

# WEEKLY ECONOMIC UPDATE

## 6 – 12 November 2017

The next week's agenda is not a very busy one. On the domestic market the key events will be the MPC decision (Wednesday) and balance of payments data (Friday). There will be a couple of economic activity indicators in Europe, but in general they will be of secondary importance. The MPC meeting will be an interesting one, as the Council will get to know the new central bank economic projections, and a couple of MPC members have signaled recently that the results of those projections may influence their views on interest rate outlook. It seems likely that GDP growth forecast will be revised up slightly (at least its starting point), but the question is more about the inflation forecast. The July's projection assumed that CPI would return to the 2.5% target not earlier than at the end of 2019, while our current forecast suggests it could take place already in mid-2018. However, we are quite skeptical if the new NBP forecast would show much faster achievement of the inflation target. Therefore, the tone of the press conference and the official MPC statement may not change substantially from the last month's. The balance of payments data for September will show, in our view, wider current account deficit than expected by the market (due to rebound in imports and slower export growth).

If the new NBP projection does not provide new arguments to proponents of quicker monetary policy normalization, then domestic government bonds might strengthen. Later in the week, after the auction, there could be a correction. On the FX market, after the recent stabilization we see chances for a rebound of EURPLN. Weak C/A data could be the trigger or the impulse could come from abroad.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (6 November)</b>							
8:00	DE	Industrial orders	Sep	% m/m	-1.4	-	3.6
9:00	CZ	Industrial output	Sep	% m/m	3.4	-	5.8
9:55	DE	PMI – services	Oct	pts	55.2	-	55.6
10:00	EZ	PMI – services	Oct	pts	54.9	-	55.8
<b>TUESDAY (7 November)</b>							
8:00	DE	Industrial output	Sep	% m/m	-1.0	-	2.6
11:00	EZ	Retail sales	Sep	% m/m	0.6	-	-0.5
<b>WEDNESDAY (8 November)</b>							
	<b>PL</b>	<b>MPC decision</b>		<b>%</b>	<b>1.50</b>	<b>1.50</b>	<b>1.50</b>
<b>THURSDAY (9 November)</b>							
8:00	DE	Exports	Sep	% m/m	-1.3	-	2.9
9:00	CZ	CPI	Oct	% y/y	2.7	-	2.7
9:00	HU	CPI	Oct	% y/y	2.3	-	2.5
<b>11:00</b>	<b>PL</b>	<b>Bond switch auction</b>					
14:30	US	Initial jobless claims	week	k	-	-	229
<b>FRIDAY (10 November)</b>							
<b>14:00</b>	<b>PL</b>	<b>Current account</b>	<b>Sep</b>	<b>€m</b>	<b>-202</b>	<b>-667</b>	<b>-100</b>
<b>14:00</b>	<b>PL</b>	<b>Exports</b>	<b>Sep</b>	<b>€m</b>	<b>17 090</b>	<b>16 892</b>	<b>15 682</b>
<b>14:00</b>	<b>PL</b>	<b>Imports</b>	<b>Sep</b>	<b>€m</b>	<b>16 846</b>	<b>16 939</b>	<b>15 384</b>
16:00	US	Flash Michigan	Nov	pts	100.0	-	100.7

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

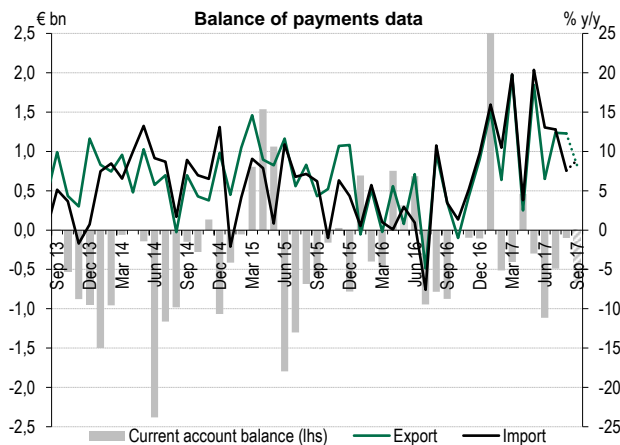
#### TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

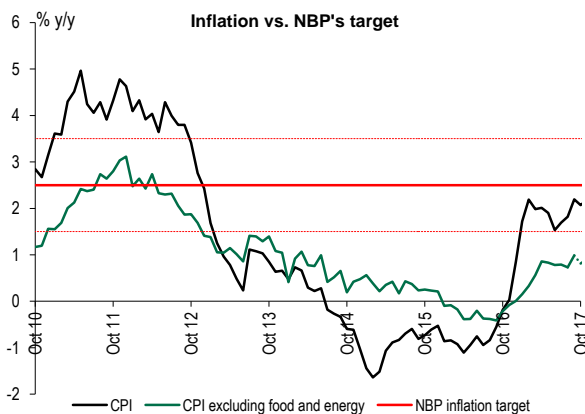
## What's hot next week – Projection and objection



▪ Will this be the turning point in Polish monetary policy? The MPC meets this week and we know that several members are almost ready to dissent from the governor's line of staying idle until at least the end of 2018. We might even see a motion to raise rates in the coming months with the right nudge from the data. The members leaning towards tighter policy might also react in case the economic outlook gets more pro-inflationary. A new NBP staff projection has been prepared for this meeting, but we think it might not provide arguments for tighter monetary policy.

▪ The September C/A data are going to be interesting due to the surprisingly poor performance of imports a month earlier. Many analysts assumed it is going to last and trade balance of goods will stay in surplus. We think import recovered from its August weakness and could have accelerate from 7.6% y/y to 8.9% despite less working days.

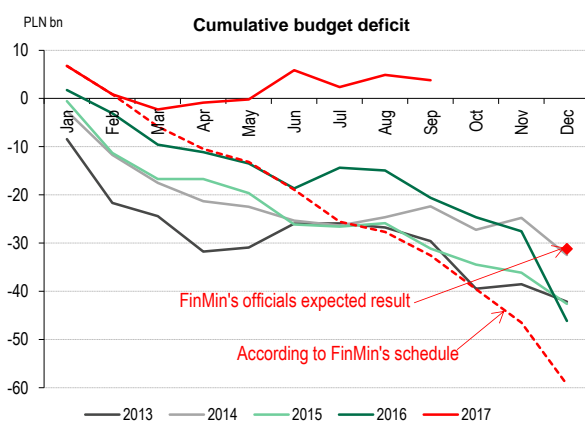
## Last week in economy – CPI down to 2.1% y/y, budget surplus



▪ Polish CPI grew 2.1% y/y in October, according to a flash estimate of the Stats office vs. 2.2% in September, in line with market consensus. The m/m measure of inflation in October beat forecasts (0.5% vs. 0.4% market median and our estimate). In our view food prices were still a strong contributor to CPI with reports of several food products (eggs, tomatoes, butter) quickly getting more expensive. We estimate that core inflation might have scaled back from 1% y/y to 0.8% in October. We do not think this reading could cause a change of stance of the MPC as a whole – to hawks it would mean a rising likelihood of hitting a target in some quarters-time, while doves might treat the September rise of inflation as only temporary, seeing that core CPI quickly came down close to the levels seen earlier in the year.

▪ Polish central budget remained in surplus after September which was a surprise. The recent comments from the Ministry of Finance point to 2017 deficit of cPLN30bn vs the planned cPLN60bn. The sound fiscal position has already prompted an amendment to the 2017 budget law (now worked on in the parliament) to allow for more expenditures and there are reports in the local press that another amendment is coming. On the other hand the Ministry is not planning to repeat the advanced pay out of VAT refunds in the final months of the year, as it did in 2016, and which significantly improved gross VAT revenues statistics in 1Q17.

▪ The government approved quickly a draft of the bill that cancels the limit on tax base for charging pension contributions, currently equal to 30 monthly average pays. According to the government's estimates, this should bring additional PLN5.5bn in the first year after implementation. The bill is expected to come into force with the start of 2018.



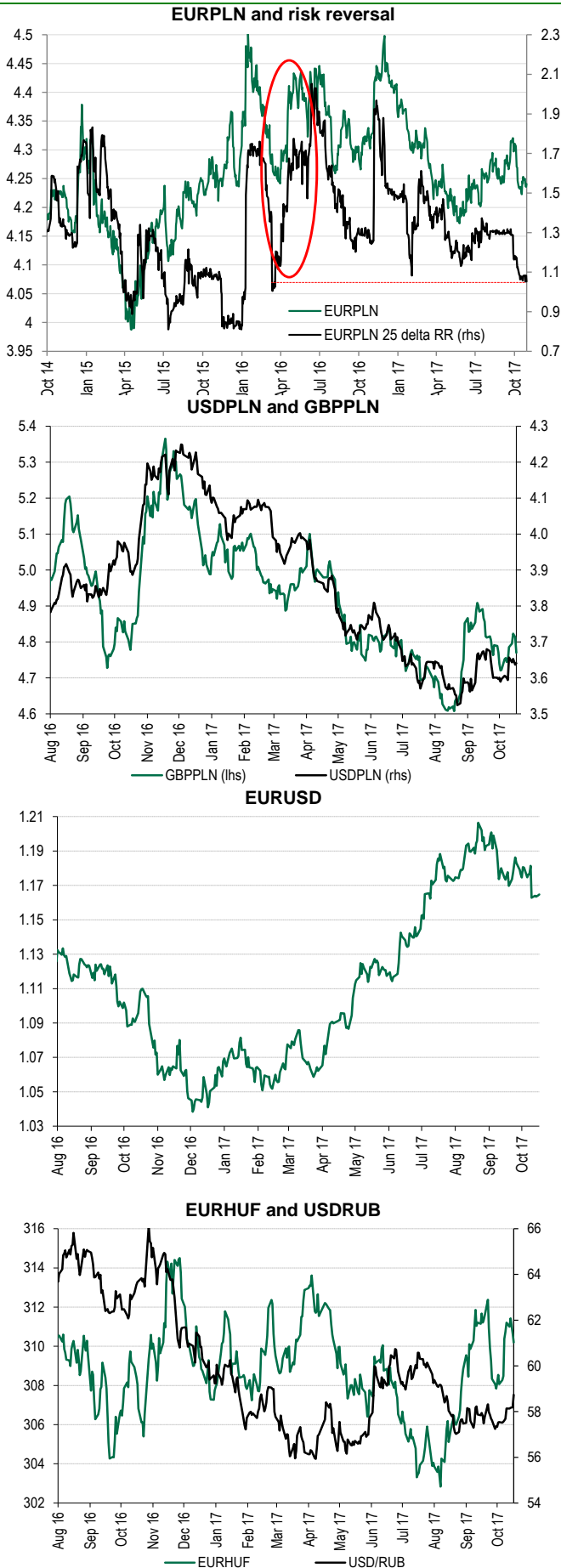
## Quote of the week – Inflationary pressures intensified

### Poland Manufacturing PMI, IHS Markit, 2 November

New order growth was maintained at the strongest rate in over two-and-a-half years, supporting another solid increase in output. Meanwhile, backlogs continued to rise despite renewed job creation. Inflationary pressures intensified, as purchase prices rose at the fastest rate since March and output charges increased at the second-strongest pace in six-and-a-half years.

October PMI reading (53.4 pts) came below market expectations (54 pts) and our forecast (54.4 pts), but the report stressed further positive developments when it comes to new orders, and the job creation index was the strongest since May. It seems that some of the pressure generated by continued strong demand goes to price increases in the face of capacity constraints (pressure on supply chains, labour shortages). What is more, producers are now less hesitant about transferring higher costs to output prices. The Polish index did not narrow the gap to German and Euro zone counterparts in October, but it suggests that the economy maintained the momentum and will be able to post a 4%/y+ growth in 4Q.

## Foreign exchange market – Waiting for trigger



### Low volatility on the Polish FX market

▪ Last week brought no significant changes on the Polish FX market, only GBPPLN plummeted to 4.75 from 4.84 after the “dovish” rate hike delivered by the Bank of England that lead to weaker pound globally. EURPLN remained around 4.24 and USDPLN did not deviate much from 3.65. There was no clear market reaction neither to weaker-than-expected Poland PMI index nor to the announcement that Jerome Powell will be the next Fed governor.

▪ Volatility on the Polish FX market has declined noticeably in the last three weeks. The 3M 25delta risk reversal is trading at its lowest since March 2016. Back then, EURPLN was also around 4.25 and the next two months saw zloty depreciating sharply to above 4.40 per euro. That was mainly triggered by concerns about Polish rating downgrade, data pointing to a noticeable GDP growth slowdown, and government plans to settle the issue of FX mortgage loans. Obviously, currently the situation is exactly the opposite which could indicate that the potential EURPLN rise might be smaller than in 2016 and that some global factor could trigger zloty’s depreciation this time.

▪ This week the economic events calendar is rather light which may mean that Polish FX market could stay stable for at least several more days. However, bearing in mind that periods of low volatility are followed by higher market swings (and EM currencies usually depreciate when volatility rises), we still think the zloty could give up part of recent gains in the year-end horizon.

### EURUSD in a horizontal trend again

▪ EURUSD stayed in the 1.16-1.17 range despite next solid US macro data and nomination of Jerome Powell as the next Fed governor. Elsewhere on the core FX market, EURGBP jumped to c0.894 from 0.873 and GBPUSD fell to 1.306 from 1.33 after the Bank of England delivered a “dovish” rate hike (by 0.25bp to 0.50%).

▪ So far, breaking the lower end of 1.166-1.188 range has not triggered further dollar’s appreciation and EURUSD, just like EURPLN, is fairly stable waiting for a trigger. This week, we will not learn many vital data so the situation on the market is likely to remain calm for at least few more days.

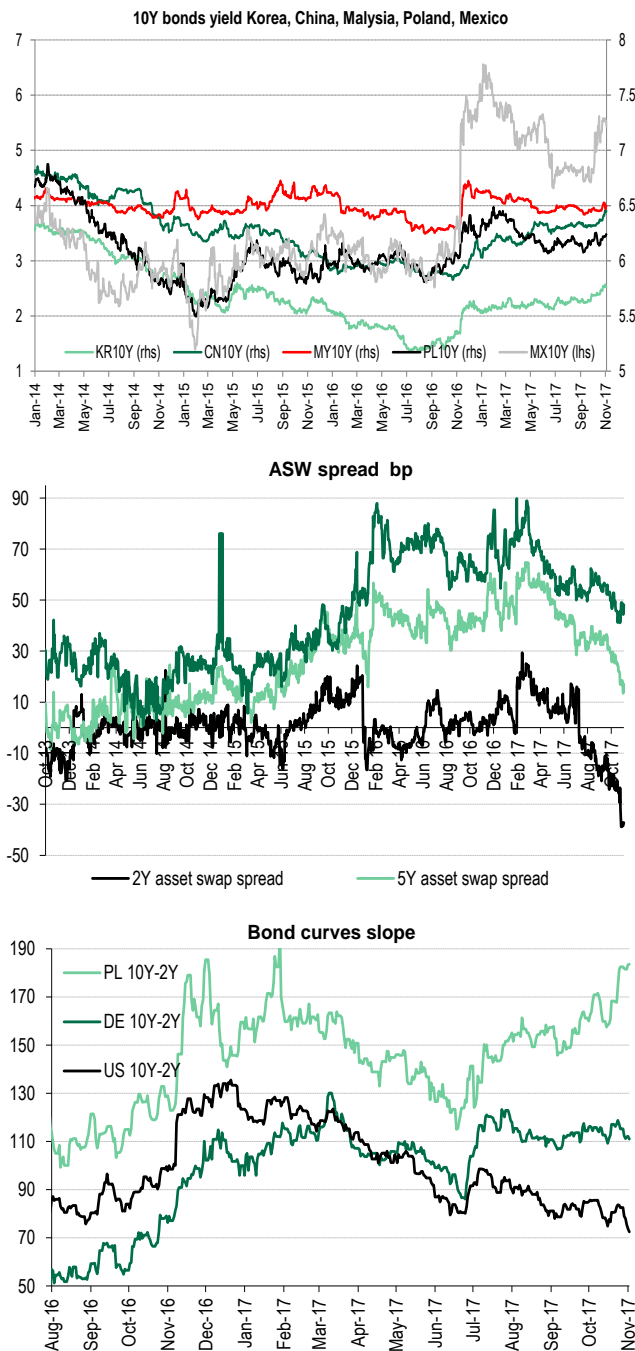
### Koruna weaker after rate hike

▪ The Czech central bank (CNB) raised interest rates by 25bp, the main rate to 0.50%. In recent weeks, some of the Czech policymakers suggested a move by 50bp but the governor Jiri Rusnok commented last week that the announced decision was unanimous. In his view, there could be further policy normalization down the road, including on the next December meeting. Still, EURCZK jumped above 25.73 on failed hopes for a 50bp rate hike and after several weeks of decline of the exchange rate ahead of the CNB meeting.

▪ Russian ruble also depreciated with USDRUB rising to 58.56 from 57.8 amid strong dollar and despite the continued rise of oil prices.

▪ EURHUF stayed at an elevated level reached in the previous weeks and was hovering around 311.

## Interest rate market – Yield increase after the switch auction?



### The post-Halloween sell-off

Over the last week on the domestic market, we observed rising IRS rates as well as bond yields. Rates and yields increases were observed in the second part of the week (after Wednesday market holiday). Polish flash CPI reading (announced on Tuesday) did not negatively affect domestic bonds pricing. The bond prices stabilization was supported by information about January-September budget surplus. The announcement of one regular auction at the end of November was received neutrally by the market. Also the core markets data did not negatively affect Polish t-bonds. The higher than expected US consumer spending and incomes data as well as US consumer confidence data were ignored by the market players, who waited for the Fed chairman successor and Fed communique. In the second part of the week, the domestic yield curve rose by 3bp in 2Y segment and 4-5 bp on the belly and long end of the curve. The IRS curve increased stronger and reached 7 bp on the long end. Changes of the IRS and yield curves were local, though they were not a reaction to the local data. In relation to last Friday the ASW spreads changed marginally.

### One regular auction in November

Ministry of Finance (MoF) announced one regular debt auction (23-Nov-17) and one switch tender in November (09-Nov-17). On the regular tender MoF decided to offer PLN4-8bn bonds (fix -OK0720, PS0123, DS0727 and float- WZ1122, WZ0528).

### The FRA curve pricing the first hike rate in Nov'18

Over the last week, the FRA curve was pushed up by 1-2 bp on the short end and by 5 bp in the 12X15-21X24 segment. This means that the market expects one 25-point rate hike in a 12-month perspective.

### Waiting for sell-off of the long end

Early this week, we expect some correction of the last week increases of the yield curve, while the second part of the week, we anticipate middle part and long end of the yield curve upward. This scenario will be supported by light macroeconomic data calendar. On the domestic market, investors will be rather focused on the core market events and data (FOMC members Dudley and Quarles speaks) than on the domestic one (MPC conference). In the next weeks horizon, we expect series of domestic data release. In our opinion the data will likely beat the expectations, which will support the sell-off of the belly and the long end of the curve. The trigger for this move may be the switch auction (scheduled on Thursday). Ministry of Finance (MoF) is planned to offer OK0720, WZ1122, PS0123, DS0727, WZ0528 bonds. On the tender, we expect limited offer of shorter OK0720 bonds. It should help to hold the short end of the curve on the lower level.

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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](mailto:ekonomia@bzwbk.pl)