

July 15 | 2019

## Weekly | 2018 | Week 28

| MARTIN LOBOTKA, (+420) 777 027 165, [MLobotka@42fs.com](mailto:MLobotka@42fs.com), [Research@42fs.com](mailto:Research@42fs.com)

## | CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**
Monday	15-Jul-19	10:00	CZ	Current Account, May'19, CZK bn.	-0.8
Tuesday	16-Jul-19	11:00	EMU	Trade Balance, May'19, EUR bn. (SA)	17.5
Wednesday	17-Jul-19	9:00	CZ	Industrial PPI, Oct18, y/y	3.3%
	17-Jul-19	11:00	EMU	(Final) headline/Core HICP, Jun'19, y/y	1.2%/1.1%
Friday	19-Jul-19	10:00	EMU	Current Account, May'19, EUR bn. (SA)	5.1%

\* LOCAL TIME IS CET

\*\* (REUTERS/ BLOOMBERG) POLL

## | JULY 2019 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2015-2027**	10-Jul-19	12-Jul-19	10-Feb-27	CZK 3 bn. max	0.25%
CZGB 2017-2033**	10-Jul-19	12-Jul-19	13-Oct-33	CZK 4 bn. max	2.00%
CZEUGB 2019-2021**	17-Jul-19	19-Jul-19	20-Aug-21	EUR 165 mn. Max	0.00%
CZGB 2017-2033**	24-Jul-19	26-Jul-19	13-Oct-33	CZK 4 bn. max	2.00%
CZGB 2007-2057**	24-Jul-19	26-Jul-19	26-Nov-57	CZK 1 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

“AFTER BUYING THEM FOR YIELDS AND BUYING THEM FOR CAPITAL GAINS, BONDS ARE NOW BEING BOUGHT FOR CONVEXITY. THIS WILL END IN TEARS”.

## WEEK AHEAD

**Not much happening midway through July.**

About the only interesting thing to be released this week is final Eurozone inflation. But this never deviates from the preliminary reading by more than 0.1-0.2 pp, so the only interesting things are the final core inflation data for big economies, especially Germany. But I ain't waiting with the bated breath for that either, seeing that inflation didn't rise much even though labor market has been tight for years in Germany.

## WEEK BEHIND

- Czech industry continues to defy PMI ▶
- CZ households with wallets / purses still wide open ▶
- Czech inflation still high & still driven by housing and food ▶
- Eurozone industry being dragged down by Germany ▶

### | FX

#### EURCZK continued to creep higher,...

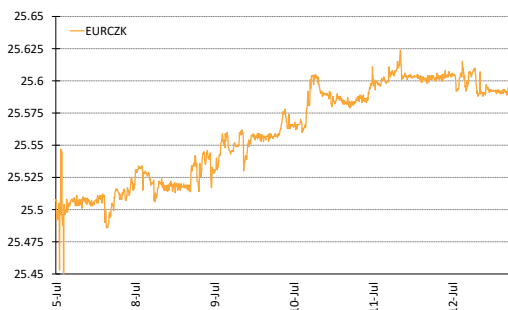
...having hit 25.60 midway through last week and thereby confirming that interest rate differential has almost nothing to do with the actual EURCZK exchange rate, CNB's regular statements to the contrary notwithstanding.

### | FI

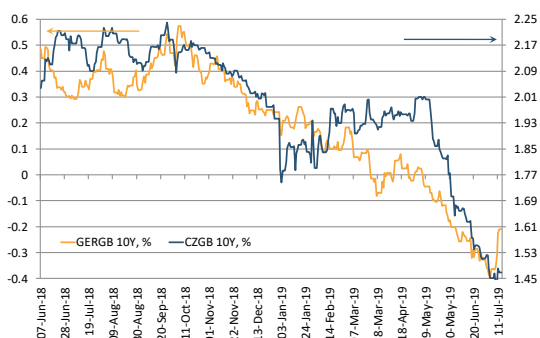
#### German 10Y yields rose for the first time week-on-week since the end of March.

And it was fairly large increase (+20 bps.), caused by the increase of US Treasury yields. This, in turn, was caused by positive surprise in US CPI inflation (2.1%\$ vs. expectation of 2%), although FED's chief Powell ignored this and said, in a testimony before Congress, that FED is open to an "insurance cut" at the next meeting (this was also message of FOMC minutes released last week as well). Although, if one goes by the data, this is like insuring against flood when in the middle of a desert on the hill.

#### CZK WEAKENS FURTHER, LARGE INTEREST-RATE DIFFERENTIAL NOTWITHSTANDING

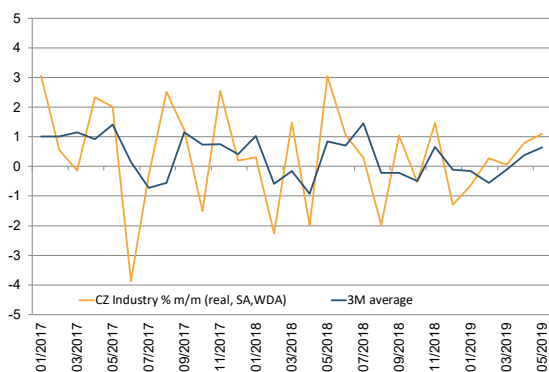


#### GERMAN YIELDS ROSE AFTER US TREASURIES DID.

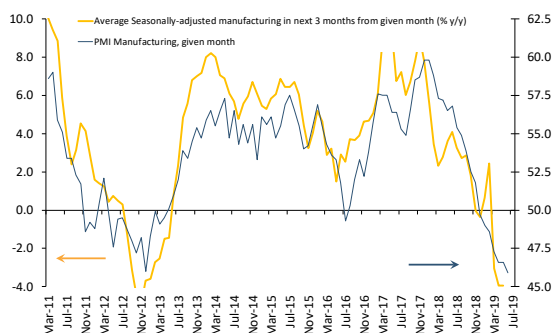


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### CZECH INDUSTRY POSTED 4<sup>TH</sup> POSITIVE MONTHLY GROWTH IN A ROW,..



### ...BUT PMI AT 10-YEAR LOW POINTS MERCILESSLY AT CONTRACTION IN THE COMING MONTHS.



## CZECH ECONOMY

**Czech industry continues to defy soft indicators. For now.**

In May, production in industry increased by 3.2% y/y (WDA), almost the same growth rate like the one seen in April (3.3% y/y). This was thus **fourth positive month in a row** in terms of month-on-month growth rate – May production increased by over 1% compared to April, making it the largest monthly gain since November. This is **very much at odds with what the PMI has been telling us in recent months: PMI fell to lowest (46.6 pts.) since 2013** in April (and remained at 46.6 in May), levels that have historically been associated with 2-3% annual *contraction* of the production. This is strange.

The improvement in industry as against the beginning of the year reflects mainly stronger car production which stagnated y/y at the beginning of the year but now grows at almost 7% (+6.9% y/y, to be precise). This is explicable: car production was negatively affected by new emissions tests in 2H18 as some cars didn't manage to test before the deadline (and hence couldn't be produced). Once they did, production bounced back.

Going forward, I expect – and I say this with full knowledge about how poorly PMI has recently predicted the actual production – that **production will contract**.

**First**, German orders collapsed in May, contracting by 8.7% y/y; orders are now smaller than what they were *three* years ago and Bundesbank is highlighting the risk of recession in Germany.

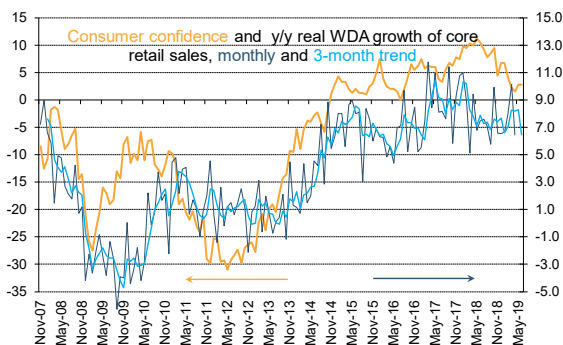
**Second**, Czech **PMI** fell to **lowest** in June in a **decade** here. It is very hard to imagine that this will not lead to contraction of actual production.

**Third**, risks remain and are abundant – Trump vs. China against the backdrop of presidential elections, Brexit at the end of October against the backdrop of Johnson becoming the next PM etc...

No, no – **there will be decline of 4% y/y at least in some months of 2H19**. And with it will come the discussion in CNB about whether to cut rates.

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**CORE RETAIL SALES STILL GROW AT 7% ANNUAL RATE**

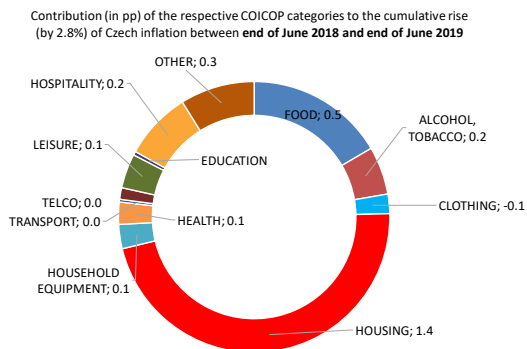


Households are still going strong and will provide a cushion against the impending weakening of the industry.

Retail sales grew 2.8% y/y (WDA,SA) in May, about the same rate as average y/y growth rate between January 2018 and April 2019 (2.9% y/y). This may not look great, but remember, one should look at the core retail sales, i.e. sales without cars, fuel and food, to better judge the households' spending appetite.

And here things are bright: core retail sales rose 6.9% y/y, slightly below the January 2018- April 2019 average growth rate of 7.7%. And yes, these are real numbers. What they tell us is unambiguous: households are still at one of their most optimistic in last 20 years.

**CZECH INFLATION 3/4 DUE TO HOUSING AND FOOD.**



Though it doesn't show in broad inflation.

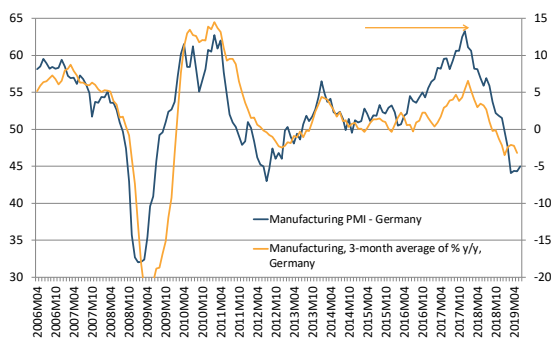
Yes, inflation remains in the upper half of the range, suggesting that the previous statements is not true. Monetary-policy relevant inflation did decline in June, but only to 2.8% y/y, its lowest since February but still firmly in the upper half of the inflation target range (2% ± 1 pp). The demand inflation actually rose from 2.5% to 2.7%. But although it looks like inflation is stubbornly high and requires tighter policy, glance at the structure says otherwise. Out of 2.8% that the MPRI is, half is due to housing and 1/4 is due to food, alcohol and tobacco. In other words, 75% of the inflation is due to just housing and food (alcohol, tobacco). And that of broad-based inflation pressures peddled by CNB.

**EUROZONE ECONOMY**

**EUROZONE INDUSTRY BEING DRAGGED DOWN BY GERMAN ONE,...**



**...AND IT IS UNLIKELY THIS WILL CHANGE SOON.**



**Germany is a sick man of Europe again,...**

...when it comes to industry. German industry is dragging the whole Eurozone performance down. But let's take it in the order.

**Eurozone production rose in May for the first time since January**, and quite strongly at that. After stagnation in February and two moderate contractions in the following two months (0.3% in March and 0.4% in April), production rose by 0.9% m/m in May, driven, primarily, by France (+2.1% m/m). Manufacturing component of the production rose at the same rate of 0.9% m/m.

**In annual terms**, though, both are still down: production is down 0.5% y/y and manufacturing is down 0.6% y/y. This has one culprit, and one culprit only: Germany. German industry is down 4.3% y/y - the only other big economy where production is down is Italy (-0.7% y/y). In France and Spain, production is up 3.7% y/y and 1.3% y/y, respectively.

The question thus is **what happens in Germany in the 2<sup>nd</sup> half?** Unfortunately, in industry, things aren't brightening up: leading indicators are pointing firmly down (though they recently stabilized at low levels) as are new orders which contracted almost 9% y/y, the most since GFC, in May. We're looking at 6-7% y/y contraction in industry over summer. Not good for Czech Republic either, given our tight links.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.170	2.220	2.005	1.685	1.603	1.593	
	-1M	2.170	2.220	1.950	1.695	1.633	1.635	
	-3M	2.020	2.060	2.118	1.945	1.880	1.870	
	-6M	2.010	2.070	2.100	1.825	1.765	1.773	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.432	-0.410	-0.277	-0.239	-0.102	-0.124	
	-1M	-0.277	-0.217	-0.143	-0.164	-0.076	-0.010	
	-3M	-0.430	-0.381	-0.318	-0.254	-0.075	0.084	
	-6M	-0.381	-0.315	-0.173	-0.081	0.010	0.086	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.573	1.445	1.483	1.446	1.501	1.469	
	-1M	1.673	1.623	1.615	1.531	1.556	1.625	
	-3M	1.688	1.669	1.677	1.691	1.805	1.954	
	-6M	1.719	1.680	1.725	1.744	1.775	1.858	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.586	4.270	325.83	4.732	6.447	1.127	
	-1M	25.551	4.257	322.40	4.724	6.613	1.121	
	-3M	25.617	4.278	321.39	4.759	6.540	1.130	
	-6M	25.551	4.291	321.73	4.680	6.248	1.147	

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

CONTACTS

MARTIN LOBOTKA, ANALYST (+420) 777 027 165, [MLobotka@42fs.com](mailto:MLobotka@42fs.com)

RESEARCH [Research@42fs.com](mailto:Research@42fs.com)

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