WEEKLY ECONOMIC UPDATE

27 November – 3 December 2017

GDP, CPI and PMI data will be released in the coming week. As regards economic growth, we will see not only its breakdown in 3Q17 but also revisions of the quarterly figures for the two previous years. We guess that the strong private consumption and positive net exports played important role in fueling GDP growth, but the most interesting will be data about investments. Last week's releases showed that local governments accelerated investment outlays but big companies are still delaying spending. We think that total investment growth could be slightly above 4% y/y. Flash CPI inflation is likely to show a jump to 2.4% y/y in November, nearing the official target, and driven mainly by higher prices of food and fuels. As regards the PMI, we see arguments that the Polish indicator should finally start converging with the corresponding measures for Germany and euro zone, which already hit 60 pts., so our forecast is 54.6. But we should mention that we had similar intuition in the previous months and this theory did not really work well.
Strong rise in November's flash CPI and improvement in PMI can surprise market, but we think the zloty has priced-in already many positive news about Polish economy, so the room for further strengthening is limited. Moreover, the uncertainty about government reshuffle and changes in judiciary system is in the air. Strong PMI and GDP should be positive for credit risk; yet, we do not expect bond yields to drop further – they may rather increase to smaller degree than swap rates.

Economic calendar

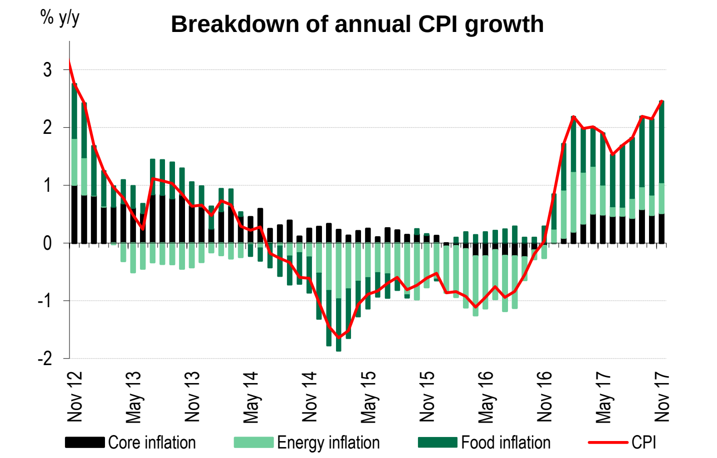
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 November)					
16:00	US	New home sales	Oct	% m/m	-6.53	-	18.9
		TUESDAY (28 November)					
16:00	US	Conference Board index	Nov	pts	123.5	-	125.9
		WEDNESDAY (29 November)					
14:30	US	Preliminary GDP	Q3	% q/q	3.2	-	3.0
16:00	US	Pending home sales	Oct	% m/m	1.1	-	0.0
20:00	US	Fed Beige Book					
		THURSDAY (30 November)					
10:00	**PL**	**GDP**	**Q3**	**% y/y**	**4.7**	**4.7**	**4.0**
10:00	**PL**	**Investments**	**Q3**	**% y/y**	**4.5**	**4.4**	**0.8**
10:00	**PL**	**Private consumption**	**Q3**	**% y/y**	**4.9**	**5.1**	**4.9**
11:00	EC	Flash CPI	Nov	% y/y	-	-	1.4
11:00	EC	Unemployment rate	Oct	%	-	-	8.9
14:00	**PL**	**Flash CPI**	**Nov**	**% y/y**	**2.3**	**2.4**	**2.1**
14:30	US	Initial jobless claims	week	k	240	-	239
14:30	US	Personal spending	Oct	% m/m	0.2	-	1.0
14:30	US	Personal income	Oct	% m/m	0.3	-	0.4
		FRIDAY (1 December)					
09:00	**PL**	**PMI manufacturing**	**Nov**	**pts**	**53.8**	**54.6**	**53.4**
09:00	CZ	GDP	Q3	% y/y	-	-	5.0
9:55	DE	PMI – manufacturing	Nov	pts	60.6	-	60.6
10:00	EZ	PMI – manufacturing	Nov	pts	58.5	-	58.5
16:00	US	ISM manufacturing	Nov	pts	58.3	-	58.7

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

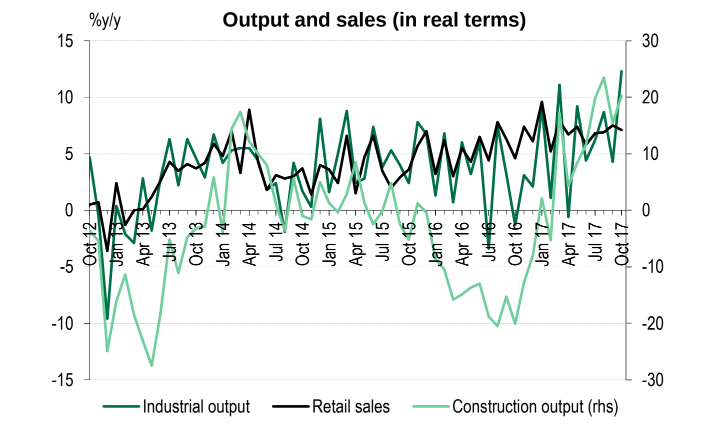
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

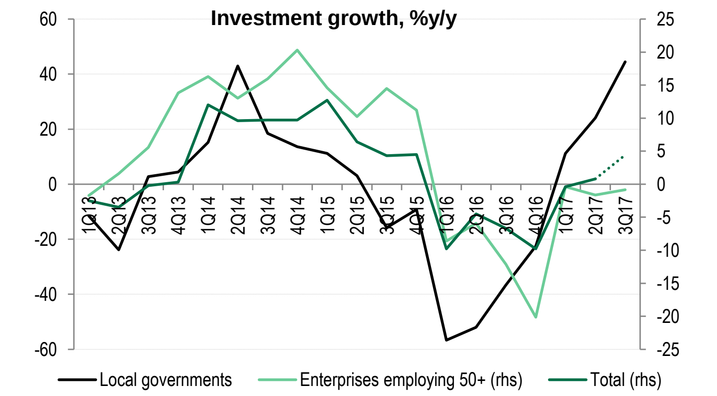
What's hot next week – CPI approaching target, the structure of GDP growth



- The partial data on investments from last week have made us wait even more impatiently for the 3Q GDP details. With enterprises employing 50+ people still on the sidelines we could well see that there is still no clear-cut evidence of investment rebound. This could also mean that much of the surprisingly strong 3Q GDP growth of 4.7% y/y came from inventory changes (apart from private consumption, which in our view added 3pp+ to overall growth, and net exports).
- Inflation was pretty close to staying at 2.2% y/y in October, but the next reading should be at 2.4% or even 2.5%, mostly due to higher prices of fuel and to some extent also food. House maintenance costs are also an important category after its surge in October on rising price of coal.
- Euro zone PMIs surged again and the Polish index may rise as well, especially that GUS indicators suggested some improvement in sentiment.

Last week in economy – Closing the 2016 gap





- Industrial output growth accelerated to 12.3% y/y (9.7% after seasonal adjustment), beating market consensus at 9.9%. Manufacturing output rose by as much as 14% y/y (the best result since Dec 2010). The data confirm that solid expansion of Polish industrial sector continues, driven by a strong economic growth in the euro zone. Meanwhile, construction production rose 20.3% y/y, which was a bit less than expected (market consensus 23.9%), but still it is a decent result. Retail sales rose 7.1% y/y in constant prices (BBG consensus 7.5% y/y). In general, the data suggest that the economic growth at the start of 4Q17 remains solid, and may even be similar to the impressive 4.7% y/y recorded in 3Q.
- Local government balance could prove neutral for the general government fiscal position in the whole 2017, judging by the PLN14.7bn surplus in 1-3Q. Local government investment spending rose by 45% y/y in nominal terms in 3Q17 (but from an extremely low base), which implies that they may have added c.3 pct. points to total investment growth and 0.5-0.6 pct. points to GDP growth - the most in at least four years.
- Data on companies employing at least 50 people showed no revival in investment in 3Q17. According to our calculations based on YTD data from Stats Office, in 3Q17 real investment outlays fell by 0.8% y/y as compared to a decline of 1.6% y/y in 2Q17. Thus, companies with 50+ employees saw negative y/y investment growth for the seventh quarter in a row.
- Wage growth accelerated broadly across the enterprise sector in October. The overall surge from 6% y/y to 7.4% was not caused by a one-off, and the measure excluding the volatile mining sector data showed a move from 6.2% y/y to 7.5% - the highest since Oct-08.

Quote of the week – MPC in 'wait-and-sleep' mode

Kamil Zubelewicz, MPC member, Bloomberg, 22 November
I've been increasingly convinced and concerned that interest rates in Poland will be put on hold throughout 2019, or even longer. I have no doubt the MPC's tolerance toward inflation is quite high, and definitely much higher than mine. The Council needs to snap out of its 'wait-and-sleep' mode. It's being reiterated that keeping the rate on hold has worked for the benefit of macroeconomic stability and sustained economic growth -- whereas in fact we foresee weaker GDP growth, slowing investments and accelerating prices. No, I don't see a well-balanced economy.

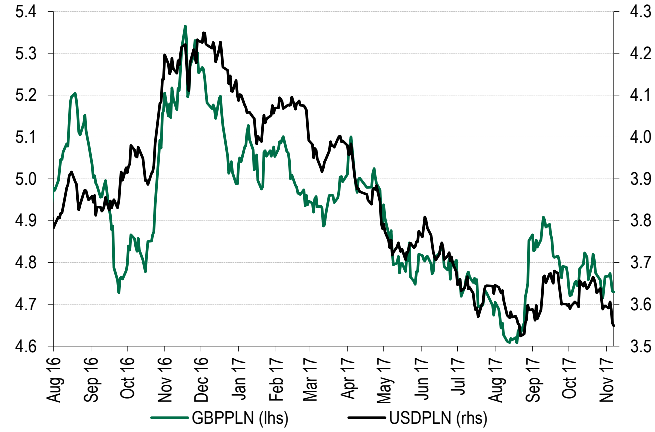
Jerzy Osiatyński, MPC member, Bloomberg, 20 November
Based on all the evidence we have now, nothing indicates that a lid will stay on wage growth to prevent it from outpacing labour productivity. I don't share the confidence of many that Poland may safely navigate with the same wait-and-see bias and the same interest rate level throughout 2018.

MPC November minutes state that majority of members still admits that rates should remain stable in the coming quarters, which will allow inflation to keep close to the target. Sizeable paragraphs covering the discussion on investments and labour market show the rising internal tensions. Still, the main parts of the minutes do not suggest that the MPC hawks are about to gain advantage (Zubelewicz even used a term 'wait-and-sleep' to describe the approach of the majority). There could be a motion to raise rates in 1Q, but in our view it could only be passed later in 2018. If CPI comes as high as we expect hawks may become more vocal, especially with wage growth rising so quickly. On the other hand, if 3Q GDP data confirms another delay in investment rebound, it would be difficult for the hawks to convince anyone more to vote for a rate hike at least before late 2018.

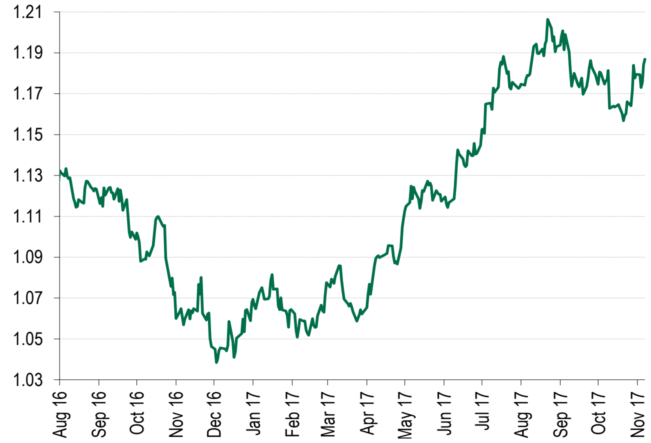
Foreign exchange market – EURPLN close to next support

EURPLN

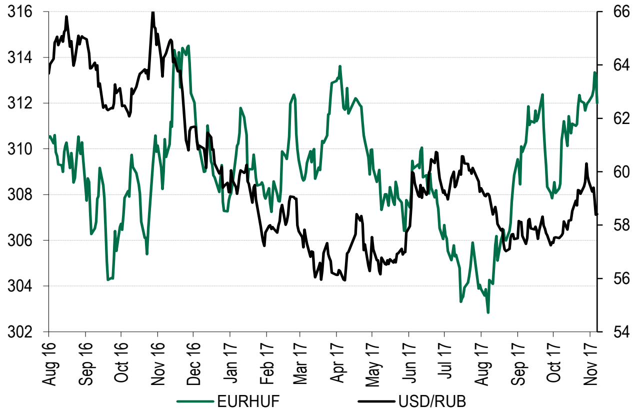
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



EURPLN below 4.22

- Recent days saw EURPLN breaking the lower end of the 4.22-4.25 range observed since early October. Positive global market mood (supporting risky assets) and surprising decision of the Hungarian central bank (details in the final paragraph) pushed the exchange rate down to c4.20, its lowest since late July. Falling EURPLN and rising EURUSD pushed USDPLN to 3.53, its lowest since September. At the same time, CHFPLN remained fairly stable around 3.62 while GBPPLN stayed near 4.74.
- EURPLN broke the support at 4.22 and neared next crucial level at just below 4.20, July's bottom.
- This week, we will learn detailed 3Q GDP data and flash CPI for November. The headline GDP shall not differ much from the first estimate and changes in components will rather not look too hawkish (we have not seen any clear evidence of any substantial revival of investments). Flash November inflation may rise noticeably vs October but like we wrote previously, recent currency-positive news have already been largely priced-in and the Thursday's data should not generate strong down pressure on EURPLN.
- Also, the recent strong European data might turn investors' attention to the ECB's reducing its QE program which could put some pressure on the CEE currencies.

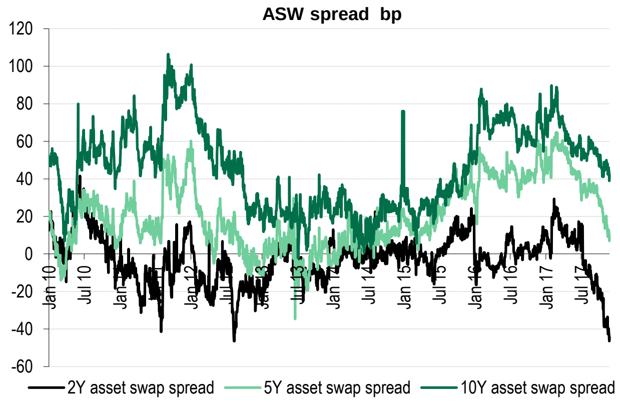
PMIs boost euro

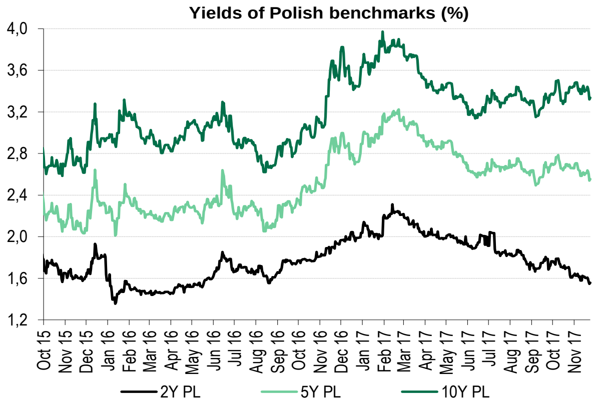
- EURUSD was rising for the third week in a row amid strong data from Europe (flash PMIs), dovish tone of the FOMC minutes and some piece of below-consensus data released at the end of the week when the liquidity was low. As a result, climbed to c1.193 breaking the local peak at just below 1.19 established in October. Negative impact of news from Germany on collapse of coalition talks proved only temporary.
- EURUSD has broken an important resistance level door for further rise towards this year's peak at slightly below 1.21 are open. This week, many US data are on the agenda. Fixed income market is fully pricing the Fed 25bp rate hike in December but the dollar has lost some ground in the recent days. If the US figures look strong, the greenback might recover slightly.

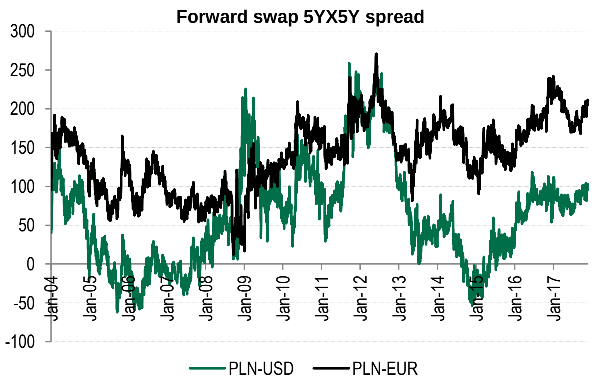
Forint underperforms after the MNB decision

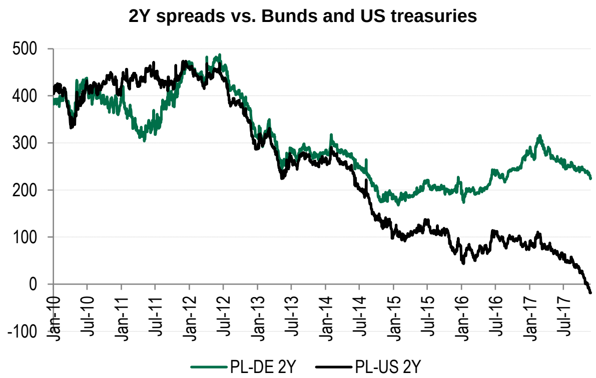
- Hungarian central bank (MBN) left interest rates unchanged with the main refi rate still at 0.90%. However, MNB decided to take action aimed at reviving fixed rate mortgages. It decided that it will start buying fixed-income mortgage bonds in order to lower yields and will introduce unconditional swaps. This decision generated additional pressure on the forint pushing EURHUF temporarily above 314, its highest since mid-April.
- The ruble gained vs the dollar amid rebound of oil price and weaker dollar worldwide. As a result, UDSRUB plummeted to 58.38 from above 59. The exchange rate neared first support and we think the room for further ruble appreciation is limited in the short term.
- Czech koruna resumed the appreciation trend and EURCZK fell below 25.5 and reached 25.4. This week Czech 3Q GDP will be released. Flash estimate pointed to acceleration to 5% y/y vs 4.7% y/y in 2Q and if this is confirmed the release shall not have much impact on the koruna.

Interest rate market – Bonds rally amid debt shortage









2Y ASW on the new record low

▪ At the beginning of the last week, the domestic yields were rising. The yield curve was pushed up by the fast pace of wages growth, record high dynamic of industrial production as well as by the US yields bonds upward move. However, the jump of the domestic market was relatively small if we compare it to power and number of impulses. On the peak, the domestic yield curve was pushed up by 2-4 bp, stronger on the long end of the curve. In the second part of the week, the yields were decreasing. The trigger for this move was a fear about political uncertainty in Europe after the coalition talks in Germany collapsed and the weaker inflation expectations reading (in Michigan index) as well as unexpectedly dovish Fed minutes (published on Wednesday). The end of the week saw rally on the bonds market. First of all Ministry of Finance decided to cut maximum auction offer from PLN8bn to PLN4bn. Second of all high auction demand strongly pushed the yield down. As a result, on the weekly basis, we observed 12 bp falls on the long end of the curve, 10 bp in the belly and by 6 bp on the front end. A slight smaller move we observed on the IRS curve, where rates dropped by 5 and 4 on the 5Y and 10Y segment respectively, and 2 bp hike on the front end. As a result, the 2Y Asset swap spread dropped to five year low.

Bond auction

▪ At the regular bond auction, the Ministry of Finance sold bonds for PLN4bn amid demand at PLN13.8bn (bid-to-cover ratio at 3.46). Most of the cash was raised from WZ1122 (PLN980mn) and WZ0528 (PLN940mn). After the auction, the Ministry said that this year's gross borrowing needs are now covered in 95.5%.

Strong PMI will push the long end up

▪ This week, we expect the domestic GDP details release, flash CPI data, and PMI. We think that solid PMI reading and GDP details will positively affect the credit risk assessment for Polish bonds. It will probably translate into slight asset swap (ASW) spread compression. Expected by us the small scale of ASW curve downshifts is a consequence of impressive ASW spread drop in the last weeks, which consumed most of the positive information from the domestic economy. The same we think that ASW compression will not be connected with yields falls. We think that likely solid GDP details, strong PMI and higher CPI will pull the belly and the long end of the bond yield curve up, however in the smaller scale than expected by us upshift of IRS curve.

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