the only meaningful change as against August was the rise of sub-index measuring concerns for future price increases (i.e., fear of inflation). Other components improved, but only marginally so.

Among businesses, the increase to 16.8 pts. brought the confidence back to June level of 17 pts. The only segment where there was a marked change was in trade where confidence shot up to 21.3 pts., highest since February. Why that was the case, I don't have a clue, but the recent calm in the EU-US trade dispute may have contributed.

To sum, September confidence data were a non-event.

CNB hiked the repo again last week, but the press conference disappointed (the hawks among) the investors.

The third tightening of the policy in as many meetings brought the 2-week repo rate to 1.50% and that outcome was in line with the expectations. But there were some aspects of the the press conference and of the post-meeting statement that took investors, apparently expecting a clearly hawkish message, by surprise.

First, Governor Rusnok didn't explicitly commit to another hike at the next meeting on November 1st. This is understandable (pre-commitment is always an unnecessary constraint) and in any case isn't anything new as Governor indicated fairly clearly in an interview few days before the meeting that he sees two hikes this year. Therefore, failing to explicitly confirm anything at the meeting should not have been viewed as dovish signal. But it was.

Second, the post-meeting statement said the risks to the recent (August) forecast – which foresaw 3M PRIBOR at 1.8% in 4Q18 - were "*balanced and insignificant*". Since the 3M PRIBOR currently stands at 1.7%, the implication is that there will be no hike for the remainder of the year.

Third, whereas at the previous 2 meetings all the Board members voted unanimously for the tighter policy, there was one dissenter now. It probably was V. Tomsik whose mandate ends in November, so it shouldn't matter much, but it does indicate that the unanimity is not there anymore (and that neither is there likely the will to go above the forecast in terms of more hikes than dictated by the actual forecast).

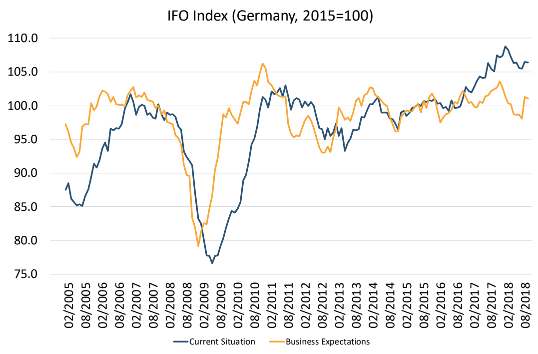
Will the new forecast to be published at the next meeting move the forecast interest rate path upwards? It well may, courtesy of the EURCZK exchange rate. See, the previous forecast had CZK at 25.30 in the final quarter of this year (and 24.80 in the first quarter of 2019), but the CNB meeting was clearly underwhelming for the market and pushed EURCZK back towards 25.80. If EURCZK stays 0.5 CZK weaker in October as against the August expectation – and with other data over August-September having come in pretty much in line with August forecast – it will lead to an upside revision of the CNB repo rate trajectory (and the hike) at the next meeting.

| EUROZONE ECONOMY

IFO index didn't change one iota in September.

After the surprising increase in expectations' component of the index in August (from 98.1 in July to 101.3 in August), September wasn't anything comment-worthy: the expectations declined slightly to 101 pts. while the assessment of the current situation decreased imperceptibly to 106.4 pts.

IFO INDEX UNCHANGED IN SEPTEMBER



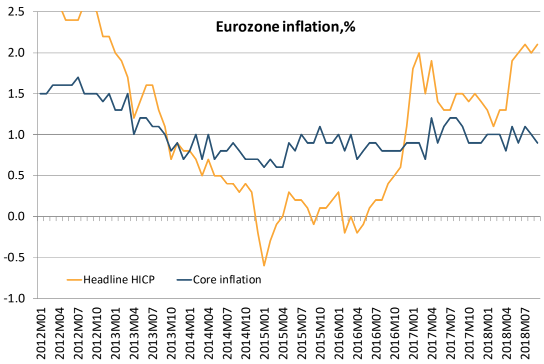
All in all, the expectations are around the average of last 5 years while assessment of the current situation is at an all-time high. If I had to choose, I'd say the latter will converge to the former, and it will do so soon.

Eurozone core inflation again under 1% in September, …

…meaning that it's been without trend for last five years, despite ECB's repeated assurances over last year or two that inflation will soon converge to 2% in a sustainable fashion.

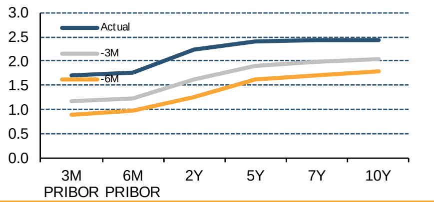
Nothing like that has happened so far this year. See, the headline inflation is around 2% (2.1% in September, according to the preliminary data), but that is not sustainable as the jump to this level in 1H18 was single-handedly caused by y/y increase in energy prices. What is sustainable when it comes to inflation is core inflation, i.e. the measure of core demand underlying inflation pressures.
But this measure of inflation didn't move anywhere over last five years – and September wasn't an exception. With dip to 0.9% y/y, core inflation has now remained in a tight range between 1.1% and 0.8% for over a year (and hasn't been higher than 1.2% since March 2013).
The lack of sustainable demand pressures is certainly not what ECB would want to see. While the undershooting of ECB forecast when it comes to core inflation will not stop QE from being phased out by the end of this year, the probability of the outright hike next year is receding further. **My call remains unchanged: first hike in 2020.**

EUROZONE CORE INFLATION STILL WITH NO TREND

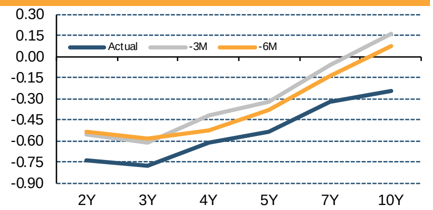


| Markets ‡

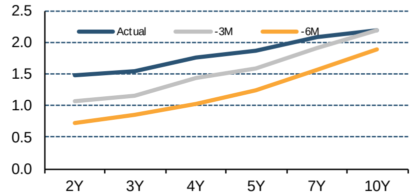
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	1.700	1.770	2.225	2.400	2.419	2.435
	-1M	1.490	1.590	2.040	2.230	2.261	2.300
	-3M	1.160	1.240	1.630	1.910	1.971	2.030
	-6M	0.900	0.990	1.270	1.630	1.715	1.800



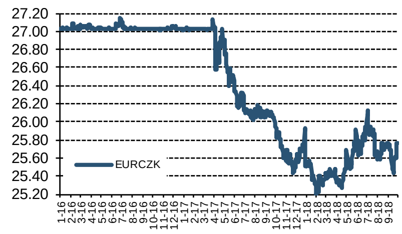
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.743	-0.776	-0.613	-0.537	-0.329	-0.248
	-1M	-0.714	-0.805	-0.698	-0.533	-0.272	-0.173
	-3M	-0.555	-0.610	-0.425	-0.329	-0.063	0.158
	-6M	-0.538	-0.581	-0.527	-0.384	-0.144	0.076



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	1.482	1.534	1.753	1.863	2.090	2.187
	-1M	1.326	1.329	1.491	1.697	1.989	2.127
	-3M	1.075	1.151	1.424	1.581	1.908	2.188
	-6M	0.732	0.851	1.022	1.246	1.571	1.876



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.765	4.281	323.41	4.654	7.034	1.160
	-1M	25.732	4.290	325.74	4.630	7.576	1.171
	-3M	25.989	4.372	329.26	4.664	5.368	1.168
	-6M	25.394	4.210	312.33	4.660	4.857	1.230



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

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