

WEEKLY ECONOMIC UPDATE

14 – 20 August 2017

Last week, the market was mostly affected by weak data from Germany and rising tension between the US and North Korea. Hence the elevated risk aversion, which hit Polish assets.

This week will be quite interesting in regard to foreign data, with many numbers from the US and important statistics from Germany (GDP). However, actual economic data is likely to be overshadowed by the looming conflict between the US and North Korea. And even if no further comments or actions emerge, the market may stay anxious. In Poland, despite the shorter week (and lower liquidity on Monday/Tuesday), we will get to see crucial economic data, including 2Q GDP and first numbers from 3Q. In our view Polish statistics will be positive, but their market impact will be insignificant given global risk-off.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (14 August)							
11:00	EZ	Industrial output	Jul	% y/y	2.8	-	4.0
14:00	PL	CPI core	Jul	% y/y	0.8	0.8	0.8
TUESDAY (15 August)							
	PL	Market holiday					
8:00	DE	Flash GDP	Q2	% y/y	1.9	-	1.7
14:30	US	Retail sales	Jul	% m/m	0.4	-	-0.2
WEDNESDAY (16 August)							
9:00	CZ	Flash GDP	Q2	% y/y	3.0	-	3.0
9:00	HU	Flash GDP	Q2	% y/y	3.6	-	4.2
10:00	PL	Flash GDP	Q2	% y/y	3.8	3.8	4.0
11:00	EZ	Flash GDP	Q2	% y/y	2.1	-	1.9
14:30	US	House starts	Jul	% m/m	0.8	-	8.3
14:30	US	Building permits	Jul	% m/m	-2.0	-	9.2
20:00	US	FOMC minutes					
THURSDAY (17 August)							
11:00	EZ	CPI	Jul	% y/y	1.3	-	1.3
14:00	PL	Employment in corporate sector	Jul	% y/y	4.3	4.3	4.3
14:00	PL	Wages in corporate sector	Jul	% y/y	5.4	4.9	6.0
14:30	US	Initial jobless claims	week	k	240	-	244
14:30	US	Philadelphia Fed index	Aug	pts.	19.0	-	19.5
15:15	US	Industrial output	Jul	% m/m	0.3	-	0.4
FRIDAY (18 August)							
14:00	PL	Industrial output	Jul	% y/y	8.4	8.5	4.5
14:00	PL	Construction and assembly output	Jul	% y/y	13.7	13.3	11.6
14:00	PL	Retail sales	Jul	% y/y	7.4	7.0	5.8
14:00	PL	PPI	Jul	% y/y	2.0	1.9	1.8
16:00	US	Flash Michigan	Aug	pts.	94.0	-	93.4

Source: BZ WBK, Reuters, Bloomberg

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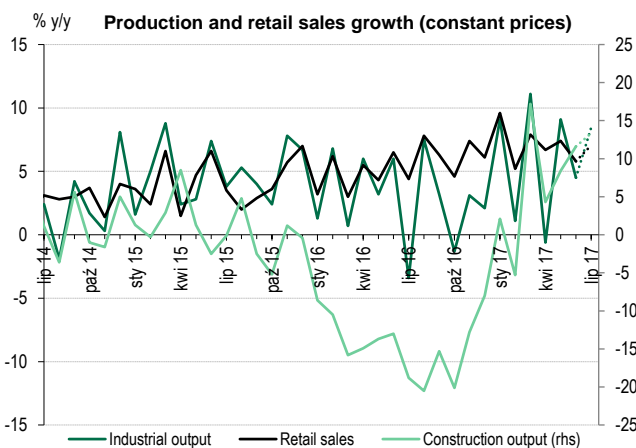
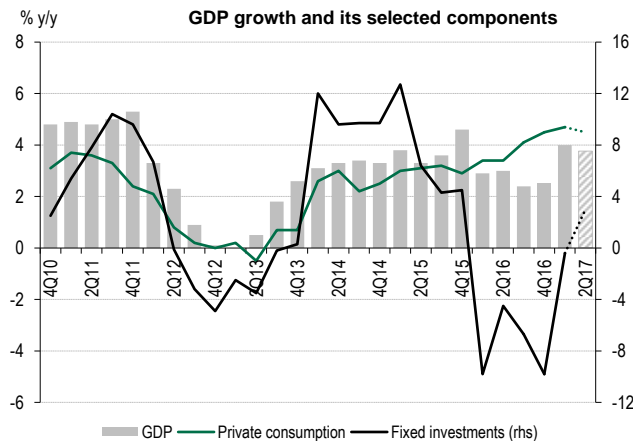
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What's hot next week – The growth story



▪ This short week (due to public holiday on 15 August) will be full of important events. Apart from GDP growth in 2Q, we will learn about first statistics from the 3Q.

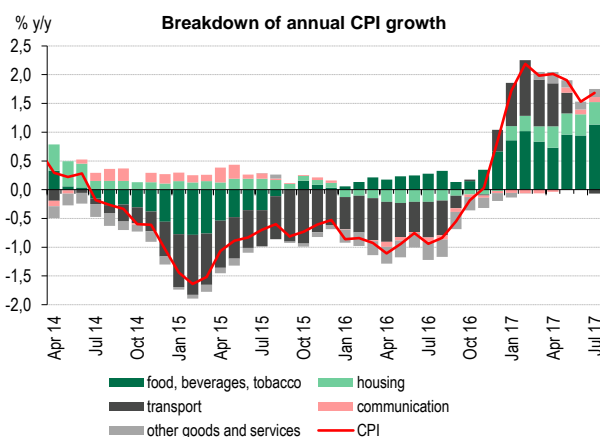
▪ In our view, GDP growth slowed down a bit in 2Q to 3.8% from 4.0% in 1Q. We expect some acceleration in investment growth, given higher growth rate of construction output, increasing numbers of EU-financing contracts and rising demand for investment loans. However, output of investment goods slowed down to 5.0% y/y in 2Q from 8.6% y/y in 1Q, which is why we are only cautiously optimistic about investment in total (+3.0% y/y in 2Q vs -0.4% y/y in 1Q).

▪ Employment growth stayed flat in July at 4.3% y/y, while wage growth slowed down to 4.9% y/y from 6.0% y/y, in our view. It should be borne in mind that June results were boosted by bonus payment in non-coal mining; in July's this effect will be reversed (base effect), while non-mining wages will rise slightly faster than in June.

▪ July's results of real-activity sectors will be positive, in our view. We expect industrial output to accelerate to 8.5% y/y from 4.5% y/y in June, construction to show 13.3% y/y vs 11.6% y/y in June and retail sales to grow by 7.0% y/y vs 5.8% y/y in the previous month. This will be the first month of the year with neutral working day effect, so July's readings will be closer to the 'underlying trend' than the previous months.

▪ In our view, PPI inflation inched up to 1.9% y/y in July from 1.8% y/y in June, mainly on the back of weaker PLN and higher commodity prices.

Last week in economy – Inflation strikes back



▪ CPI inflation amounted to 1.7% y/y in July, in line with flash reading, CPI's rise vs June (1.5% y/y) was mostly due to changes in food prices, which fell by 0.2% m/m – the least since 2000. We estimate core inflation excluding food and energy prices stayed unchanged at 0.8% y/y. In our view inflation will stabilise in months to come and could ease slightly at the end of the year. Risk to our forecast is tilted to the upside given the likely acceleration of upward trend in food prices.

▪ C/A balance declined but much less than we expected (from €-298m to €-932m with our forecast at €-1496m). June export left us a bit disappointed due to, slowing down from 16.2% y/y to 8.7%. Import remained strong in June, growing +15% y/y which confirms that domestic demand improved further in 2Q.

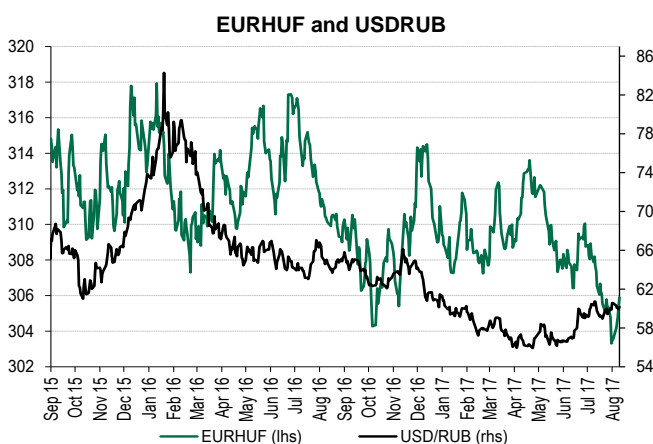
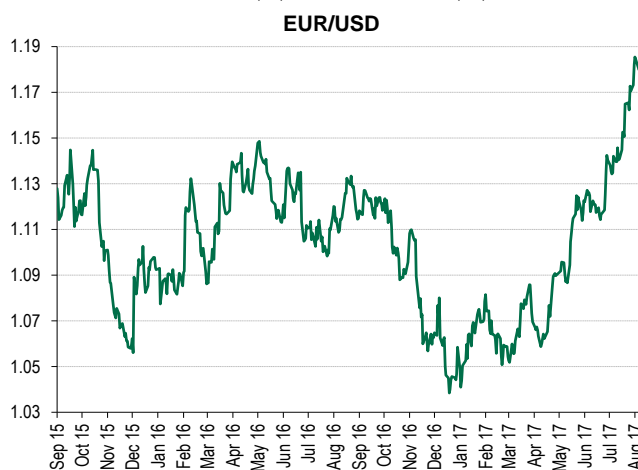
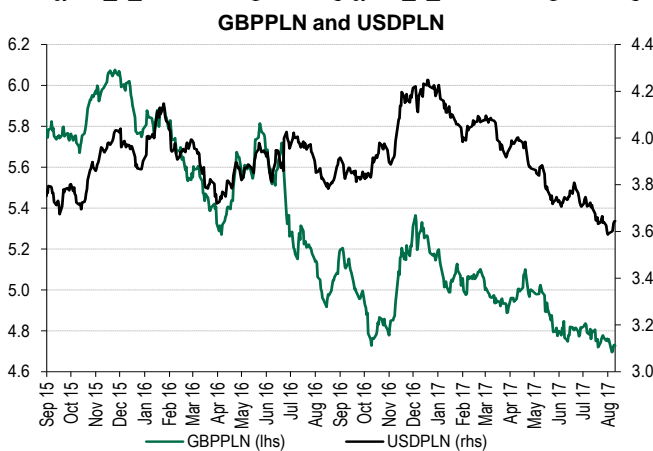
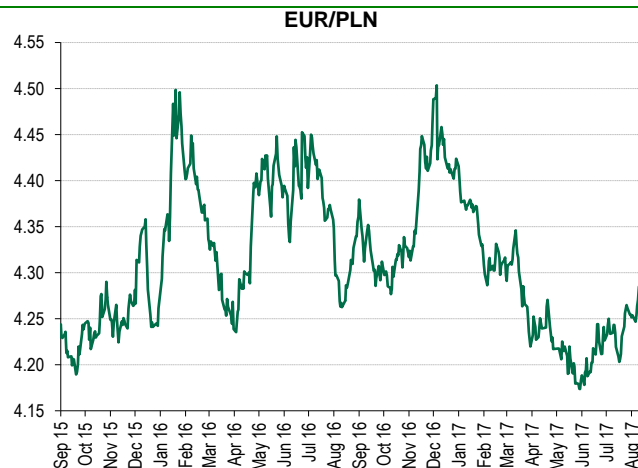
Quote of the week – Rates unlikely to stay unchanged in 2018

Grażyna Ancyparowicz, MPC member, 7 August 2017, Reuters

Currently available forecasts (for the Polish economy) are optimistic and this means a lack of reasons to change the stance in monetary policy at least until the end of this year, and perhaps longer. Neither the decisions of the (U.S.) Federal Reserve, the European Central Bank, the rate hike by the Czech central bank nor other events in the neighbourhood of our economy are reasons to depart from the 'wait and see' policy which has so far - effectively performed its stabilizing function. In the middle of next year inflation is expected to return to its reference level (2.5 percent). Moreover, one has to take into account a rise in political pressures related to the local elections.

MPC's Grażyna Ancyparowicz again said that this is unlikely that rates will not change at all in 2018 (while the central bank's governor Adam Glapiński claims the Council in his view will not take action until 2019). She is of the opinion that inflation will accelerate in mid-2018 and political tensions could intensify ahead of the local government elections. What is interesting, Ancyparowicz remains dovish even though she expects inflation to return to target in mid-2018. We still expect the first rate hike to come in 4Q18 and this is currently also the consensus view.

Foreign exchange market – Little room for the zloty to recover



EURPLN breaks upper end of a range

▪ Last week the zloty depreciated vs the euro, dollar, franc and pound. Poor sentiment persisting on the global market due to weaker-than-expected German macro data and intensified tensions between the US and North Korea boosted demand for safe currencies like the US dollar and the Swiss franc and weighed on the EM assets. As a result, EURPLN broke the upper end of the 4.23-4.27 range observed since mid-July and reached 4.29, its highest since late April. USDPLN rebounded to 3.65 from 3.60, CHFPLN jumped to 3.80 from 3.68 and GBPPLN rose to 4.74 from 4.68.

▪ Last week, we recalled statistics saying that August is usually poor month for the zloty vs the euro and so far EURPLN holds this pattern.

▪ Lower holiday's market liquidity is likely to fall even further in the coming days as there is a market holiday in Poland on Tuesday and on Monday, trading activity is likely to be very low as well.

▪ Polish macro data should be neutral or slightly negative for the zloty as they will confirm that the domestic economy has slowed in 2Q vs 1Q. Our forecasts for industrial output and retail sales are close to market consensus.

▪ Globally, investors will be watching the US data and trying to get more clues on the outlook for the US monetary policy from the minutes of the last FOMC meeting.

▪ EURPLN broke 4.27 and the other technical factors also suggest there is more upside potential.

Dollar depreciation pauses

▪ EURUSD upward trend halted after four consecutive weeks of a rise as demand for safe assets rose and German data proved unsupportive for the euro. The exchange rate fell to 1.17 and ended the week near 1.18.

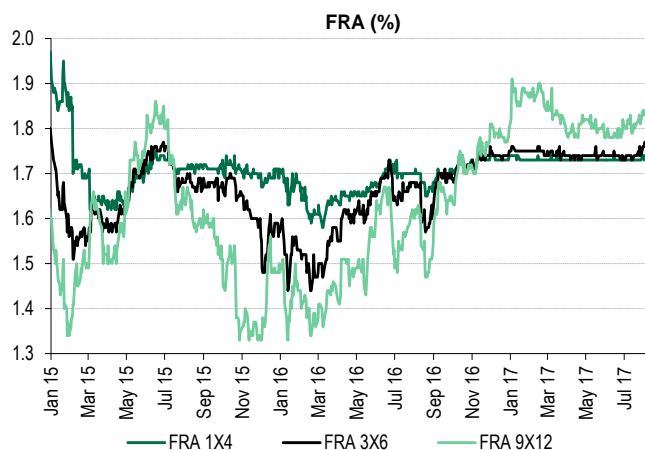
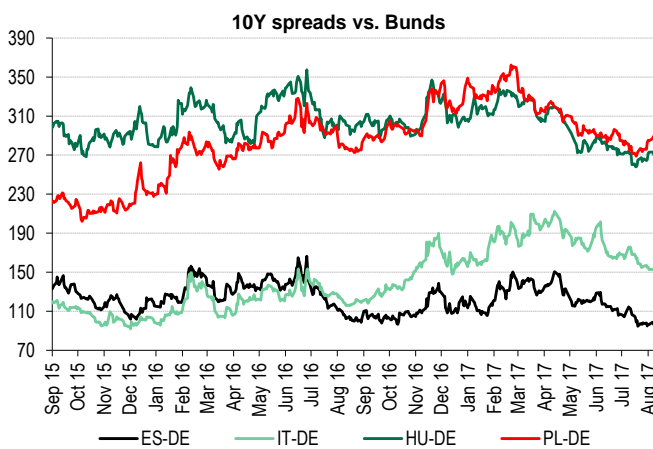
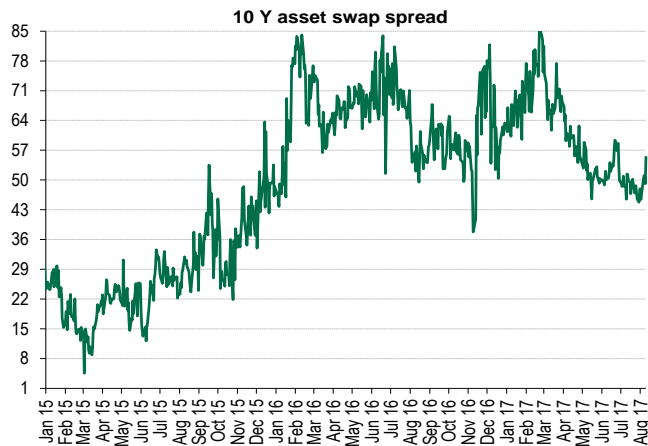
▪ This week the numerous US macro data will be in the center of attention. In contrast to our scenario, the market is currently not pricing a next Fed rate hike to be delivered later this year. That is why we think there could be a bigger reaction if the US data surprise to the upside than when they disappoint.

Koruna and forint weaker, ruble stable

▪ Last week, both the koruna and the forint lost vs the euro with EURCZK rising to 26.2 from c26.05 and EURHUF climbing to 306 from 303.5. Both Czech and Hungarian inflation figures surprised to the upside but failed to neutralize the negative effect of global risk aversion. At the same time, USDRUB remained fairly stable near 60 despite dollar's appreciation on the global market and thanks to oil prices staying close to the recent peaks.

▪ Technical analysis tells us that forint may continue giving up part of its recent gains vs the euro while USDRUB could start a longer and deeper downside correction anytime soon.

Interest rate market – Risk aversion dominated trading



Asset swap spread rose

▪ Last week we observed a gradual rise of Polish bond yields. The biggest part of this move resulted from rising cost of credit risk, which pushed the 10Y asset swap spread up by c10bp, while the 5Y spread rose by c8bp. 2Y spread remained relative stable and rose only by c4bp. In our opinion, the spread widening was a correction of overoptimistic trading in last months, and not a result of deterioration of domestic economic performance. The domestic asset swap spread widening was correlated with selling of Eurozone periphery and emerging markets debt, as well as slump of stock prices, commodities and emerging markets currencies. It is worth pointing out that the asset swap spread for 10Y Polish t-bonds denominated in EUR stays in a 36-41bp range compared to 55bp at the issue spread and 75bp peak at the beginning of April.

▪ The IRS rates didn't change during the week. The 10Y rate oscillated between 2.84%, and 2.88%, for 5Y between 2.37%, an 2.40%, and 2Y around 1.95%.

▪ Polish FRAs and WIBORs stayed unchanged despite more comments of the MPC members.

Domestic data on the spotlight

▪ We think that risk aversion which dominated trading last week will be the main driver for the debt market activity next week. In the days to come we expect domestic asset swap spread to rise, however the scale of decompression will most likely be subdued.

▪ This week we anticipate a bunch of solid domestic figures (GDP, industrial production, retail sales, employment and wages data) to be released. In our view, this data could generate some upside pressure on domestic IRS and bond yields. Given the recent sharp drop of the asset swap spreads, we think the IRS and debt market reaction could be similar.

▪ Numerous US data are on the agenda this week. The market is not pricing that Fed rates could be lifted later in the year so in our view the core market reaction could be bigger if data are better than expected. However, it should be noted, that the 1M correlation between 10Y Polish and German/US bonds is negative and the adverse effect of any sell-off abroad might have a limited impact on domestic debt.

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