WEEKLY ECONOMIC UPDATE

20 – 26 November 2017

Last week was rather calm as regards global events, with rising optimism about the US tax reform and good GDP data from the Euro zone as the main market drivers. In Poland, we saw some upward surprises in GDP, current account and wage data, as well as numerous comments from the MPC members, including two hawks suggesting a need to hike rates as early as in 1Q18. However, impact on the Polish assets was only temporary.
This week we will get to see flash PMI data from Europe. They are amongst crucial numbers as regards expectations about ECB policy normalization, recently fueled by positive data from the Euro zone. Currently the market is expecting some downward correction, so better reading can be a real market mover. In Poland, data on real activity are due for release. In our view, these numbers will be positive, further supporting expectations for rate hikes in Poland and bringing up yields on the shorter end of Polish end curve. Moreover, we expect the Finance Ministry to offer mostly longer maturity securities on Thursday auction, so also the longer end may be under pressure in the second half of the week. Still, domestic factors should remain positive for the Polish currency, yet the market reaction may be limited given large scale of strengthening witnessed recently.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 November)					
14:00	**PL**	**Industrial output**	**Oct**	**% y/y**	**9.9**	**11.3**	**4.3**
14:00	**PL**	**Construction and assembly output**	**Oct**	**% y/y**	**23.6**	**25.7**	**15.5**
14:00	**PL**	**PPI**	**Oct**	**% y/y**	**2.8**	**2.7**	**3.1**
14:00	**PL**	**Real retail sales**	**Oct**	**% y/y**	**7.2**	**7.2**	**7.5**
		TUESDAY (21 November)					
14:00	HU	Central bank decision		%	0.90	-	0.90
14:00	**PL**	**Corporate sector financial results**	**3Q**				
16:00	US	Home sales	Oct	% m/m	0.19	-	0.75
		WEDNESDAY (22 November)					
14:30	US	Durable goods orders	Oct	% m/m	0.3	-	2.0
14:30	US	Initial jobless claims	week	k	235	-	249
16:00	US	Michigan index	Nov	pts	98.2	-	97.8
20:00	US	FOMC minutes					
		THURSDAY (23 November)					
9:30	DE	Flash PMI – manufacturing	Nov	pts	60.3	-	60.6
9:30	DE	Flash PMI – services	Nov	pts	55.0	-	54.7
10:00	EZ	Flash PMI – manufacturing	Nov	pts	58.2	-	58.5
10:00	EZ	Flash PMI – services	Nov	pts	55.2	-	55
10:00	EZ	Flash PMI – manufacturing	Nov	pts	58.2	-	58.5
11:00	**PL**	**Bond auction**					
14:00	**PL**	**MPC minutes**					
14:00	**PL**	**Money supply M3**	**Oct**	**% y/y**	**5.5**	**5.6**	**5.4**
		FRIDAY (24 November)					
10:00	DE	Ifo	Nov	pts	116.5	-	116.7
10:00	**PL**	**Unemployment rate**	**Oct**	**%**	**6.7**	**6.6**	**6.8**

Source: BZ WBK, Reuters, Bloomberg

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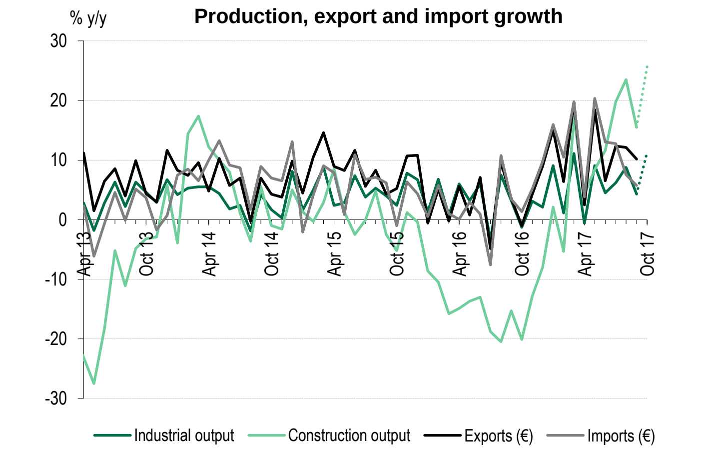
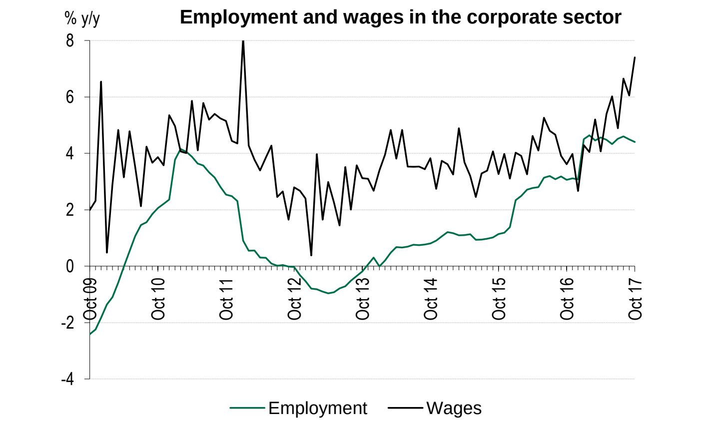
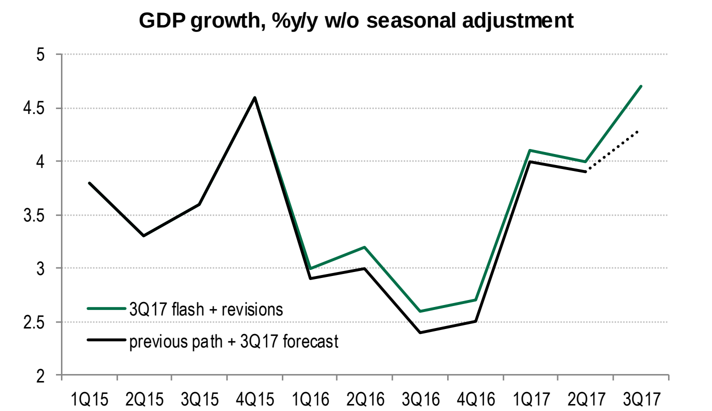
What's hot next week – Waiting for investments



- The economy is waiting for investment rebound as 1H provided no signs of improvement. The flash 3Q GDP reading (giving only the headline growth) was so high that it seems investment had to play a part. We are waiting for confirmation investments rose in 3Q and there will be releases this week that could help – corporate sector financial results on Tuesday with a paragraph on investments in enterprises with 50+ employment and Statistical Bulletin on Friday with the value of new investment outlays.
- Real activity data for the first month of 4Q should come on the strong side. We expect industrial and construction output to beat the market consensus while real retail sales growth could exceed 7% y/y again.
- MPC minutes are now a far better gauge of the balance of power inside the Council than the statement, and may include important remarks regarding new NBP projections.

Last week in economy – Strong 3Q GDP and wage growth





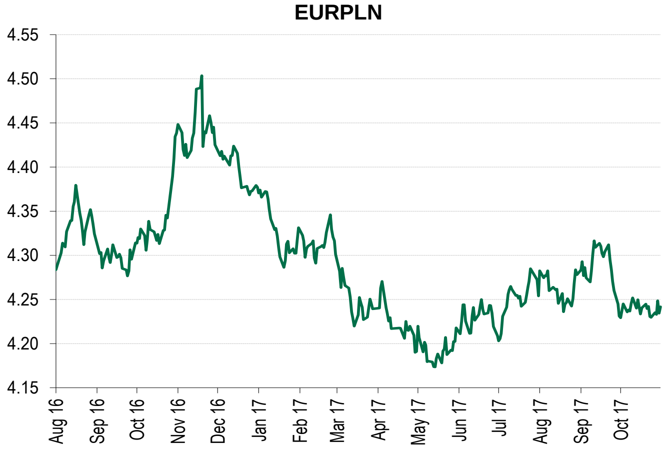
- Wages increased 7.4% y/y in October, up from 6.0% vs 6.6% consensus. In our view the acceleration of wages vs. September came from three factors: the positive working days effect (adding c0.5pp), rising wage pressure and one-off effects like bonus payments. Employment rose 4.4% y/y in October, close to expectations.
- September current account deficit was only €100mn (consensus -€350mn, our forecast of -€667mn). Exports surprised to the upside while imports disappointed again. Surprisingly good results of foreign trade must have stood behind the surprisingly strong 3Q GDP growth at 4.7% y/y according to GUS flash estimate.
- Seasonally adjusted y/y growth reached 5% and y/y growth rates for the previous six quarters were revised up. The structure of 3Q GDP is yet not known but stat office official confirmed that consumption growth was even stronger than in 2Q. The net export contribution turned positive, in our view (after -1.5pp in 2Q). The biggest question mark is investment growth. We think that there was a modest revival in 3Q17 (near 4% y/y), which was suggested by rising construction output, and the next quarters should see a further recovery. While GDP growth might decline in 4Q, the entire year should end up with GDP growth at 4.3% (versus 2.9% in 2016).
- Inflation declined from 2.2% y/y to 2.1% in October. Core CPI returned from 1% y/y to 0.8%, which means it made no progress since April. We expect that in November the CPI inflation will rise again, even to 2.3-2.4% y/y amid continuing growth in food prices, and a surge in fuel prices triggered by a recent spike in Brent oil. In December we may see a drop again but probably not below 2% y/y.

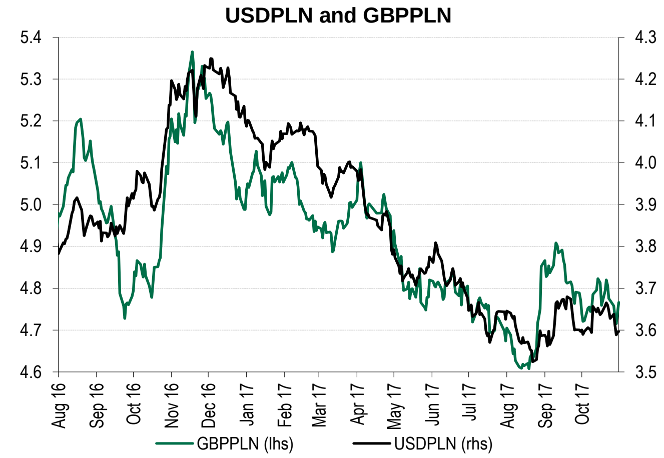
Quote of the week – The governor may be right

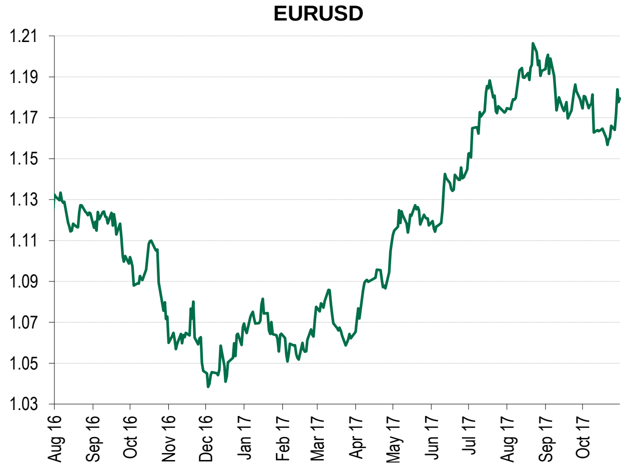
Grażyna Ancyparowicz, MPC member, Reuters, 15 November
The governor may be right in assuming a pause on rates until end-2018. We must not raise the cost of money in the face of such sluggish investment.
Łukasz Hardt, MPC member, Rzeczpospolita, 15 November
I said it's too early to call for tightening at the press conference, but it doesn't mean it will still be too early in February or March.
Rafał Sura, MPC member, Bloomberg, 13 November
I would be for beginning the discussion about tightening in the middle of the next year if I see further acceleration of inflation after 2019.
Eugeniusz Gatnar, MPC member, PAP, Bloomberg, 16 November
Polish CPI may reach target in 1Q 2018 and it will be the right moment to raise rates by 25bps. I don't see why inflation should fall after 1Q.
Jerzy Kropiwnicki. MPC member, Reuters, 16 November
I do not see a risk of inflation exceeding the upper band from the inflation target, I believe rates should remain where they are now. At least for the coming year.

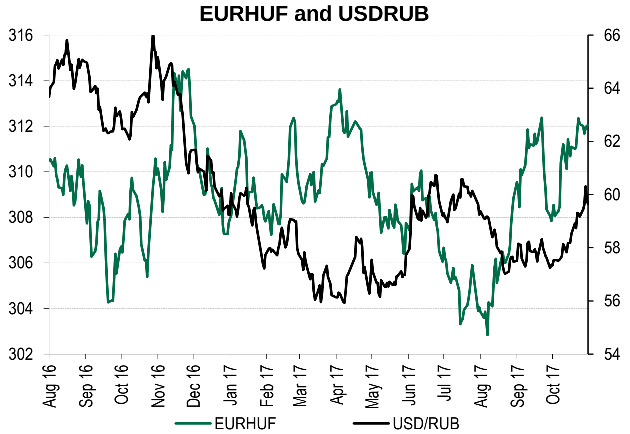
The new NBP projection showed a higher CPI path. When the projection was released, one could assume that that the higher CPI path in 2018 (from 2% to 2.3%) had to do with accelerating wages pushing core CPI up. It was not the case – the rise came from energy and food prices. Core inflation forecast was raised but only for 2019 (to 2.7%). Some MPC members we had considered as potential hawks (Ancyparowicz, Kropiwnicki) softened rhetoric having analyzed the projection, while others (Hardt, Gatnar) confirmed their opinion that a rate hike in 1Q18 (ie much sooner than the market and analysts predict) may be needed. We think that hard data in coming months (mainly wages, CPI, investments) will decide on the MPC stance. Strong releases should encourage more members to consider earlier hikes.

Foreign exchange market – EURPLN still in a range









EURPLN still in range

- EURPLN continued to move sideways around 4.23. Just like we suspected, zloty's positive reaction to strong Polish flash 3Q GDP data was only temporary. Somewhat higher volatility of EURUSD (see below) also failed to trigger any noticeable and persistent move of EURPLN. USDPLN fell to 3.58 from 3.64 but remained in the wide 3.57-3.68 range witnessed since late September. CHFPLN continued gradual downward trend and neared 3.61 with GBPPLN staying close to 4.74.
- This week we will learn Polish October industrial output and retail sales data. Our forecast for the former is somewhat above the consensus. It should be noted though that for the five weeks now the zloty has not been responding noticeably to any positive signals from the domestic economy and we do not expect this week be anyhow different. Obviously, a lot of supportive information has already been priced in. Also, the most recent comments of the MPC members clearly showed that there is still a long way to the first interest rate hike in Poland.
- Volatility on the Polish FX market is still very low and the zloty is still waiting for the trigger. For now, we can only repeat that that periods of low volatility are followed by higher market swings and EM currencies usually depreciate when volatility rises. Our base case scenario is EURPLN going slightly up in the remainder of the year.

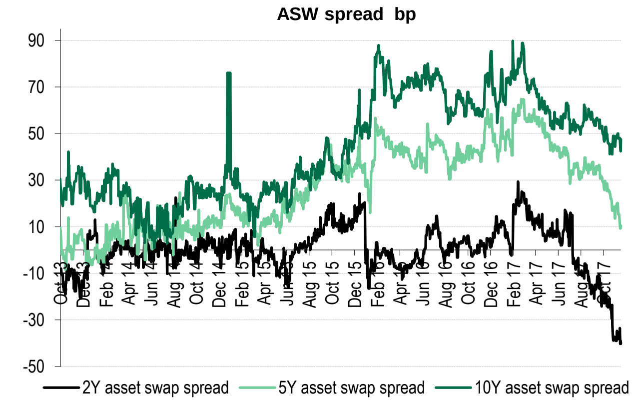
Euro gains on European data

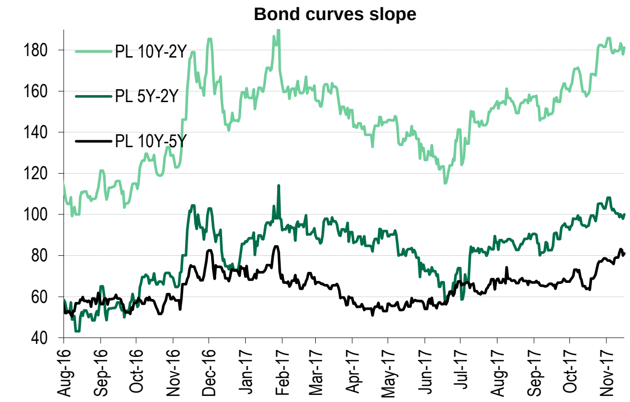
- Volatility of EURUSD rose somewhat owing to better-than-expected European flash GDP data and mixed news-flow from the US on the tax reform progress. As a result, EURUSD rose sharply but temporarily to 1.186 from 1.165 leaving the 1.155-1.17 trading range observed since mid-October.
- EURUSD neared the 1.188 resistance and this week's events could determine if this level is broken or not. Flash 3Q GDP data released in Europe boosted the euro and so could flash November PMI's if they surprise to the upside. However, the dollar could regain ground if US policymakers agree on the final shape of the tax reform.

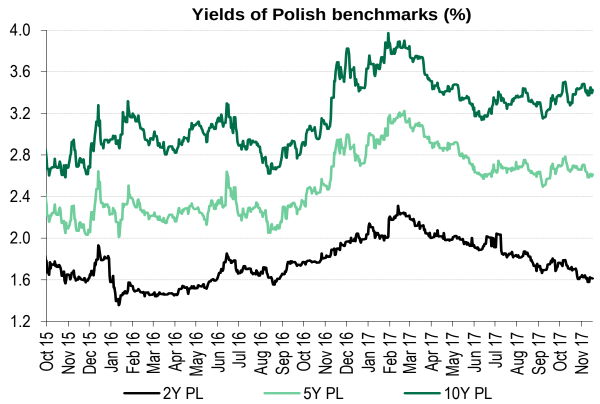
Other CEE currencies hold their trends

- Russian ruble continued to depreciate vs the dollar as the oil prices fell last week. As a result, USDRUB jumped above 60 (its highest since August) from 59. We think the exchange rate could rise further in the weeks to come.
- Czech koruna remained strong as head of the central bank said more rate hikes are on the horizon. Comment of Jiri Rusnok helped EURCZK to stay near its multiyear low at 25.5.
- This week the Hungarian central bank (MNB) will decide on the interest rates. MNB maintains its dovish rhetoric repeating it is ready to ease monetary policy further if needed. In our view, the central bank will keep its easing bias but could refrain from taking any action this month. We do not expect forint to gain after the MNB meeting and EURHUF may stay near 312-313, its highest since May.

Interest rate market – Yield curve likely to steepen







Yields followed the European data

- Last week we observed slight sell-off of domestic bonds, after the previous week rally. The stronger (5bp) move was seen on the long end of the curve. The belly and the front end were pulled up by 3 bp. The most of this move was observed on Monday when the market rebounded after the previous week falls. The sell-off of longer bonds was supported by surprising strong current account data (released on Monday). Since Tuesday the market moves have been correlated with core market activity, while in the rest of the week yields stayed in the horizontal trend. Only the yields of 2Y bonds gradually decreased. In the second part of the week, the domestic market was driven by core market's data. On the US market, investors was focused on the tax reform process approve. On the European front, the market attention was focused on the GDP and inflation data as well as on the progress in German coalition talks. The European GDP data surprised mostly on the positive side. The domestic GDP and wages (better than estimates) data, as well as inflation data, were ignored by investors.The belly and the long end of the IRS curve were pulled up strongly at the beginning of the week. This move was partly neutralized in the second part of the week. The front end of the IRS curve remained stable. The FRA curve went up by 5 bp in the segment +12M.

Asset swap spreads go down

- Those changes were reflected in asset swap spreads narrowing, the strongest in the 4-5 segment. In our opinion, it was a result of a shift of investors demands from the front end of the curve to the belly, in the circumstances of extremely low short end ASW spread.

Bonds auction

- On Thursday the Ministry of Finance will hold a regular bond auction when it intends to sell debt for PLN4-8bn. We think that the Ministry will try to extend the average debt maturity and so most of the issuance will consist of the WZ1122 and WZ0528 floaters and fixed coupon PS0123 and DS0727. Zero-coupon OK0720 shall again have the smallest share in total sale.

The domestic data will pull the long end up

- At the beginning of the week, we expect Polish bonds to be under pressure after strong readings of industrial output, construction output and retail sales. Later in the week, belly and short end should stabilize. In our view, flash PMIs in Europe could be somewhat weaker than recently and could generate a downside pressure on IRS/yields. Long-term rates could rise after the bond auction scheduled for Thursday. We still expect the asset swaps to narrow in 3-6Y segment. In our view, this could be the result of strong demand for these bonds from banking sector amid rising share of short-term on-demand deposits.

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