WEEKLY ECONOMIC UPDATE

16 – 22 October 2017

The nearest week will be full of domestic data releases that may verify expectations regarding economic growth in 3Q17. We have just revised up our GDP forecast to 4.3% y/y in 3Q and 4.4% in 4Q and we hope to see the data that would confirm such an optimistic picture – industrial production rising 6.1% y/y, construction output by 16.6% y/y and retail sales growth at 6.8% y/y. The growth rates will be slightly weaker than in August, yet mainly due to working days effect. The balance of payments for August should be also positive, as the data released today by the stats office showed very strong exports and the first trade surplus since June.

More important than data releases may be comments of central bankers and political events abroad. The EU leaders' summit is scheduled for Thursday-Friday while on Wednesday the 19th National Congress of the Communist Party of China will start. Investors will be also watching the situation in Spain and in the UK, as well as the progress in work on US tax reform.

On Friday evening the S&P rating agency will update Poland's rating. We do not expect to see any change in the rating or outlook as the improvement in economic and fiscal outlook should be outweighed by the agency's concerns about institutional changes in Poland.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 October)					
14:00	**PL**	**Current account**	**Aug**	**€m**	**-651**	**-1008.7**	**-878**
14:00	**PL**	**Exports**	**Aug**	**€m**	**15 512**	**15 891**	**14 939**
14:00	**PL**	**Imports**	**Aug**	**€m**	**15 920**	**16 325**	**15 486**
		TUESDAY (17 October)					
11:00	EZ	CPI	Sep	% y/y	1.5	-	1.5
11:00	DE	ZEW index	Oct	pts	88.5	-	87.9
14:00	**PL**	**Wages in corporate sector**	**Sep**	**% y/y**	**6.3**	**5.9**	**6.6**
14:00	**PL**	**Employment in corporate sector**	**Sep**	**% y/y**	**4.6**	**4.6**	**4.6**
15:15	US	Industrial output	Sep	% m/m	0.3	-	-0.9
		WEDNESDAY (18 October)					
14:00	**PL**	**Industrial output**	**Sep**	**% y/y**	**5.1**	**6.1**	**8.8**
14:00	**PL**	**Construction and assembly output**	**Sep**	**% y/y**	**18.1**	**16.6**	**23.5**
14:00	**PL**	**Real Retail sales**	**Sep**	**% y/y**	**6.8**	**6.8**	**6.9**
14:00	**PL**	**PPI**	**Sep**	**% y/y**	**3.1**	**3.1**	**3.0**
14:30	US	Housing starts	Sep	% m/m	0.0	-	-0.8
14:30	US	Building permits	Sep	% m/m	5.7	-	3.4
20:00	US	Beige Book					
		THURSDAY (19 October)					
14:00	**PL**	**MPC minutes**					
14:30	US	Index Philly Fed	Oct	pts	20.3	-	23.8
14:30	US	Initial jobless claims	week	k	-	-	243
		FRIDAY (20 October)					
14:30	US	Home sales	Sep	% m/m	-0.9	-	-1.7

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:

al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40

email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl

Piotr Bielski +48 22 534 18 87

Marcin Luziński +48 22 534 18 85

Grzegorz Ogonek +48 22 534 19 23

Konrad Soszyński +48 22 534 18 86

Marcin Sulewski +48 22 534 18 84

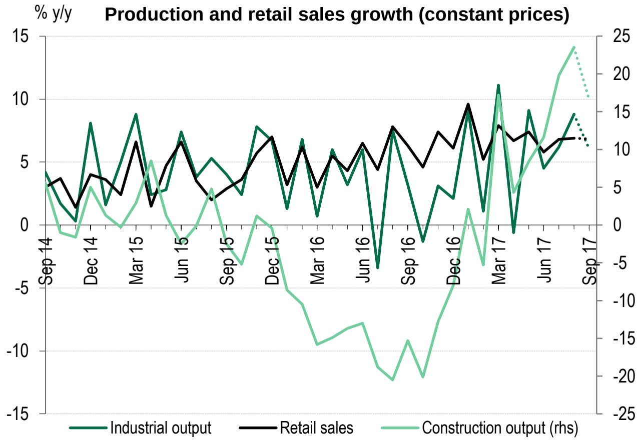
TREASURY SERVICES:

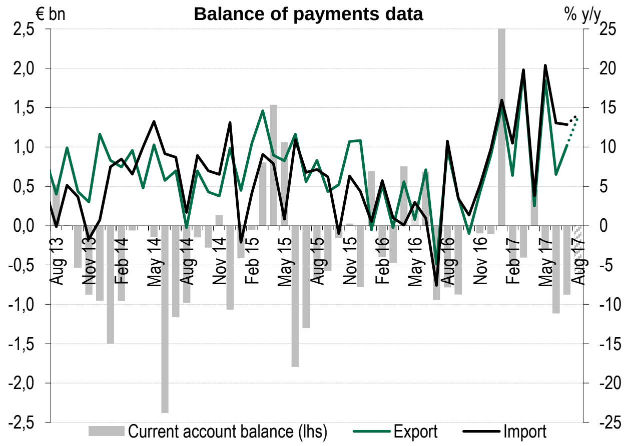
Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

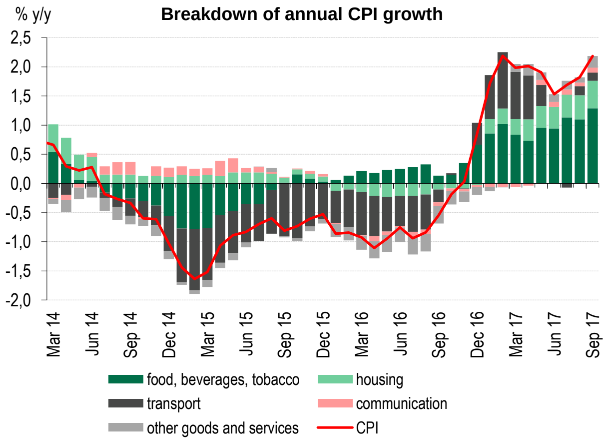
What's hot next week – Can September live up to expectations?





- Plenty of data from the Polish economy coming this week. After the positive surprises in August readings we saw market GDP forecasts go up. We also revised our 3Q estimate. The September set should be a real test if analysts got carried away or if we are facing a true acceleration of economic activity. Many readings are destined to come lower than previously in y/y terms due to negative working day difference.
- We put emphasis on wage growth seeing how divided the Monetary Policy Council has become on this issue of pass-through from labour market tensions to CPI. In our view the negative calendar factor brought it down from 6.6% y/y to 5.9%. Our retail sales forecast is quite solid. We think consumer spending remained strong in September with the help of earlier-than-last-year purchases of winter-fall clothes collection (this factor pushed up core CPI in September). With increasing impression that labour shortages have to eventually take their toll on industrial and building sector performance we expect the September output data to stay quite strong even with the working days handicap.
- The current account monthly report with export and import both most likely pushing to c14% y/y, the highest growth since May, will serve as a reminder of the overall strong activity level in August. German data on export, output and new orders for August all surprised to the upside which bodes well for the Polish trade data. GUS trade data even point to a possibility of a trade surplus thanks to strong export.
- On Friday evening S&P is expected to review Polish credit rating. It already upgraded Polish growth forecast for 2017 to 4.2% from 3.6% and for 2018 to 3.8% from 3.1%. In the agency's opinion fiscal situation will also look better than it was expected so far. The full country report might thus sound either neutral or slightly positive without changing grade and outlook.

Last week in economy – Core CPI the highest in three years



- CPI inflation climbed from 1.8% y/y to 2.2% in September. The acceleration came from categories like food, alcoholic drinks, clothing & footwear (due to bad weather), health (due to base effect - the government program of free medicine for the elderly was launched a year ago). Core CPI increased to 1.0% y/y in September from 0.7% y/y and after 0.8% was recorded between April and July. This is the strongest core reading since 1H14.
- That said, the contribution from core inflation to the headline y/y figure of 2.2% is still relatively low at 0.6pp. What is more, we do not expect CPI and core CPI to go much higher from September levels still this year. Only with the start of 2018 there could be a jump in core CPI that would take it above the 1.5% y/y threshold that in the past served as an important trigger for the MPC to change its stance.

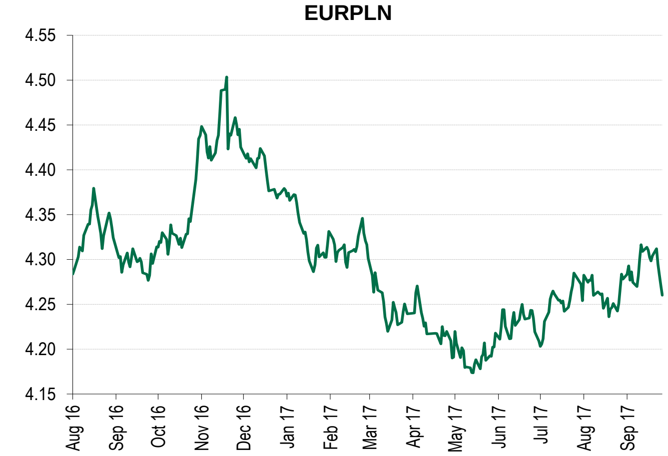
Quote of the week – The 50-50 moment

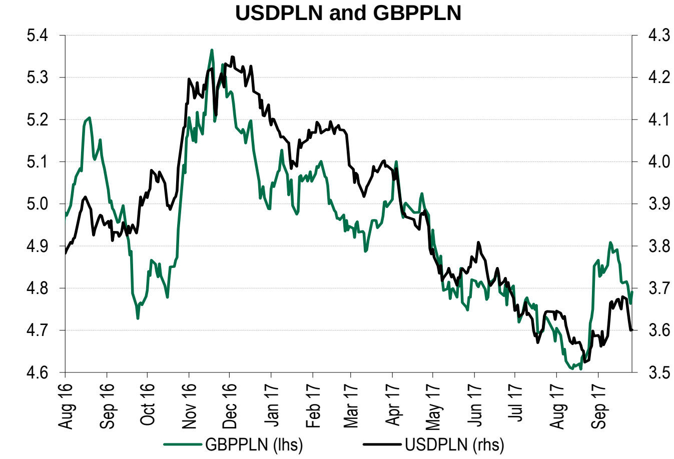
Łukasz Hardt, MPC member, Reuters, 9 October

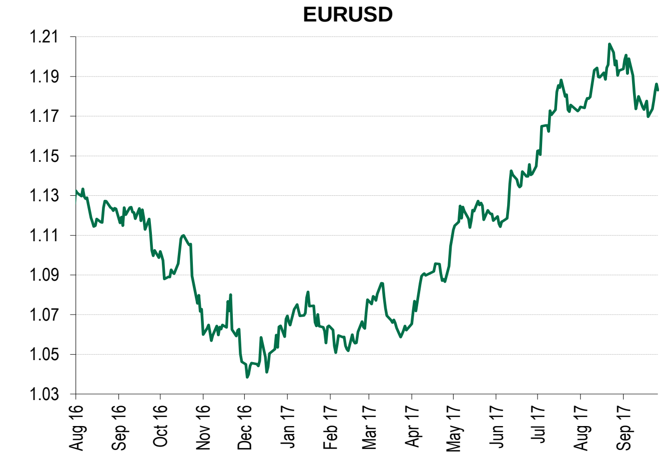
The statement that nothing will change in monetary policy until the end of 2018 is burdened with risk. At the moment we do not know how strongly wage growth will translate into inflation pressure in the economy. one cannot exclude that tensions on the labour market supply side ... will lead to higher inflation. Then a reaction may be needed at the start of 2018. If we see rising inflation pressure, if our forecasts show that in the next two, three quarters we may overshoot 2.5 percent, then we should consider a small hike in the interest rate. It seems to me that the rise in inflation pressure, and as a consequence the necessity to consider a tightening of monetary policy, is equally likely as a the scenario of status quo. These two scenarios have a similar likelihood of materialising. One has to remember that our understanding of forces responsible for inflation is imperfect.

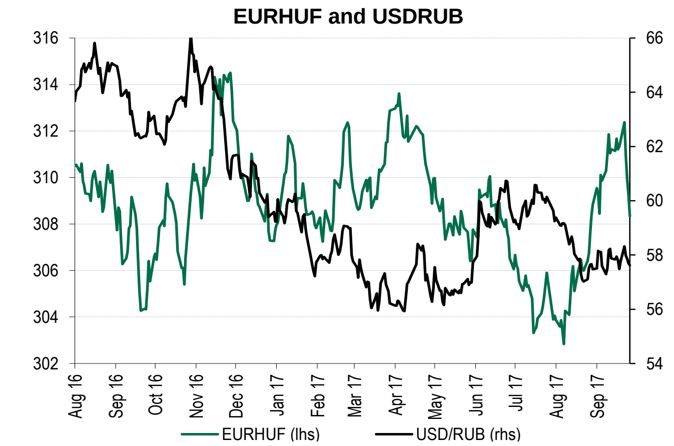
The MPC's Łukasz Hardt gave us a recipe for a rate hike already in early 2018, at least from his point of view. The necessary ingredients are evidence of transmission from the tight labour market to CPI and a significant rise of core inflation, pointing to a severe risk of the headline inflation breaching the 2.5% y/y target in 2018. This interview was given ahead of the full release of September CPI with its rise of core inflation. Grażyna Ancyparowicz said last week that interest rates „could remain unchanged until the mid-2018". This is already the fourth member in a 10-strong Council (after E.Gatnar, K.Zubelewicz and Ł.Hardt) suggesting that a rate hike is possible in 2018. The discussion about a change of monetary policy stance should become more animated next year. However we expect the first 25bp hike to be delivered in 4Q18.

Foreign exchange market – Door for zloty appreciation opened









EURPLN below support

- In our previous weekly report we wrote that calm market mood might support the zloty and this was actually the case. Recent days saw no breaking events, the dollar appreciation paused, IMF raised Poland GDP forecasts and MPC member Grażyna Ancyparowicz seems to have joined the hawkish camp which all together pushed EURPLN below first support level at 4.26. Last week saw the biggest weekly appreciation of Polish currency vs the euro since August 2016. USDPLN fell to 3.60 from c3.675 while CHFPLN eased to 3.69 from 3.76.
- Numerous Polish economic activity data are on the agenda this week. Our forecast for August C/A points to bigger deficit than the market expects but we are above the consensus with our September industrial output estimate. Thus, the net effect of these releases could be positive for the zloty given the recent rise in inflation and another MPC member probably joining the hawkish camp.
- Last week showed that trend of EURUSD is an important factor for EURPLN. This week we will learn more data from the US that could drive EURUSD.
- EURPLN broke the first support at 4.29 we mentioned last week and in our view this opens door for further decline towards September bottom at 4.23.

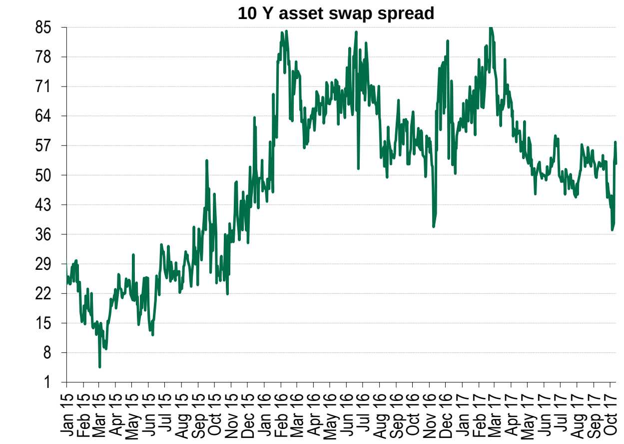
Dollar recovery halts

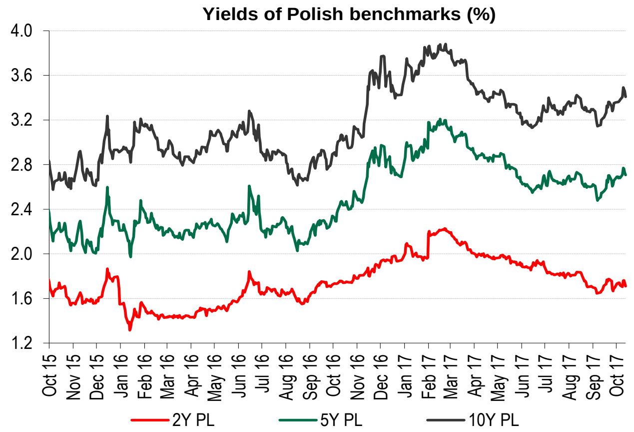
- Last week, the dollar's appreciation paused amid concerns about Trump's tax reform, dovish interpretation of minutes from last FOMC meeting and solid data from Germany. As a result, EURUSD did not break the August bottom at 1.166 and rose to nearly 1.19 from c1.17.
- EURUSD has stabilized below the this year's peak after the rally seen in the previous months. The market is pricing higher chances for a December rate hike but uncertainties related to political situation in the US and still decent US data curb dollar gains. As a result, the US data due to be published in the days to come may be just one of the drivers of EURUSD this week. We still think the dollar could gain vs the euro in the remainder of the year.

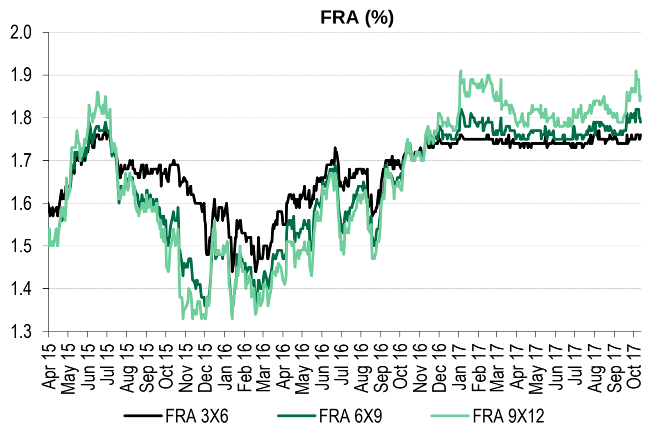
Forint outperforms its CEE peers

- The other CEE currencies also gained with the forint clearly outperforming its peers. EURHUF plummeted to 308 (its lowest since late September) from above 312. Since mid-August the forint has been under clear pressure vs the euro amid dovish rhetoric of the Hungarian central bank and rising chances for a December Fed rate hike.
- USDRUB eased marginally amid slight rise in oil prices but the exchange rate remained within a 57.3-58.5 range.
- EURCZK fell to 25.04 from 25.92 but this just a party correction of a jump seen in the previous week. Koruna gained in the last few days amid speculation that more rate hikes will take place later this year.
- There are no important data releases from Hungary, Czechia and Russia on the agenda this week, so the global sentiment should be the key driver for the forint, koruna and ruble.

Interest rate market – Political tensions ease and push yield down







ASW spread shrink

- Last week we observed the domestic bond market rally, After the previous week sell-off on the bond market The yield curve downward move was a reaction to the decreasing concerns about sharp monetary policy tightening in US and gradual declining of negative impact of political tension between Poland and EC, which were overshowed by German government negotiations and Brexit talks. As a result domestic debt was a beneficent of IRS rates decrease as well as downturn of credit risk prices. As a response the domestic yield curve slid by 10-15bp on the belly and long end of the curve, while the short end dropped by 6-7 bp. The IRS curve decline was a little smaller than bonds one, 7-10 bp on the belly and the long end and by 2bp on the short end. It made asset swap (ASW) spread shrink by 2-4 bp across the curve. The local news and data were not in the investors' focus, the domestic CPI reading for September was totally ignored by the market players.

Limited supply will keep yields low

- In our opinion, this week the core market focus will be dominated by the information about prepared by ECB on cutting QE purchases program and discussion about the Fed president successors. We think that these information as well as the Polish t-bond principal and interests repayments scheduled for next week (and a poor calendar of new issue for 4Q17) will dominate the domestic debt market. We think, these events will have the strongest impact on the ASW spread compression as well as will push the front end bonds yield curve down. Domestic FRA rates are likely to benefit from these changes. Moreover, news about protracted German government coalition negotiation should positively influence the Polish t-bonds. The domestic industrial production and labour market data (we forecast high reading for September) may have a minimal but negative impact on the longer domestic t-bonds.

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