Weekly | 2018 | Week 14

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**
Monday	8-Apr-19	9:00	CZ	Industrial production, Feb'19, y/y	1.5%
	8-Apr-19	9:00	CZ	Unemployment, Mar'19	3.0%
Tuesday	9-Apr-19	8:45	FRA	Industrial production, Feb'19, y/y	-0.2%
	9-Apr-19	9:00	CZ	CPI, Mar'19, y/y	2.9%
Wednesday	10-Apr-19	10:00	ITA	Industrial production, Feb'19, y/y	-1.1%
	10-Apr-19	13:45	EMU	ECB monetary-policy meeting, Refi / Marginal / Deposit Rate	0/0.25/-0.4%
Thursday	11-Apr-19	8:00	GER	Final HICP, Mar'19, y/y	1.4%
	11-Apr-19	8:45	FRA	Final HICP, Mar'19, y/y	1.3%
Friday	12-Apr-19	9:00	SPA	Final HICP, Mar'19, y/y	1.3%
	12-Apr-19	11:00	EMU	Industrial production, Feb'19, y/y WDA	-0.9%

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

APRIL 2019 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2015-2026**	3-Apr-19	5-Apr-19	26-Jun-26	CZK 5 bn. max	1.00%
CZGB 2017-2033**	3-Apr-19	5-Apr-19	13-Oct-33	CZK 5 bn. max	2.00%
CZGB 2019-2021**	10-Apr-19	12-Apr-19	20-Aug-21	EUR 100 mn. max	0.00%
CZGB 2018-2029**	10-Apr-19	12-Apr-19	23-Jul-29	CZK 5 bn. max	2.75%
CZGB 2007-2057**	10-Apr-19	12-Apr-19	26-Nov-57	CZK 0.5 bn. max	4.85%
CZGB 2015-2030**	24-Apr-19	26-Apr-19	15-Jan-00	CZK 5 bn. max	0.95%
CZGB 2006-2036**	24-Apr-19	26-Apr-19	4-Dec-36	CZK 2 bn. max	4.20%

* 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.
*** TO BE DETERMINED ACCORDING TO THE ACTUAL MARKET SITUATION.

THOUGHT OF THE WEEK

"MAY = LINO. LEADER IN THE NAME ONLY [THE GUARDIAN]".

WEEK AHEAD

Lots of releases both here and in the Eurozone.

In the **Czech Republic**, **February industry should post another weak result,** if German data are anything to go by. But it should be better than ≈1% m/m contractions seen in December, January. **March inflation** will still be primarily due to real estate prices (and housing segment in general) and due to tobacco and alcohol.

In the Eurozone, **the biggest event is obviously the ECB meeting.** But this one will be very uneventful one, compared to last three or so. First, no change in the policy is expected, second, ECB already backtracked on its optimism at the last two meetings (so there won't be any more dovish backtracking here) and, third, new forecast was published at March meeting. Still worth keeping an eye on, though, especially the press conference.

WEEK BEHIND

Czech government is a weathervane when it comes to budget ▶

Disinvestment boom over, profitability of firms still worsening ▶

Czech households still on spending spree… ▶

…while industry is worsening, and shall continue to worsen ▶

Eurozone data make ECB tightening unlikely even for 2020 ▶

German industry still in the doldrums ▶

| FX

EURCZK moved down and hit 25.60…

… in response to the string of solid local data (PMI ignoring) and as slight to the safety of German bunds ended. Still, we're talking EURCZK levels where EURCZK was at the beginning of this year. Hence, no strengthening in first 100 days of 2019.

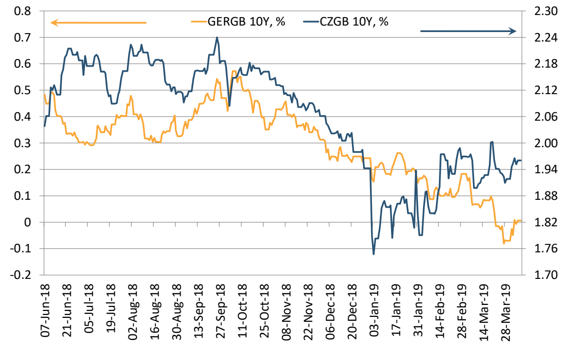
CZK STRENGTHENS TO BEGINNING-OF-THE YEAR LEVELS OF 25.60

| FI

10Y Bund returned to zero last week,…

…as prospects of soft Brexit (with May finally doing what she should've done from the get-go, i.e. asking MPs what kind of Brexit they want) heartened the investors, as did the news that China-US trade deal is going to happen. These even exceeded in its impact the weak industry data ▶.

BUND 10Y YIELD RETURNS TO ZERO AFTER A TWO-WEEK TRIP IN NEGATIVE TERRITORY



| CZECH ECONOMY

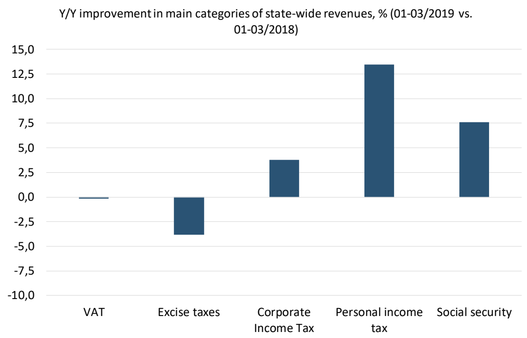
Now we know why the suddenly rediscovered fiscal prudence of government ↗, of February didn't last too long.

Recall that weak January-February budget data sent PM Babiš and his Minister of Finance frantically searching for savings in February (see page 4 here ↗). But, come March, this glimmer of fiscal prudency went out of window. Maternity allowance increase of 80.000 CZK is pretty much done deal, the debate being only about whether it will apply to all parents or just the parents whose kid was born in 2020, i.e. whether it will cost 6 or 10 bn. (small change anyway, right? …). Another bump in pensions was approved in March, this time of CZK 900 CZK / month. Just these two spending items of March will cost us CZK 40 bn. (!) in annual additional expenditures.

Why such an **abrupt reversal,** then? **Well, because tax receipts improved in March, that is why.** VAT receipts swung from being markedly negative y/y in first two months of 2019 to being flat y/yin March. Yes, this should be a huge disappointment and a lifted finger to government not to spend much, considering that government planned for 7% increase this year, but it would have to be different government to view it like that. This government sees that taxes are up, especially for individuals (reflection of strong growth in wages, especially in the public sector…), and that so are social security / health insurance contributions (for the same reason) – and it is enough for it to spend like there is not tomorrow.

Not only are these spending plans for 2020 disconcerting from the budget perspective, so is the evolution of expenditures this year. The current year's expenditures are higher, of course - salaries cost us 8.4% more than a year ago, transfers to lower levels of government (again, mostly for salaries of teachers etc.) are up 16%, social spending is up 8%. **Overall, the expenditures are up 13.4% (!), and if one subtracts the EU contributions, it is 11.3% - or CZK 37 bn.!**

GOVERNMENT BACK TO SPENDING MODE AS VAT RECEIPTS IMPROVE AGAINST JANUARY-FEBRUARY.



I've never expected this government to be a long-term thinking one, but turning each month in the budgetary wind like a weathervane is a novelty even for short-termism that's characterized Czech governments historically.
And no, last week's data that showed the overall debt of government had fallen to 32.7% GDP last year and that it thus remains very low by Western European standards, aren't of comfort. The problem is that we could've done much, much better instead of handing over money to everyone. And that Western Europe's example is not one to emulate when it comes to fiscal policy,

But, hey, retail sales continue to provide the government with illusion that economic growth is forever.

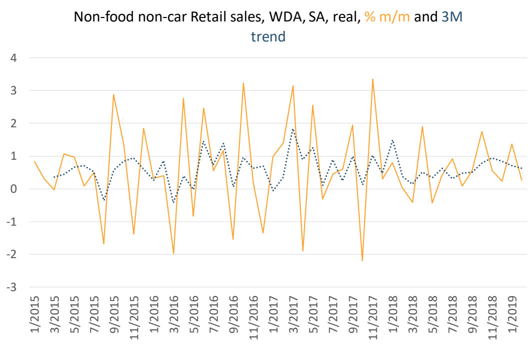
The retail sales (incl. cars, fuel) rose 3.4% y/y in February, their fastest annual growth since July of last year. This was due to the return of car sales to slightly positive growth (0.2% y/y), as opposed to 5% annual declines we've seen since September. Fuel sales also grew at the fastest rate since May of 2018.
The core retail sales (no car, no fuels, no food) grew 7.4% y/y, exactly what the average annual growth was over January 2018-January 2019. Their quarterly annualized growth remains almost 8% y/y.

All in all, households still go strongly, and understandably so: unemployment is non-existent, public sector wage hikes spread across the economy and so consumers have more money in their pockets. But this will not last forever.

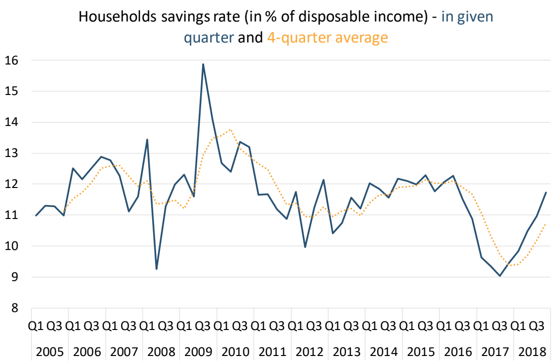
Final GDP for 4Q18 was marginally lower (0.8% q/q) than before (0.9% q/q), bringing the overall 2018 growth to 2.9%, exactly like in US.

As is usual, the final release didn't bring anything new in terms of growth data, The only new information were household savings rate and profitability of non-financial corporations. The former went up again, rising to 11.7% of disposable

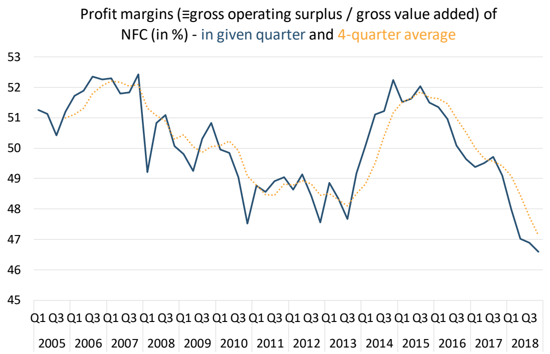
RETAIL SALES STILL GOING STRONGLY, ESPECIALLY IN CORE SEGMENT



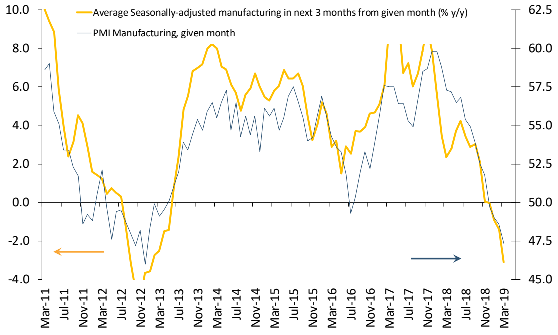
SAVINGS RATE BACK AT HISTORICAL AVERAGE, HOUSEHOLD BACK TO TYPICAL SAVINGS' MODE



Profitability of NFCs continues to worsen



Czech PMI hints at more weakness in manufacturing in 2Q19



German industrial orders fell most since late 2009

income in 4Q18 (seasonally adjusted), i.e. 2.2 pp. higher than at the end of 2017 and 0.8 pp. higher than at the end of 2016. The debt boom of last years is thus definitely over.

The profitability of non-financial corporations, on the other hand, worsened further, probably a reflection of double whammy of (public sector-driven) wage increases and weaker manufacturing sector. This certainly doesn't bode well for fixed investments in the future.

Czech PMI suggests industry is in for further weakening.

Conditions in manufacturing deteriorated further at the end of 1st quarter, with PMI having fallen to lowest (47.3) since the end of 2012. 1Q19 average was lowest since average PMI in 4Q12. As was to be expected given the weak new orders' sub-index in previous months, actual production was a No.1 factor behind the March 2019 weakness.

And this effect will continue: growth of new orders in March 2019 was weakest since late 2012 and so will, in the coming months, translate into weak actual production, thereby dragging production down. Another bad omen is the continuing pessimism among the manufacturers: the confidence sub-index was the weakest since end of 2012. And, in a sign that even previously optimistic consumers may be about to experience the harder times, the hiring contracted at the fastest rate since January 2013. There will certainly not be anywhere close to wage growth seen in last three years in the coming years.

All in all, clear signs of continuing weakness in industry. And that is no wonder, considering Germany (read below).

| EUROZONE ECONOMY

German industry was weakening further in February.

Total **production did rise by 0.7% m/m**, true, and it was more than expected, **but the growth was only due to construction and energy**. The manufacturing was bleak: after 0.4% m/m contraction in January, it fell 0.2%. Hence, in last fourteen months it only posted positive growth in four – the annual decline in February was 1.8%. This really leaves me scratching my head: I mean, not that there aren't headwinds (trade tensions, slowdown in EMs, Brexit) but this persistent weakness seems to be unexplainable by just these…

... especially when combined with **brutal decline of factory orders** in February. Orders plummeted 4.2% m/m, which does seem like at least partially being due to factors that won't last beyond February, but the truth is that even half the decline would've been bad. **As it stands, the y/y decline of 8.2% is now largest since October 2009.** It was cause by decline in capital goods orders.

Bottom line: Czech industry will contract further. And ECB will not hike in next two years.

Inflation is, and shall remain, low for the foreseeable future.

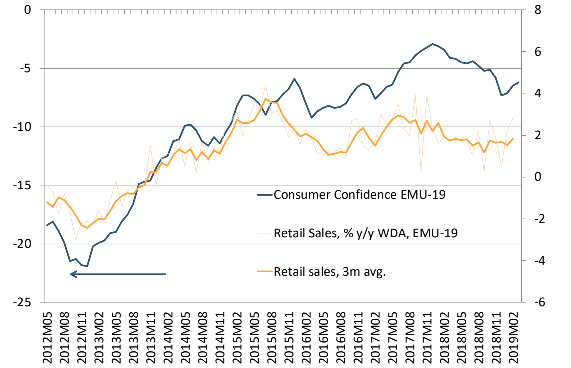
This is what follows from inflation, retail sales and unemployment data released last week.

First, **retail sales**, although having improved, are still far from price stability-threatening levels: February's 2.8% growth is fastest since November 2017, but it'd have to be double that to send CPI up.

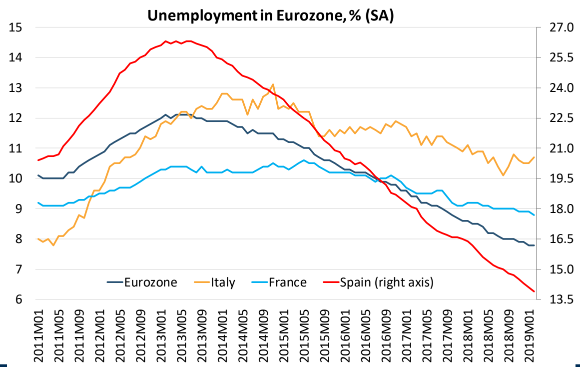
Second, **unemployment** remained at 7.8% in Feb'19 (SA), same as in January and thus only 0.7 pp. lower than in February 2018. At this rate of labor market improvement, it will take three years for it to get to NAIRU levels.

No surprise, then, that **inflation** didn't go anywhere in **March**. The headline inflation returned to January 1.4%, but the core inflation declined to lowest (0.8%) since April of 2018. Although this is likely just a blip and April'19 will see return to 1%, the important thing is that inflation's been stuck around 1% forever now, with no trend whatsoever. And, unless household consumption quickens markedly, it will remain so.

EMU RETAIL SALES QUICKEN, BUT GROWTH STILL TOO WEAK TO CAUSE INFLATION ANYTIME SOON

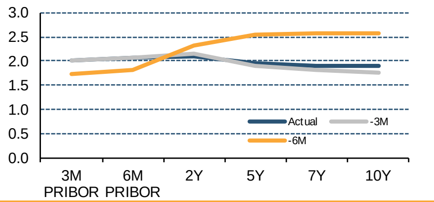


…AND UNEMPLOYMENT IMPROVING TOO SLOWLY TO CAUSE INFLATION ANYTIME SOON.

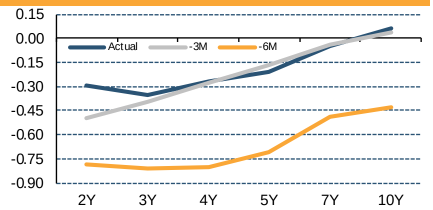


| Markets ‡

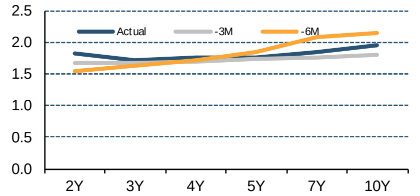
MM / IRS (%)	3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
Actual	2.020	2.060	2.110	1.968	1.898	1.903
-1M	2.030	2.070	2.215	2.005	1.928	1.930
-3M	2.010	2.070	2.160	1.900	1.805	1.773
-6M	1.740	1.810	2.330	2.555	2.563	2.580



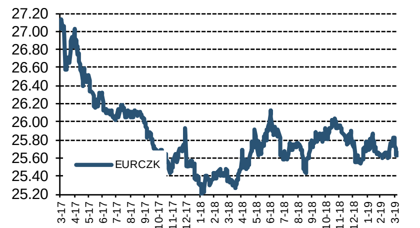
ASW spread* (bps.)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	-0.296	-0.355	-0.272	-0.209	-0.051	0.058
-1M	-0.346	-0.403	-0.311	-0.196	-0.017	0.030
-3M	-0.498	-0.398	-0.280	-0.171	-0.043	0.037
-6M	-0.782	-0.811	-0.805	-0.713	-0.492	-0.432



CZGB** (%)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	1.814	1.715	1.748	1.759	1.847	1.960
-1M	1.869	1.765	1.772	1.809	1.910	1.960
-3M	1.662	1.667	1.700	1.729	1.762	1.809
-6M	1.548	1.634	1.713	1.842	2.071	2.148



FX	EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
Actual	25.653	4.294	321.03	4.749	6.314	1.122
-1M	25.628	4.314	316.21	4.743	6.136	1.119
-3M	25.563	4.297	321.16	4.663	6.183	1.147
-6M	25.758	4.305	324.81	4.671	7.068	1.152



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

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