Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

2 – 8 October 2017

Last week the dollar gained on the global market while the emerging currencies depreciated sharply. The main driver driving FX market and pushing bond yields up was rising support for the Trump's tax reform that boosted chances for a December Fed rate hike. Outcome of the German parliamentary elections implying a risk of a prolonged formation of the new government weighed on the euro, while the zloty under additional pressure lack of approval of president's court bills by the government which may be a signal of some tensions between the Law and Justice and president Duda.

Politics could be in the centre of attention also at the beginning of this week as probably there will be attempts to call a Catalonia independence referendum. Spanish government is against this referendum. There could be some risk aversion if protests break out during the weekend. Later in the week the market attention will focus on the US data that are likely to be distorted by the extreme weather conditions. We think that poor figures will be rather viewed as a temporary weakness and only surprisingly strong numbers could have a material impact on the market. In Poland, Polish MPC will decide on rates but we do not expect any changes in this front. We think Polish PMI rebounded after months of underperformance vs European indexes which, together with Friday's flash CPI figure, could support the zloty and weigh on bonds.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (2 October)					
9:00	**PL**	**PMI – manufacturing**	**Sep**	**pts**	**53.2**	**54.0**	**52.5**
9:55	DE	PMI – manufacturing	Sep	pts	60.6	-	59.3
10:00	EZ	PMI – manufacturing	Sep	pts	58.2	-	57.4
16:00	US	ISM – manufacturing	Sep	pts	57.5	-	58.8
		TUESDAY (3 October)					
9:00	CZ	GDP	Q2	% y/y	4.7	-	3.0
		WEDNESDAY (4 October)					
	PL	**MPC decision**	**Oct**	**%**	**1.50**	**1.50**	**1.50**
9:55	DE	PMI – services	Sep	pts	55.6	-	53.5
10:00	EZ	PMI – services	Sep	pts	55.6	-	54.7
11:00	EZ	Retail sales	Aug	% m/m	0.3	-	-0.3
14:15	US	ADP report	Sep	k	160	-	237
16:00	US	ISM – services	Sep	pts	55.1	-	55.3
		THURSDAY (5 October)					
14:30	US	Initial jobless claims	week	k	-	-	260
16:00	US	Industrial orders	Aug	% m/m	0.7	-	-3.3
		FRIDAY (6 October)					
8:00	DE	Industrial orders	Aug	% m/m	0.7	-	-0.7
14:30	US	Non-farm payrolls	Sep	k	70	-	156
14:30	US	Unemployment rate	Sep	%	4.4	-	4.4

Source: BZ WBK, Reuters, Bloomberg

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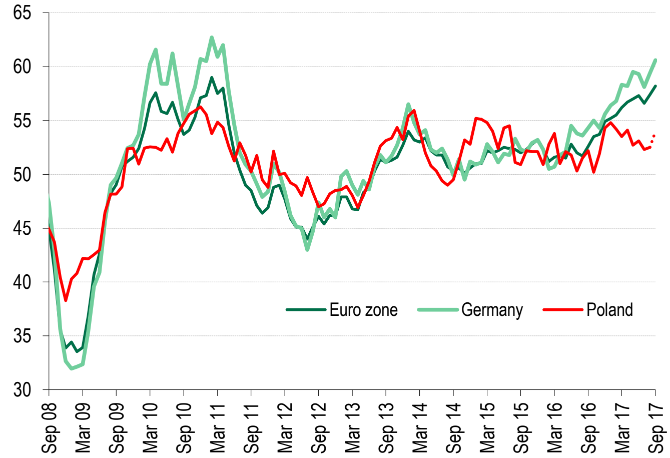
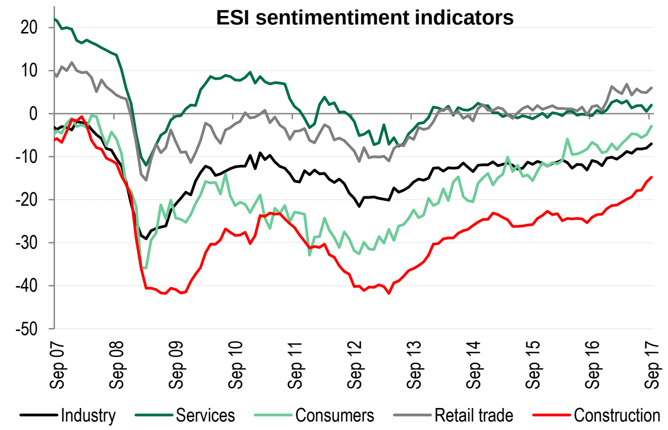
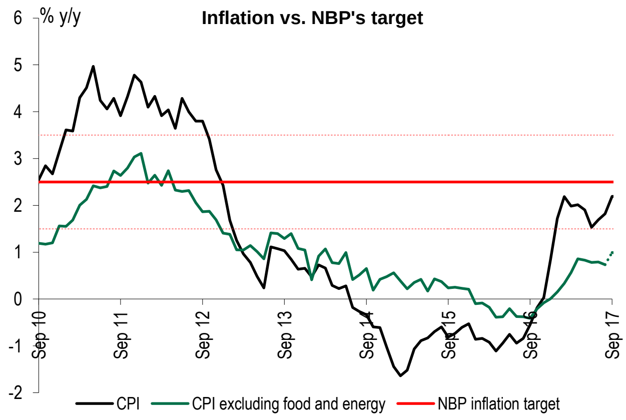
What's hot next week – The defiant PMI



- We once again expect the Polish manufacturing PMI to recover and return to the close correlation with the business sentiment indicators for Germany and the Euro zone. Its performance in the recent months has been systematically disappointing. However we do not expect this divergence between the Euro zone and Poland to be long-lasting. After all, alternative indicators of business sentiment for September already released by the Statistical Office and by the European Commission continued to point to improving situation.
- The MPC decides on rates but any changes to policy are out of question at this stage and there were no changes to the monetary policy guidelines approved by NBP for 2018. We continue to see the first rate hike in 4Q18. That would be in our view the only rate hike next year, followed by only one more in the whole 2019.

Last week in economy – A shot of inflation





- ESI indicators for September came quite strong with the economy-wide index and its industry, building and consumer components all showing the highest level of optimism in around nine years. For the building sector indicator this is the thirteenth m/m improvement in a row. When it comes to the services and retail trade sector the sentiment has improved greatly in late 2016 but is still showing no uptrend from there. The industrial sector which seemed unsure about the upswing in output still in 1Q is now systematically upgrading its output expectations so that the index that describes these exceeds the value of the index of current output. The strongest level of new orders index since mid-2008 may justify this optimism and could mask any influence of the very tight labour market on expectations about the future scale of industrial activity.
- Flash CPI for September was equal to 2.2% y/y, up from 1.8%, while the market was divided between 1.9% and 2.0% in its forecasts. We attribute the rise of the headline figure to the behavior of fuel prices and the continued high input from food as well as a base effect in health. But it may still not be enough to explain the whole jump. Core CPI might have risen from 0.7% y/y to 1%. The MPC members who do not exclude rate hikes usually refer to significant increase of the price pressures as a factor that could make them more openly support monetary tightening. So it is not only about headline breaching some preset level, but about trends in core price categories that could clearly be linked to strong domestic demand. If the climb of inflation is based on fuel prices and unexpected and quite unusual surge of butter prices it is highly unlikely it will impress the Council. However the MPC will not know the CPI details on the meeting next week.

Quote of the week – For the MPC credit dynamics are most important

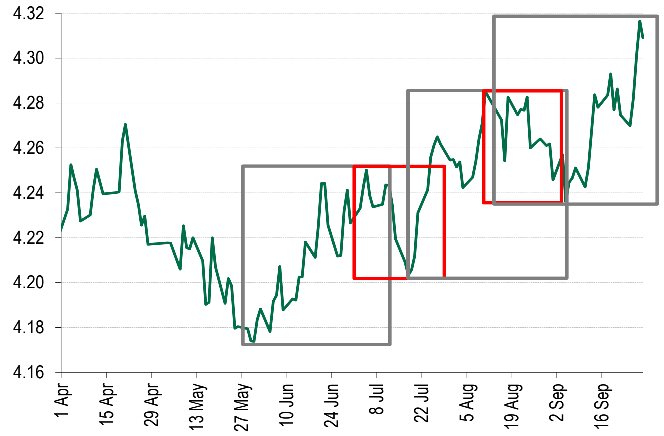
Jerzy Żyżyński, MPC member, Reuters, 25 September

If economic growth translates into excessive credit growth then we will have to react. And as long as inflation is within the target range (1.5-3.5 percent) we do not have to react. As for now, all indicates that 2018 will be stable with respect to the level of interest rates. It does not make sense to cool down the economy in order to limit wage increases if credit is not growing excessively. From the point of view of the Monetary Policy Council credit dynamics are most important. Growth in wages fuelled by credit is currently not the reason for rising inflation. Hence, monetary policy would not stop growth in wages. As for now (...) credit is not growing as fast as one could expect.

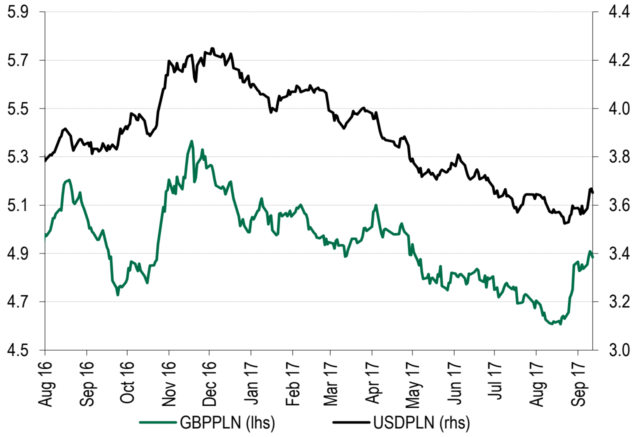
Jerzy Żyżyński is a dovish member of the MPC who often refers to credit growth. He made a good point that loan dynamics still look bleak given the economic rebound and historically low interest rates. We expect a rebound of credit soon as investments most likely accelerated in 3Q and consumers' propensity to spend seems rising. However his remark on credit growth being the most important point for the MPC may be an exaggeration as the governor rarely comments the developments on the money creation side, but instead sometimes mentions deposits to refer to the MPC hawks' worries about side effects of keeping real rates below zero for an extended time.

Foreign exchange market – Politics weigh on the zloty

EURPLN

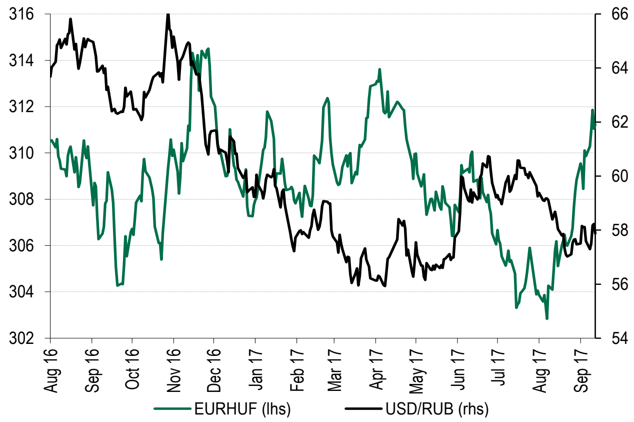


GBPPLN and USDPLN



EURUSD

EURHUF and USDRUB



Politics weigh on the zloty

- Outcome of the German parliamentary elections (implying a risk of a prolonged formation of the new government) together with rising chances for a December Fed rate hike hit the EM currencies with only Mexican peso performing worse than the zloty. Additional pressure on the Polish currency might have been generated by lack of approval of president's court bills by the government which may be a signal of some tensions between the Law and Justice and president Duda.
- As a result, EURPLN jumped above 4.30 resistance reaching 4.33, its highest since mid-March. USDPLN rose to 3.70 from 3.57 and CHFPLN to 3.79 from 3.68. GBPPLN stayed flat.
- In our opinion, this week's EURPLN peak is a first important resistance. At that level the current upside wave is equal to previous upside impulses seen in June and July/August – see the first chart. If resistance is broken, this opens door for further zloty's depreciation. We assume that the global market will stabilize soon and positive fundamentals of Polish economy will encourage investors and corporates to utilize recent zloty's depreciation to purchase PLN/sell euro.
- Our forecast of September PMI is above market consensus and implies a sharp rebound after clear underperformance vs European indexes seen in the last months. The US data will likely be distorted by the extreme weather conditions and could have a market impact only in the case of a surprisingly strong above-consensus readings.

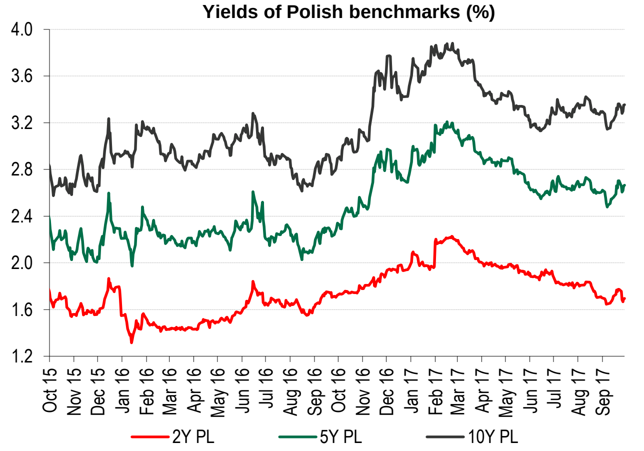
German elections hit the euro

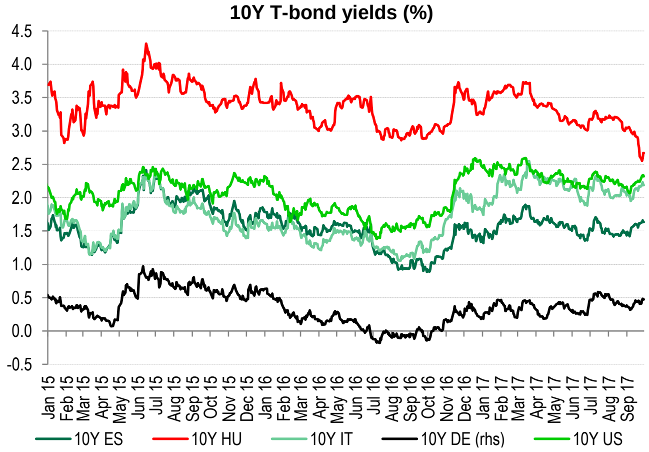
- Last week the dollar gained vs the euro as the outcome of the German parliamentary elections means that it may take time to form a new government and chances for a Fed rate hike rose. As a result, EURUSD fell temporarily to nearly 1.17 and now the downside move from recent multi-year peak at c.1.21 is the biggest down leg in the upside trend observed this year.
- We have recently been repeating that we expect EURUSD to correct to c1.15 until the year-end and the mix of outcome of the German elections and rising chances for a 25bp Fed rate hike this year amid higher support for Trump's tax reform could work in favour of the dollar.
- This week we will learn US nonfarm payrolls data. Consensus is very low probably owing to expectations that hurricanes have caused distortions in hiring process. We think that poor figures will be rather ignored (viewed as a temporary weakness) and only surprisingly strong numbers could have a material impact on the market.

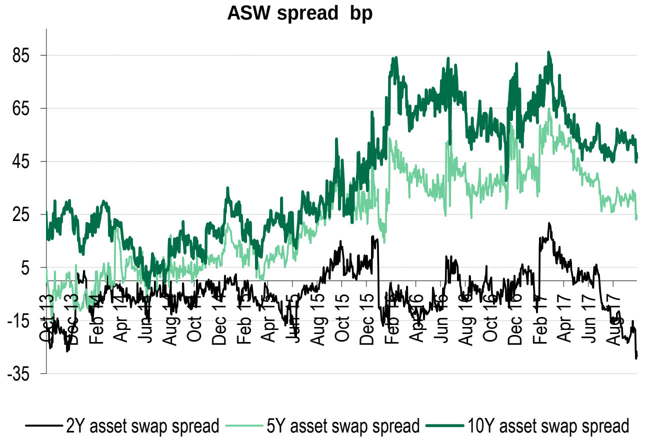
Czech national bank holds fire

- Czech central bank left interest rates unchanged this week with the main refi rate still at 0.25%. Bank governor Jiri Rusnok said that economic conditions have turned to more inflationary but the majority of the central bankers wanted to wait for the updated GDP and CPI forecast before hiking rates again this year. There were three votes for a rate increase this week and four against. Koruna depreciated only temporarily after this decision was announced and EURCZK remained near 26.0.
- Both EURHUF and USDRUB rose last week amid unstable global market and gaining dollar. The ruble managed to pare part of losses thanks to a rebound in oil price while the forint remained under pressure vs the euro.

Interest rate market – 2Y asset swap spread on the 5 year lows







Political uncertainty pushed yields down

- Last week, German and France election results added some political uncertainty to the Euro zone economic outlook. On the east side of Rhine former government coalition members (CDU/CSU and SPD) saw poor election results, which implies longer process of new government formation. On the west side of Rhine French President Emmanuel Macron's centrist party suffered its first electoral blow previous Sunday, as traditional conservatives dominated Senate elections. It means that implementation of ambitious plan of reform of French labour market may be delayed. As a result, yields on the core and domestic market were pushed down in the first part of last week. On the domestic market the long end of the sovereign yield curve dropped to 3.29%, while the belly to 2.62% and front end to 1.68%. US yields rose 5-7bp while German bond curve remained stable

Central banker remarks triggered bonds sell-off

- The second part of last week was dominated by central bankers' remarks and surprisingly high reading of US durable goods orders. On Tuesday evening Fed governor Janet Yellen said that rates still need to be raised despite uncertain inflation outlook. This statement was a trigger for the market to pull global and domestic rates and yields up. High reading of durable goods orders in the US extended the rise of yields. Polish September CPI (2.2% y/y) helped to lift rates up again, and brought the long end and the middle part of the curve 2-3bp above the previous week closing. The short end stayed 6bp lower compared to the level seen at the end of previous week. Despite the substantial increase of the yield curve in the second part of the week, the asset swap spreads (ASW) curve in the long end and belly the curve stayed anchored close to the early August low, while the short end of the ASW spread curve remained close to levels seen last time in 2012.

The US non-farm payrolls in the spotlight

- In the first part of this week, we expect stabilisation of the domestic yield curve. Anticipated high level of PMI reading in Poland should exert upward pressure on the domestic yield curve. In our opinion, this effect will be offset by the ASW spread compression (higher inflation = potentially higher budget revenues). Additionally investors should be encouraged to buy bonds by the relatively modest 4Q offer of T-Bonds announced by the Ministry of Finance (it plans to offer PLN8-16bn of bonds in 2 regular tenders in 4Q17). In the second part of the week, we see some risk of a sell-off of the long end of the curve if the US non-farm payrolls surprise on positive side.

Additional information is available on request. Please contact Bank Zachodni WBK S.A., Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 87, email ekonomia@bzwbk.pl