

# WEEKLY ECONOMIC UPDATE

## 18 – 24 September 2017

Last couple of days saw the Polish market weakening with the zloty depreciating against major currencies and bond yields going up. Yet, the trends were mainly in reaction to changes in global market sentiment rather than to local events. In our view, neither the news from the rating agencies nor the European Commission's announcement about the second step in the infringement procedure had a significant market impact.

Next week, there will be plenty of domestic data releases. In most cases our forecasts are above the market median, so they may be slightly supportive for investors' moods. We think the data should confirm that GDP growth in Poland remains close to 4% y/y in 3Q17. Nevertheless, we believe that the direction on the market will continue to be determined by external factors. The FOMC meeting will be probably the key event, with Fed likely to present lower expected path of future interest rates, but at the same time signaling the start of balance sheet reduction.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (18 September)</b>							
11:00	EZ	CPI	Aug	% y/y	1.5	-	1.3
14:00	PL	Wages in corporate sector	Aug	% y/y	5.7	5.9	4.9
14:00	PL	Employment in corporate sector	Aug	% y/y	4.6	4.7	4.5
<b>TUESDAY (19 September)</b>							
11:00	DE	ZEW index	Sep	pts	86.8	-	86.7
14:00	HU	Central bank decision		%	0.90	-	0.90
14:00	PL	Industrial output	Aug	% y/y	5.9	6.1	6.2
14:00	PL	Construction and assembly output	Aug	% y/y	24.0	27.9	19.8
14:00	PL	Real retail sales	Aug	% y/y	6.7	7.5	6.8
14:00	PL	PPI	Aug	% y/y	3.0	3.2	2.2
14:30	US	House starts	Aug	% m/m	2.2	-	-4.8
14:30	US	Building permits	Aug	% m/m	-0.8	-	-3.5
<b>WEDNESDAY (20 September)</b>							
16:00	US	Home sales	Aug	% m/m	0.6	-	-1.3
20:00	US	FOMC decision		%	1.00-1.25	1.00-1.25	1.00-1.25
<b>THURSDAY (21 September)</b>							
14:00	PL	MPC minutes					
14:30	US	Philly Fed index	Sep	pts	17.0	-	18.9
14:30	US	Initial jobless claims	week	k	-	-	284
<b>FRIDAY (22 September)</b>							
9:30	DE	Flash PMI – manufacturing	Sep	pts	59.1	-	59.3
9:30	DE	Flash PMI – services	Sep	pts	53.7	-	53.5
10:00	EZ	Flash PMI – manufacturing	Sep	pts	57.3	-	57.4
10:00	EZ	Flash PMI – services	Sep	pts	54.8	-	54.7
10:00	PL	Unemployment rate	Aug	%	7.0	7.0	7.1
14:00	PL	Money supply	Aug	% y/y	5.2	5.3	5.0

Source: BZ WBK, Reuters, Bloomberg

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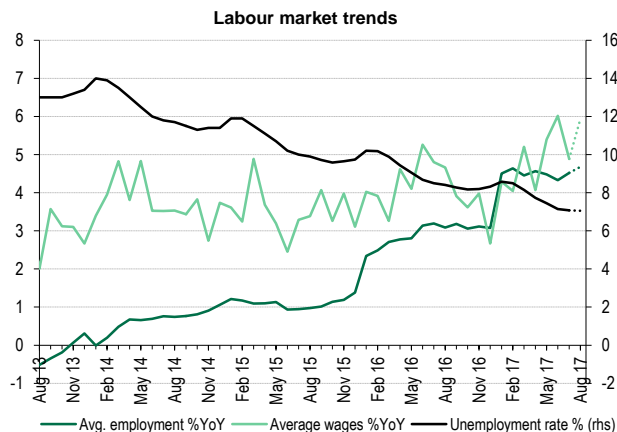
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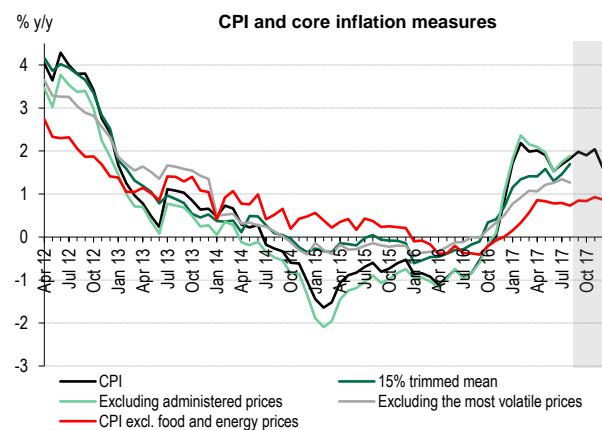
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**What's hot next week – Strong data for August**

▪ This week, there will be plenty of domestic publications covering economic activity in August. In most cases our forecasts are above the market median. August is a popular holiday month and this year there was a stronger incentive than in 2016 to take an additional leave around the 15-Aug public holiday as it fell on Tuesday instead of Monday. However, in our view the yearly difference of effective working days was only marginally negative and the underlying trends in activity and in wage growth remained strong.

▪ We think that construction output after a fine c20% y/y growth in July could possibly climb to almost 30%. This release will be watched as a proxy for investment activity.

▪ Lower core inflation in August may have left an impression that the recent increases in headline CPI are nothing to worry about. August PPI could cause second thoughts as producer prices most likely pushed from 2.2% y/y to 3%+.

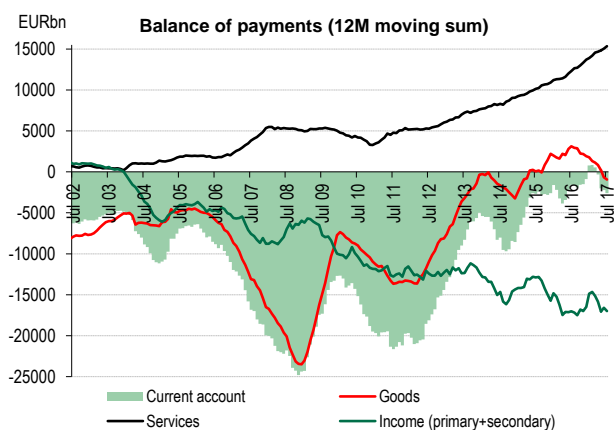
**Last week in economy – Balanced view of rating agencies, core CPI down**

▪ In August, inflation reached 1.8% y/y, in line with the flash estimate. Core CPI, excluding food and energy prices, eased to 0.7% y/y after four months at 0.8%. We expect inflation to rise further in the coming months but the high base effect should drive down CPI well below 2% in December.

▪ July C/A balance amounted to -€878mn, close to the previous reading and the market consensus. The annual pace of export and import remained solid thanks to the low base effect - export accelerated from 8.7% to 10.7% y/y and import grew 12.5% vs 15% back in June. In our view the growth of exports will continue at a relatively high level in the remaining part of 2017, although the average growth might slip below 10% y/y and should be slower than the growth in imports.

▪ The Moody's agency expects 2017 GDP at 4.3% and 2018 at 3.5%. GG deficit is expected at 2.4% of GDP in 2017 and 2.7% in 2018. The agency said that risks for Poland should remain balanced as long as economic growth is solid and the deficit does not exceed 3% of GDP, and public debt 55% of GDP. The forecast of the latter has been brought lower and no longer goes above 55%. According to the agency, reforms that improve long-term sustainability of the pension system would be credit-positive, while a sharp worsening of investment climate would be credit-negative.

▪ S&P is of the view that Poland's sound macroeconomic fundamentals are offset by political/institutional risk. Lower external debt as well as fiscal deficit are conditions for rating upgrade. S&P is monitoring the conflict between the Polish government and the European Commission. S&P doubts the conflict could lead to suspension of Poland's rights in the EU or to a cut of EU funds before 2020. The agency kept its 3.6% forecast for 2017 GDP growth.

**Quote of the week – It's doves' turn****Jerzy Żyżyński, MPC member, PAP, Bloomberg, 12 & 14 September**

Stabilization and predictability provide additional support for the Polish economy. In my view then, interest rates should stay unchanged until the end of 2018, or longer. There is no room for rate cuts at this moment of the monetary-policy cycle.

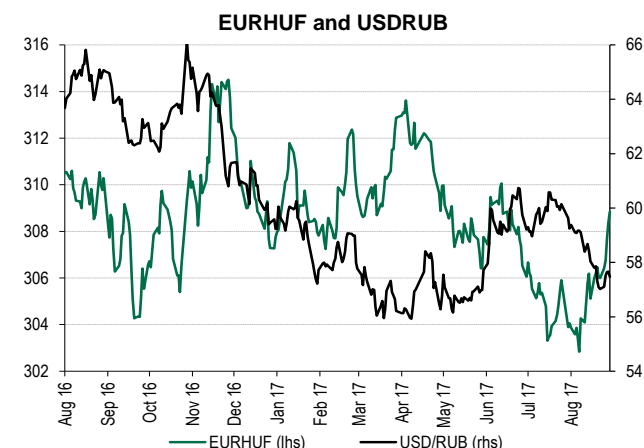
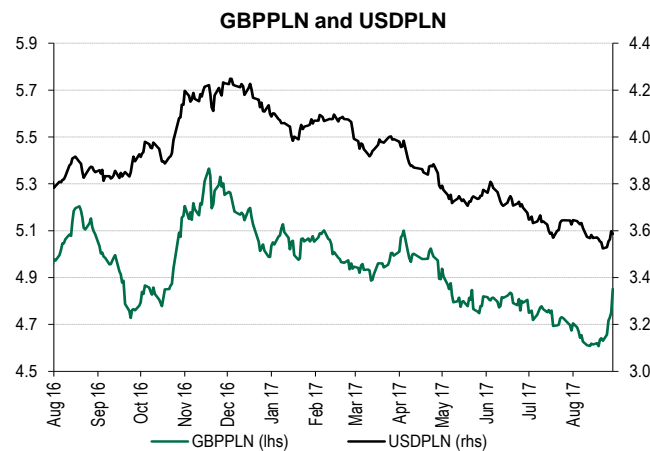
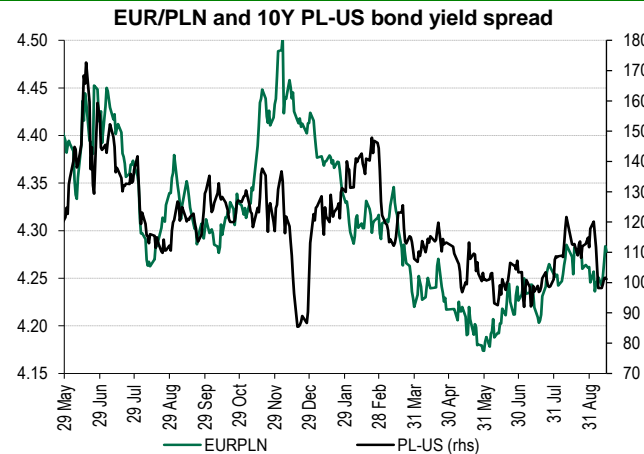
**Eryk Łon, MPC member, PAP, Bloomberg, 11 September**

A need to loosen the monetary policy may arise in the coming months. I am considering more and more intensively a 50bp cut. I wish to make an emphatic point that easing Poland's monetary policy, if it's needed, should be carried out in a ruthless manner. It's similar to cutting down a tree with the help of a sharp axe. We shouldn't be afraid of using the said axe. Monetary conditions have tightened by means of the big appreciation of the zloty since December. The monetary policy should do whatever it takes to support the growth in investment outlays and export.

Last week we could hear from the most dovish MPC members. Eryk Łon appeal for a rate cut was not mentioned by the NBP governor Adam Glapiński during the September press conference and most likely will not be referred in detail in the upcoming minutes. We treat it as an outlier. Even another ultra-dovish member, Jerzy Żyżyński, distanced himself from the idea of easing the monetary policy at this stage and instead supported the line represented by Adam Glapiński that rates should be kept unchanged this year and next.

Our forecasts regarding the monetary policy stay the same – the first rate hike is likely in the last quarter of 2018.

## Foreign exchange market – FOMC key for the zloty and dollar



### Zloty eyeing FOMC

▪ Last week was far from calm as long as we consider the EM FX universe. The majority of emerging market currencies gained versus the euro and lost vs the dollar and when compared to last Friday, the zloty was the weakest among them. Currencies from the CEE region underperformed their Middle East and LatAm peers. It seems that additional pressure on the zloty may have been driven by the European Commission's decision to take a second step in the infringement procedure against Poland. As a result, EURPLN climbed to 4.29 nearing its local resistance at nearly 4.30. As the same time, USDPLN jumped to 3.62 from 3.53 as the dollar gained on the global market. The zloty recorded significant depreciation also vs the British pound – GBPPLN surged to 4.83 from 4.65 amid higher-than-expected UK CPI data and Bank of England hawkish remarks.

▪ EURPLN did not manage to break important support level at 4.23 and remained in the 4.23-4.30 range.

▪ This week important Polish economic activity data are on the agenda. Our forecasts are slightly above consensus and may provide some support for the zloty.

▪ However, on weekly basis the global market sentiment may prove key. The first chart shows that since the beginning of the year there has been a strong correlation between EURPLN and 10Y PL-US bond yield spread. In our view, this suggests that the outcome of the FOMC meeting might have impact on the zloty.

### US events key for dollar

▪ Euro's appreciation vs the dollar paused and EURUSD fell temporarily below 1.19. Downside pressure on the exchange rate was fueled by the signals from the US – rising chances for a tax reform and some solid data.

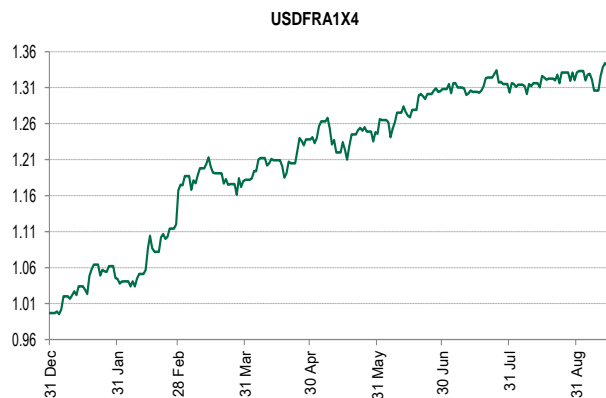
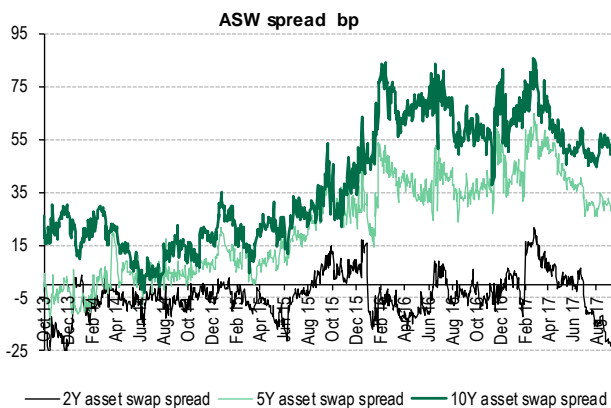
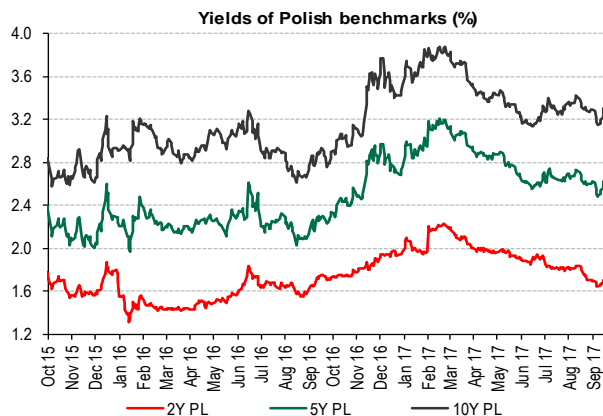
▪ This week, market attention is likely to remain focused on the US events as the FOMC will decide on the interest rates and the central bank will release new economic forecasts. Since the last meeting in July, market has seen even lower chances for another 25bp rate hike this year and in our view any cautious remarks shall not trigger big market reaction and flash PMIs could determine where the exchange will end the week. We think that only clear suggestion from the US central bankers that a December hike is still likely could support the dollar.

### Ruble and forint weaker, koruna stable

▪ As regards the other CEE currencies, EURCZK stayed firm slightly above 26.0, while forint and ruble lost. EURHUF rose for the fourth week in a row reaching 309, its highest since early July. Hungarian currency was pressured by mounting expectations that already this week the central bank will ease more the monetary policy.

▪ Russian ruble lost part of its recent gains vs the dollar despite continued rise of the oil price. In line with expectations, Russian central bank cut interest rates by 50bp, main refi rate to 8.50%, and said that more easing may take place later in the year.

## Interest rate market – Fed in the spotlights



### Yields rose driven by small business confidence

▪ Last week the global bonds market was dominated by rising yields. After the series of dovish remarks from the main central bankers (ECB and Fed) which ended the previous week, the bonds market started to reverse. The sell-off was triggered by NFIB data (small business consumer confidence index) - released on Tuesday – which showed that expectation for capital expenditure as well as compensation index of the small business sector was rising strongly. It was interpreted by debt market players as a confirmation of strong condition of US economy.

▪ As a consequence yields of core bonds as well as emerging markets yields and rates started to increase. Domestic market reaction was only marginal. The Polish yield curve was pulled up by 5bp across the curve compared to 10-15bp upshift of the US curve and 6-10bp upshift of the German curve. The main driver of these moves was the IRS rate increase. The asset swap spread rose only by 2bp on the long end and the belly of the curve, and by 5bp on the front end of the curve. The domestic news and data like CPI release and dovish MPC members remarks were ignored by market players. Market players treated the S&P message and European Commission statement in the same way.

### FOMC in focus

▪ We expect that bond yield curve increase to continue in the first part of this week (especially on the long and middle part of the curve). This move will be fuelled by expectations for the FOMC meeting. The USD FRA pricing suggested that market players anticipations for the interest rates hike were on the rise since the beginning of the last week. However we think that FOMC conference will disappoint investors and as a result at the end of this week domestic yields and rates will return to the last Friday levels. The asset swap spread should be stable across this week.

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