

WEEKLY ECONOMIC UPDATE

23 – 29 October 2017

Last week, the zloty's appreciation vs the euro paused while bonds lost amid yields rising worldwide as the market was pricing in that the new Fed governor will be more hawkish than Janet Yellen. In Poland, we learned solid economic activity data, although industrial output figure was below consensus and more MPC members gave hawkish comments suggesting that support for a rate hike in 2018 is rising.

On Friday October 20, S&P may release a Polish rating review. Recently the agency upgraded the GDP growth forecast for Poland 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 expected so far. We think the tone of the report will be neutral or slightly positive. In our opinion only a rating or outlook upgrade could affect the market, but we find such outcome highly unlikely.

Globally, the US data and ECB decision will be in the spotlight. Market awaits the details on the planned pace of scaling back the ECB asset purchase program. Investors expect that monthly bond purchases will be reduced to €40bn from €60bn but the QE will be prolonged into 2018. However, we think that the market is now ready to take profit from recent zloty appreciation and the decision to cut monthly bond purchases could weigh on the zloty. Additional pressure on Polish bonds could be generated by market uncertainty related to the new Fed governor.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (23 October)							
14:00	PL	Money supply	Sep	% y/y	5.6	5.6	5.5
TUESDAY (24 October)							
9:30	DE	Flash PMI – manufacturing	Oct	pts	60.0	-	60.6
9:30	DE	Flash PMI – services	Oct	pts	55.6	-	55.6
10:00	DE	Flash PMI – manufacturing	Oct	pts	57.7	-	58.1
10:00	DE	Flash PMI – services	Oct	pts	55.8	-	55.8
10:00	PL	Unemployment rate	Oct	%	6.9	6.9	7.0
14:00	HU	Central bank decision		%	0.90	-	0.90
WEDNESDAY (25 October)							
10:00	DE	Ifo index	Oct	pts	115.0	-	115.2
11:00	PL	Bond auction					
14:30	US	Durable goods orders	Sep	% m/m	1.3	-	2.0
16:00	US	New home sales	Sep	% m/m	-1.8	-	-3.4
THURSDAY (26 October)							
13:45	EZ	ECB decision		%	0.0	-	0.0
14:00	PL	MPC minutes					
14:30	US	Initial jobless claims	week	k	-	-	222
16:00	US	Pending home sales	Sep	% m/m	0.3	-	-2.6
FRIDAY (27 October)							
14:30	US	Advance GDP	Q3	q/q	2.5	-	3.1
16:00	US	Michigan index	Oct	pts	101.0	-	95.1

Source: BZ WBK, Reuters, Bloomberg

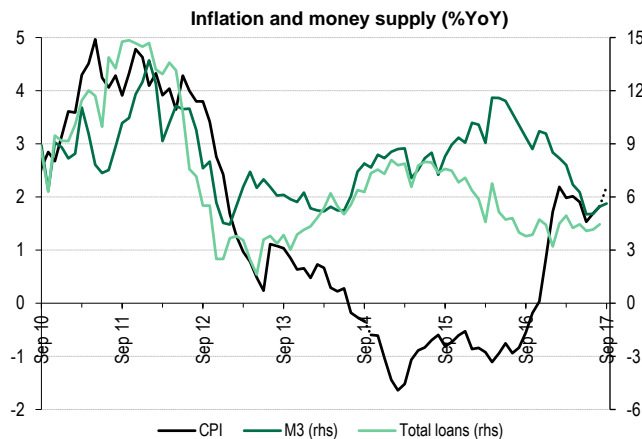
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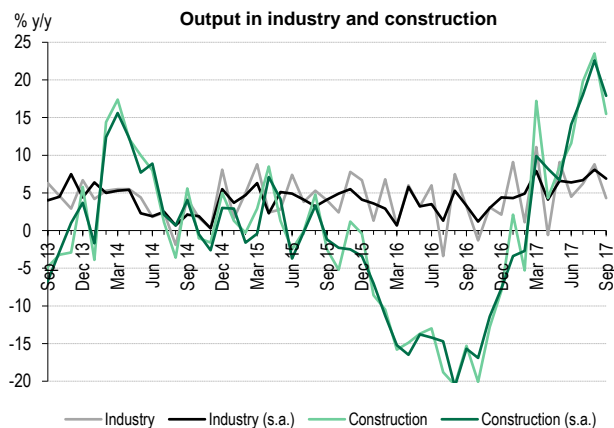
What's hot next week – Money supply and MPC minutes



- The broad money supply growth, after a decline from above 11% y/y in 1H16 to 5% y/y in July this year may be starting to accelerate again. In August it was already at 5.5% y/y. The growth of enterprise investment loans is already on the rise, while consumer loans and PLN-denominated mortgage loans maintain a steady pace of c8% and c10% y/y respectively. The fx part of the mortgage portfolio is being paid up and shrinking with appreciation of PLN – to see M3 gain momentum we need the credit demand stemming from strong economy and very high households' optimism to outweigh the negative fx mortgage factor. The supply side is also weakened by the persisting low rates environment with people turning to alternative financial investments.

- MPC minutes get published with a week delay. The important quotes we got since the last meeting suggest this document may be outdated in the moment of release.

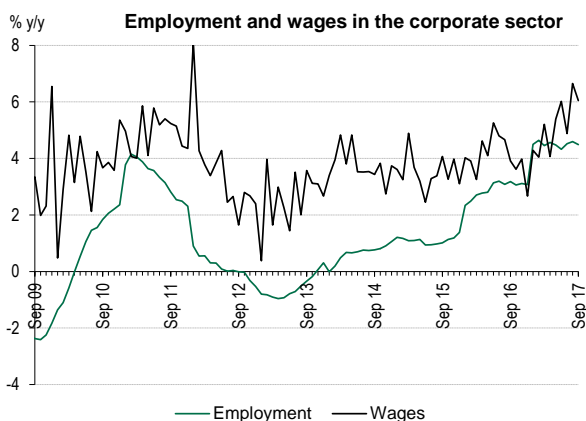
Last week in economy – Disappointing output and import, wage growth remained decent



- Industrial output disappointed rising 4.3% y/y in September vs impressive 8.8% y/y in August and vs market consensus at 5.2% and our forecast at 6.1%. In our view, this deceleration does not signal any deterioration of situation. First, we had a negative working day effect. Second, there were some one-off effects: extraordinary energy output in August and high base effect in mining in September 2016. Construction and assembly production was close to expectations and rose by 15.5% y/y (our forecast: 16.6% y/y, market consensus: 18.4% y/y). Retail sales growth surprised to the upside in September, accelerating from 6.9% y/y to 7.5% in real terms, mostly under impact of cold September, which supported clothing sales. In general, September data supported our forecast of some acceleration in GDP growth in Q3 and a results above 4.0% y/y.

- Current account deficit reached €100mn in August, way less than we and the market expected (€602mn and €660mn, respectively) on imports slowdown (temporary in our view) to 7.6% y/y from 12.8% y/y compared to consensus above 11% and average growth in Jan-Jul at 14%. Exports rose by healthy 12.3% y/y, similarly to July.

- Average wage in corporate sector rose 6.0% y/y in September, after 6.6% y/y in August, roughly in line with forecasts. The slowdown was caused mainly by the less positive calendar effect (one working day less than last year), and by the lower pay rise in mining, which has been very volatile in recent months. Overall, wage growth remains decent and in our view it should keep accelerating in the coming quarters. Employment increased by 4.5% y/y and 5.2k m/m, which is a bit less than we and the market expected (4.6% y/y).



Quote of the week – I am concerned about the wage pressure

Jerzy Kropiwnicki, MPC member, PAP, Bloomberg, 20 October

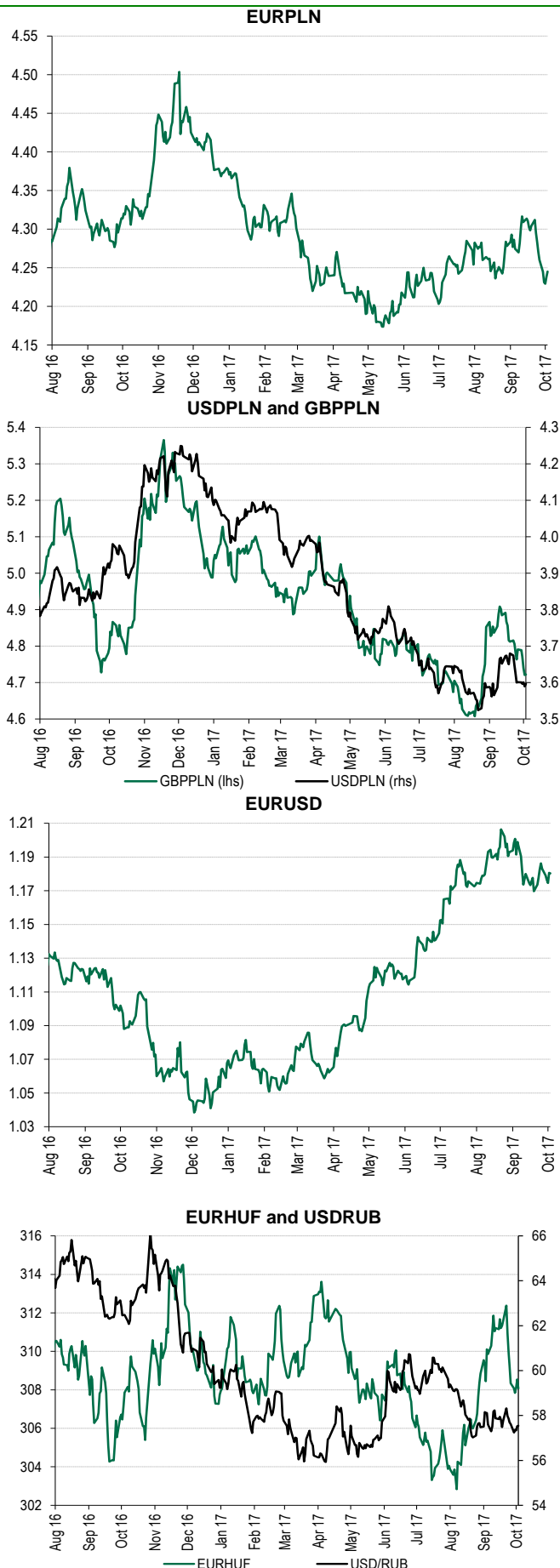
There is a risk we will see a combination of rising food prices and wages, all the more so that a budget situation presented by the government as exceptionally favorable may boost expectations for higher wages in the whole budget sector (after an effective protest of a group of doctors). That may trigger an inflationary spiral. Interest rates should stay unchanged in 1H18, I will inform about a possible change of my view in late November.

Jerzy Osiatyński, MPC member, PAP, Bloomberg, 20 October

I am concerned about the wage pressure, we will know more in November. Should wage pressure persist and considering the delayed impact the MPC decisions have on the economic activity, maybe we will have to consider rate hike earlier than our forward guidance was suggesting so far (...) sooner than in 4Q.

We have heard from the two MPC members that accompanied the NBP governor Adam Glapiński in the next-to-last, September post-decision press conference. Back then they sounded relaxed about labour market developments, generally aligning their views with the governor. Glapiński expected the interest rates to remain unchanged in both 2017 and 2018. However, last remarks of Jerzy Kropiwnicki and Jerzy Osiatyński show that both are hesitating and considering a change of stance depending on what the next NBP staff macroeconomic report and projections show in November. If both turn into dissenters then it seems we already end up with a 5:5 vote distribution, but some hawks pointed to mid-2018 as the moment when a change of MPC stance might be introduced - under some conditions. We do not argue a rate hike could be voted on in near future, but rather in 4Q18.

Foreign exchange market – Time to take profit



Likely profit taking from zloty rally

- Last week, the zloty's appreciation trend vs the euro paused and Polish currency gave up part of recent gains. EURPLN has tried to break the 4.23 support but failed to stay below that level for longer and was above 4.24 at the end of the week. Polish macro data were ambiguous and only the lower-than-expected C/A deficit provided temporary support for the zloty.

- On Friday October 20, S&P may release a Polish rating review. Recently the agency upgraded the GDP growth forecast for Poland 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 expected so far. We think the tone of the report will be neutral or slightly positive. In our opinion only a rating or outlook upgrade could affect the market, but we find such outcome is highly unlikely.

- EURPLN stabilized in the last few days after the positive news-flow related to Poland (GDP forecasts upgrades by IMF, WB, rating agencies after strong macro data) seen in the previous weeks. In our view, this suggests, that a stronger impulse is needed so that the zloty could continue its appreciation trend.

- We think that next weeks could see some profit taking after EURPLN's fall. This could be particularly the case if now the market becomes more confident that the US tax reform will be implemented after the Senate approved next year's budget.

- This week the ECB holds a meeting and market awaits the details on the planned pace of scaling back the asset purchase program. Investors expect that monthly bond purchases will be reduced to €40bn from €60bn but the QE will be prolonged into 2018. However, we think that the market is now ready to take profit from recent zloty appreciation and the decision to cut monthly bond purchases could weigh on the zloty.

EURUSD waiting for a trigger

- Last week, EURUSD remained stable around 1.18 and the weekly high-low trading range was the narrowest since mid-July. Euro was benefiting from positive macro data while the dollar was supported by higher changes for a December Fed rate hike after the US Senate approved the next year's budget making in the market's view the tax reform more likely.

- In our view, key events for this week are the US data (with the advance 3Q GDP estimate most awaited) and the decision of the ECB. Like in the previous month, the central bank shall try to sound dovish in order not to trigger euro's appreciation. EURUSD has stabilized in the 1.166-1.188 range and is waiting for a trigger. We still think the dollar could be strong in the remainder of the year.

Czech elections and MNB decision

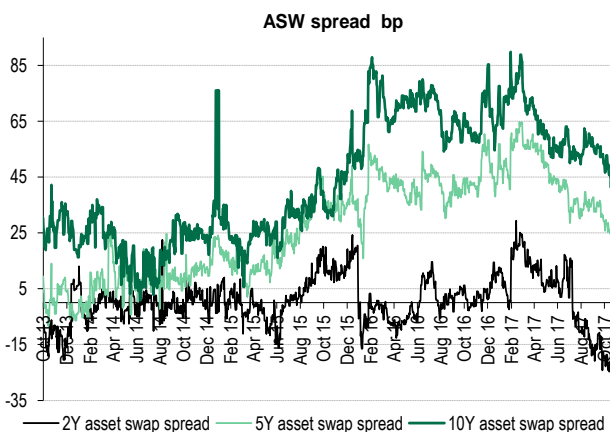
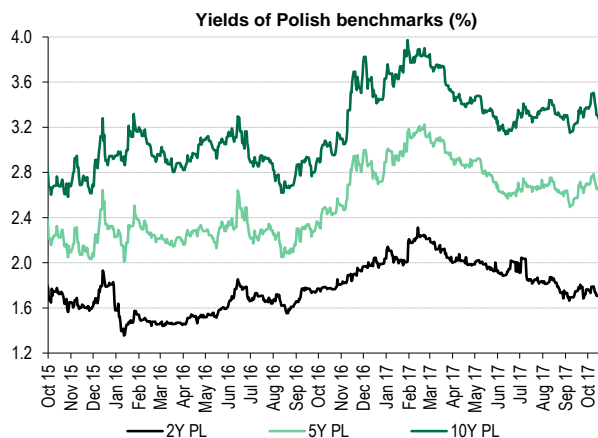
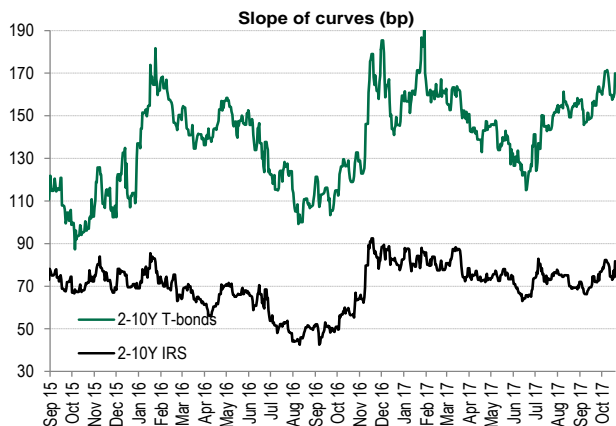
- Last week, EURHUF stabilized around 308 (after a plunge from above 312 seen in the previous two weeks), EURCZK was testing 25.7 while USDRUB settled around 57.4.

- The main events in the CEE region in the days to come will be the Czech parliamentary election (this weekend) and decision of the Hungarian central bank (MNB).

- We expect politics could halt the koruna's appreciation. ANO party is leading in the polls but will likely have to form a coalition to govern the country. Its leader, Andrej Babis, has been charged with fraud and this may make future coalition talks difficult so it could take longer than usual to form a new government.

- MNB is likely to sound dovish. The bank may refrain from easing monetary policy after it cut 1-month deposit rate last time but may try to use its rhetoric to stop forint's appreciation.

Interest rate market – Follow the central bankers



End of the yields downtrend

At the beginning of the last week, the domestic bond yields were falling, discounting large number of bonds maturing this week. Monday-Tuesday yields slide in the 5Y-10Y segment was also supported by positive mood on the German sovereign bond market. The German bund gains were fueled by growing concerns about European political scene after Freedom Party of Austria success in general election in Austria. Later in the week, positive mood on the German market wasn't affecting Polish debt. Gradual yield increases in Poland were a consequence of resumed market talking about Fed chairman successor. In the market opinion, the front-runner for the Fed chair race is a Kevin Warsh, described as a hard money hawk. As a consequence, the US yield curve was pulled up and this negatively affected Polish t-bonds in the 5Y-10Y segment. On the short end of the curve we observed a different scenario. The short-term bond yields were sliding across the week, discounting the next week cPLN13bn debt maturing. As a result, the short end of the curve decreased by c2bp, while the long end increased by c5bp. Domestic industrial production, retail sales and labour market data didn't affect the domestic market significantly.

ASW spread shrink

The IRS curve told a slightly different story. On the long end and the belly of the curve, the IRS rates were rising faster than the bonds yields. On the short end of the IRS curve rates were rising despite the bonds yields falls. As a result, we observed 1-2bp upshift on the short end of the IRS curve and c6bp on the belly and the long end. These changes have been reflected in asset swap spread compression by 5bp in the 5Y and 1-2bp in 2Y and 10Y segment.

ECB in the spotlight

We expect the long-term IRS rates and yields increases to continue this week. Information that US Senate approved budget plan for 2018 would be a support for the investors view that the US tax reform will lead to the higher and faster Fed rates increases. We think that the market will be focused on the ECB conference (investors expect that monthly bond purchases will be reduced to €40bn from €60bn but the QE will be prolonged into 2018.). We think that investors will be encouraged to take the short position on the belly and the long end of the curve by information from ECB and expectations for a strong leading indicators (PMI) reading from Europe. Moreover, the bond auction scheduled for 25 October will probably deliver extra supply in the 5Y+ segment of the curve. The short end of the bonds yield curve will probably be stable, while shorter IRS are expected to rise gradually.

On 20 October S&P may release a review of Polish rating. In our opinion only the rating or outlook upgrade could affect the bond market, but this scenario is highly unlikely, in our view.

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