

June 10 | 2019

## Weekly | 2018 | Week 23

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## CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**
Tuesday	11-Jun-19	9:00	CZ	CPI, May'19, yy	2.7%
	11-Jun-19	9:00	CZ	Export Prices, Apr'19, y/y	N/A
Thursday	13-Jun-19	10:00	CZ	Current Account, May'19, CZK bn.	20.0
	13-Jun-19	11:00	EMU	Industrial production, Apr'19, y/y	-0.5%

\* LOCAL TIME IS CET

\*\* (REUTERS/ BLOOMBERG) POLL

## JUNE 2019 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2015-2026**	12-Jun-19	14-Jun-19	26-Jun-26	CZK 3 bn. max	1.00%
CZGB 2017-2033**	12-Jun-19	14-Jun-19	13-Oct-33	CZK 4 bn. max	2.00%
CZEUGB 2019-2021**	19-Jun-19	21-Jun-19	20-Aug-21	EUR 0.1-0.2 bn.	0.00%
CZGB 2017-2033**	26-Jun-19	28-Jun-19	13-Oct-33	CZK 4 bn. max	2.00%
CZGB 2007-2057**	26-Jun-19	28-Jun-19	26-Nov-57	CZK 0.5 bn. max	4.85%

\* 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

“WOODFORD GATED THE FUND ↗. BUT DOES IT REALLY COME AS A SURPRISE WHEN IT WAS INVESTED IN COLD FUSION? ↗“

## WEEK AHEAD

**Just May'19 Czech inflation is worth looking at this week.**

But even this is going to be pretty uneventful: half of it will again be shown to have been due to housing, just like in last year, and then another 0.4 pp due to food. In other words, real demand inflation nowhere to be seen.

In Eurozone, there is April industrial production but given weak German numbers ▶ that came out last week and despite solid Spanish (1.7% y/y growth) and French data (1.1% y/y) the market expectation is for contraction of 0.5%. To me, that is too pessimistic but I don't expect more than slightly above zero growth rate for April. And that is nothing to cheer at.

## WEEK BEHIND

**Czech industry continues to perform much better than PMI would suggest** ▶

**Czech household still going strong at the beginning of 2Q19** ▶

**ECB came to grips with reality, returning QE on the table in a...** ▶

**...decision vindicated by weak inflation, weak retail sales and...** ▶

**...weak German industry data of last week.** ▶

**EURCZK FALLS TO 25.60**

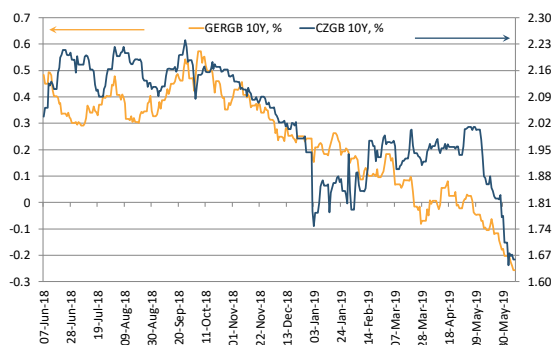


## | FX

**EURCZK fell to 25.60,...**

...with CZK having been pushed higher by combination of stronger euro against the dollar and good domestic data. Still, this is far from 24.50 that CZK should be at by this time based on 2018 CNB forecasts.

**CZECH 10YS YIELDS CONTINUE TO DECLINE**



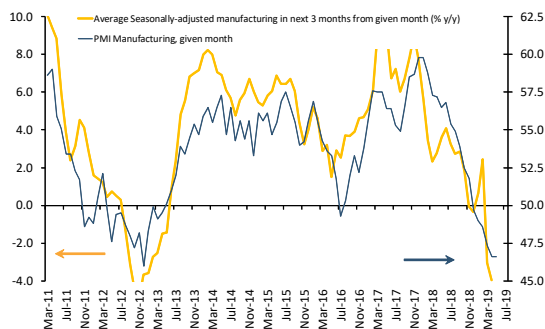
## | FI

**Czech yields continued to fall,...**

...as did the German ones. German 10Y fell to new low of almost -30 bps., CZGBs fell below 1.70%. Weakening economic outlook and thus flatter expected interest rate path (or switch to downward-sloping one) were the reasons.

**| CZECH ECONOMY**

**INDUSTRIAL PRODUCTION GREW SURPRISINGLY WELL IN LAST THREE MONTHS, DEFYING PMI**



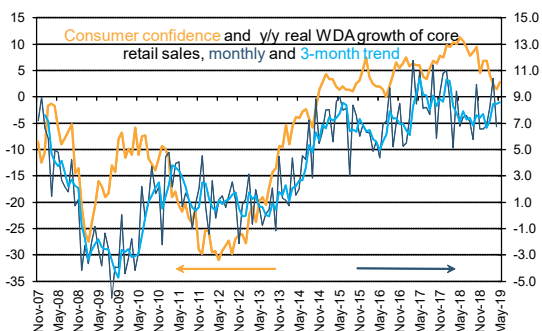
**Czech industry continues to perform much better than PMI would lead one to believe.**

Industrial production posted a third positive month in a row in April 2019, and so did the manufacturing component thereof. Sure, the monthly rates of growth of 0.3%, 0.1% and 0.8% in February, March and April, respectively (or, for manufacturing, 0.4%, 1.3% and 0.5%) aren't off-the-chart, but with PMI deeply below 50, one cannot but acknowledge the huge discrepancy here. Considering that the PMI of January-February forecast 1.5% y/y average contraction in the February-April period, the positive growth of industry (1.6% y/y on average) and of manufacturing (2.4% y/y) over that were clearly at odds with what leading indicators suggested. And I don't know why.

That said, further decline of PMI to 46.6 April and, as last week's data showed, to the same in May, corroborated, finally, by Czech statistical office measure of confidence, makes me convinced that industrial production over next three months (May-July) will be significantly worse than February-April. Although, if it will be as low as -3.3% y/y that PMI at 46.6 predicts is far from clear. But sure as hell I can't imagine industry growing with PMI this deep below 50.

**Same story, different month: weak headline, strong core. That's April retail sales.**

**CORE RETAIL SALES STILL STRONG,...**

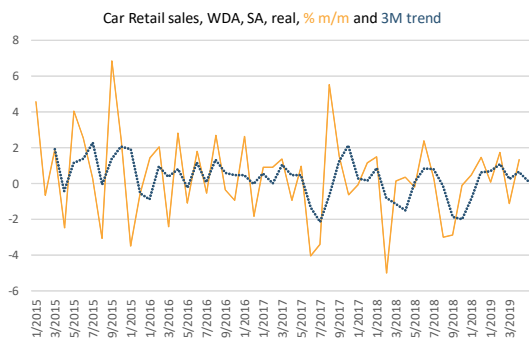


Total sales grew at the same 4.1% annual rate as in March. And they seem to be stable now: much weaker growth of total retail sales as opposed to core retail sales (i.e., sales without car, fuel or food) has been, as you recall, caused by weak car sales; these have only recently returned (from below) to y/y stagnation. Looking at m/m data, stagnation is what we see there too. **Bottom line: car sales shouldn't be a drag on retail sales any more going forward.**

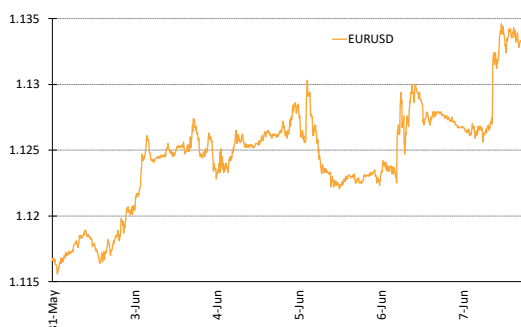
And if the weakness of car sales, so at odds with optimism seen in core retail sales, is found to have

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## ...CAR SALES STAGNATE.



## EURUSD RISES DESPITE UBER-DOVISH ECB MEETING



been due to new emissions tests that took many car models off the market for some time, we may see car sales rebounding and turning into a boost to retail sales growth in the 2<sup>nd</sup> half of the year.

Because, see, it isn't like households are holding back on spending, just the contrary: **core retail sales** (ex-cars, food, fuel) grew 6.8% y/y in April, and almost 9% y/y on average in last three months. No pessimism, no tight purses and wallets to be seen anywhere.

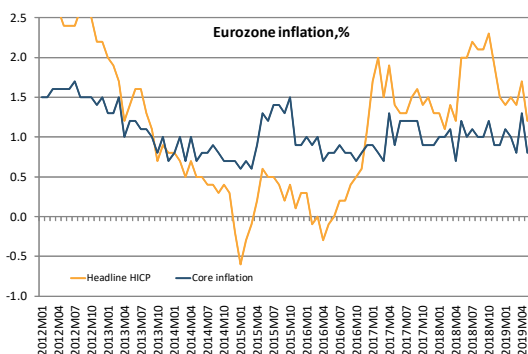
## | EUROZONE ECONOMY

**ECB meeting was another (predictable) episode in TV show named "Coming to grips with reality".**

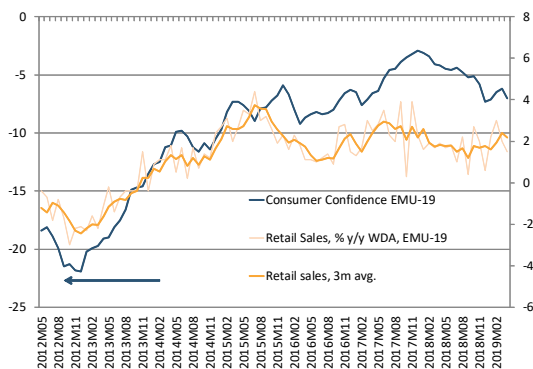
Remember how, just 6 months back, against the backdrop of Trump's anti-trade tweet tirades, Brexit, sub-50 PMI readings and core inflation at 1%, Draghi was only willing to guarantee that ECB rates will stay unchanged in the first half of 2019. Well, that changed in March 2019 to "*at least through the end of 2019*" and changed again, last Thursday, to "*at least through the first half of 2020.*"

And this extension of the forward guidance wasn't the only dovish message. And it wasn't even the most dovish one. That award goes to the confirmation, of Draghi, that discussion at ECB about how to deliver on the prior promises to "*act in the case of adverse contingencies*" got more "*granular*". Specifically, Draghi said that "*several members raised the possibility of further rate cuts [and that]..other members raised the possibility of restarting the asset purchase program, or further extensions in the forward guidance.*" He obviously wouldn't elaborate on what those "contingencies" would be, saying the discussion just "started". **But, hey, 6 months after the end of QE, the QE is now firmly back on table.** This must be the second fastest turn in monetary-policy stance in recent years, second only after CNB decided to go for full hike couple of months after it ended the interventions in 2017.

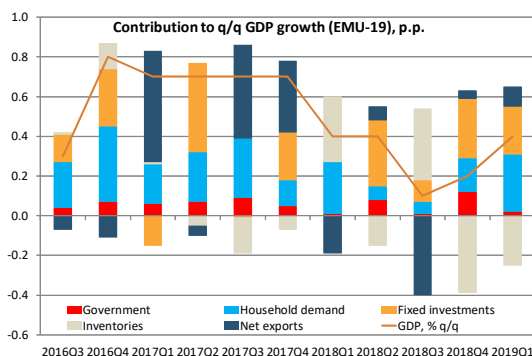
**CORE INFLATION IN EUROZONE AGAIN BACK BELOW 1%,...**



**...AND RETAIL SALES DON'T POINT AT THIS CHANGING FOR BETTER ANY TIME SOON.**



**EUROZONE 1Q19 GROWTH STRUCTURE POSITIVE FOR 2Q19**



Reiterating the dovish message, he said curt “NO” to the question of the journalist whether it is “correct [to expect] that the next move in interest rates is more likely to be an increase than a cut?” “Nuff said.

Regarding the TLTRO-III, details on pricing were published: these are basically only slightly worse than in TLTRO-II. The logic here, as Draghi himself admitted, is to “mitigate potential cliff effects” stemming from need to pay back the previous TLTROs coming due. In other words, Draghi said some banks are now on permanent liquidity lifeline. As is, seeing the negative interest rates, the whole economy.

So, here we are, with ECB contemplating easing, just like FED. The fact that markets price in outright cuts by year-end in US was responsible for the fact that response of EURUSD to the uber-dovish meeting was unnatural: EURUSD went up to 1.13...

**The macro data released last week vindicated ECB stance.**

Preliminary **May core inflation fell back to 0.8%**, the market-based inflation expectations are at all-time lows. Core inflation has thus been around 1% for most of the last 6 years. Not exactly job well done for Draghi, if you ask me.

And **April retail sales** do not indicate we should expect increase here anytime soon. Monthly dynamics is only slightly positive (sales grew just 0.3% in last three months ending in April) and so y/y growth of just 2.2% in last three months shouldn't really come as surprise (April alone was 1.5%). **Even in Germany** where unemployment has been non-existent for years, **the retail sales grew at just the same 2.2% y/y average rate in February-April.**

**The only somewhat positive data release was thus the structure of 1Q19 Eurozone growth.** Why? Well, because not only were all important aggregate demand components positive

**GERMAN CAR PRODUCTION STILL IN DOUBLE-DIGIT Y/Y CONTRACTION, WEIGHING ON...**



**...PRODUCTION IN GENERAL.**



**SINCE ORDERS KEEP CONTRACTING, ONE CANNOT EXPECT PRODUCTION TO REBOUND SOON.**



contributors to growth, but also because the only negative contributor to growth were inventories. If this decline of inventories was reflection of actual demand exceeding actual production (which was based on weak expectations, as seen in IFO and PMI), rebuilding of inventories will boost growth in 2Q19.

But, this will not help inflation. For that, we'd need much, much stronger demand of households for much, much longer.

**German industry remains in the doldrums and it doesn't appear change for the better is on the horizon.**

Industrial **production** (-1.8% y/y) fell most m/m (1.9% m/m) in four years in April and the **orders** grew just 0.3% m/m. Obviously, the weakness in the production was widespread, but most of the fall was due to capital goods (-3.3%) and consumer durables (-3.7%); manufacturing was down 2.5%.

Orders' growth could be seen as positive, with April being second positive month in a row (March was +0.8 m/m). The problem is that it came after 6% fall in January and February. And it is hardly a harbinger of better future: trade war fears persist, global economy is slowing.

Weak industry is certainly ECB's worry. Draghi at the conference asked himself: *"The key issue is: how long can the rest of the economy be insulated from a manufacturing sector that keeps on being weak?"* So far, services have been holding up, but really, are they immune to weakness in manufacturing? I tend to think no.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.180	2.230	1.960	1.745	1.680	1.688	
	-1M	2.210	2.260	2.225	2.058	2.000	1.998	
	-3M	2.030	2.070	2.155	1.955	1.893	1.888	
	-6M	2.010	2.070	2.290	2.323	2.293	2.265	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.269	-0.271	-0.210	-0.181	-0.049	-0.029	
	-1M	-0.473	-0.507	-0.429	-0.298	-0.125	0.012	
	-3M	-0.298	-0.344	-0.274	-0.157	-0.056	0.011	
	-6M	-0.681	-0.711	-0.654	-0.549	-0.365	-0.243	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.691	1.594	1.590	1.564	1.631	1.659	
	-1M	1.752	1.661	1.681	1.760	1.875	2.010	
	-3M	1.857	1.751	1.751	1.798	1.837	1.898	
	-6M	1.609	1.609	1.679	1.774	1.928	2.022	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.613	4.259	320.23	4.718	6.609	1.133	
	-1M	25.727	4.292	324.27	4.757	6.926	1.119	
	-3M	25.648	4.301	315.36	4.746	6.116	1.124	
	-6M	25.864	4.291	323.26	4.647	6.038	1.138	

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

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AVAILABLE AT THOMSON REUTERS EIKON MESSENGER

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