

WEEKLY ECONOMIC UPDATE

27 August – 2 September 2018

The zloty gained amid a fairly positive global market sentiment and decent Polish macro data while situation on the Polish fixed income market has not changed significantly with the yields holding the horizontal trends despite the bond switch auction and government releasing the 2019 budget draft.

Next week we will see some important US data. In our view, these releases should be viewed in the context of the Fed's Powell speech at the Jackson Hole symposium that will take place later this Friday. We think Polish data should be of a secondary importance. Final 2Q GDP is likely to be close to the flash estimate and the breakdown that will be published shall not be a meaningful impulse for the market at the end of the week. Flash August CPI will show a decline vs July, in our view. Our forecasts is below market consensus.

We think EURPLN could stay somewhere near 4.30 in the days to come while bond yields could rise slightly as debt issuance at September auctions is likely to be larger than in the previous weeks.

Economic calendar

TIME	COUNTRY	INDICATOR	PERIOD		MARKET	BZWBK	OSTATNIA
CET							WARTOŚĆ
MONDAY (27 August)							
10:00	DE	Ifo index	Aug	pts	101.9	-	101.7
TUESDAY (28 August)							
16:00	US	Consumer confidence index	Aug	pts	126.5	-	127.4
WEDNESDAY (29 August)							
14:30	US	Preliminary GDP	Q2	% q/q	4.0	-	4.1
16:00	US	Pending home sales	Jun	% m/m	0.5	-	0.9
THURSDAY (30 August)							
14:30	US	Consumer income	Jul	% m/m	0.4	-	0.4
14:30	US	Consumer spending	Jul	% m/m	0.4	-	0.4
14:30	US	Initial jobless claims	week	k	-	-	210
FRIDAY (31 August)							
9:00	CZ	GDP	Q2	% y/y	2.3	-	2.3
10:00	PL	GDP	Q2	% y/y	5.1	5.1	5.2
10:00	PL	Flash CPI	Aug	% y/y	2.0	1.8	2.0
11:00	EZ	Flash HICP	Aug	% y/y	2.0	-	1.9
16:00	US	Michigan index	Aug	pts	95.7	-	95.3

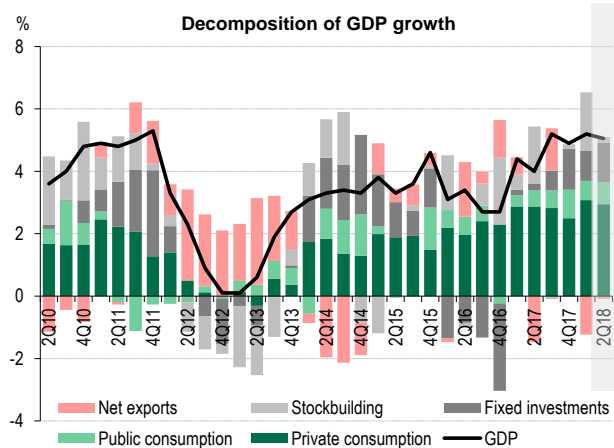
Source: BZ WBK, Reuters, Bloomberg

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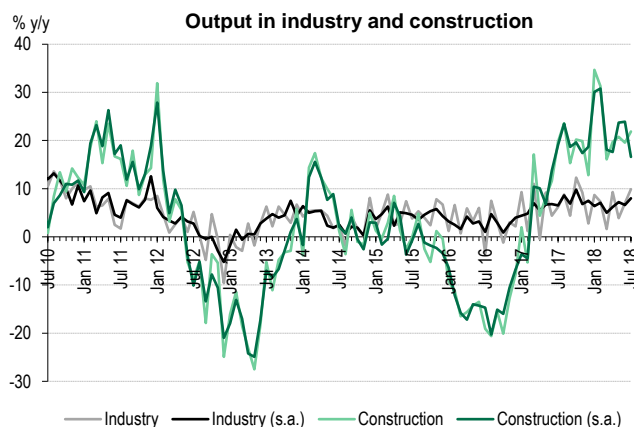
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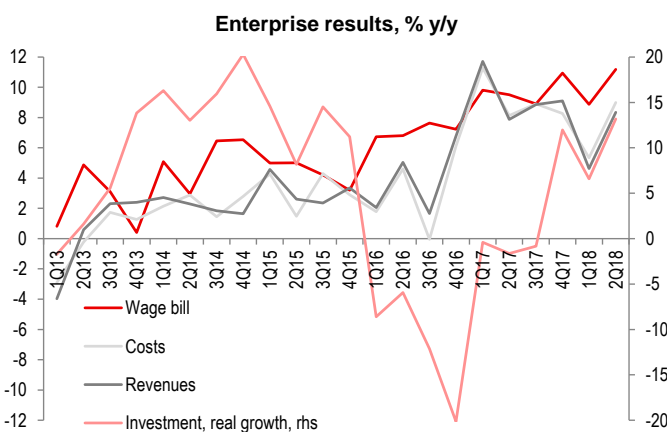
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What's hot next week – Full GDP breakdown, flash CPI

- We assume that the private consumption remained strong at c5% y/y, supported by healthy growth of households' income. Recent data on investment in biggest companies and local governments (details below) suggest that investment growth may be faster than 8% y/y. The contribution of net exports to GDP growth was probably almost neutral, after -1.2pp in 1Q.
- We think that the pace of economic growth in Poland will decelerate slightly in 2H18, amid slowing expansion of investments (construction sector reaching its capacity limits) and a bit more negative contribution from net exports (strong import boosted by domestic demand, export slowly feeling the impact of global trade wars).
- We are expecting CPI inflation to slide to 1.8% y/y in August primarily due to slower growth of food and fuel prices, driven down by base effect, while core inflation will go up to 0.7% y/y. Hike of gas prices will add 0.05pp to CPI, in our view. We are expecting CPI to go down until December.

Last week in economy – Private investment started to revive

- In July, industrial output reached 10.3% y/y vs. 6.8% y/y in June. Construction and assembly output rose 18.7% y/y in July, versus 24.7% y/y in June. We had expected growth to stay above 20%, while at the same time we had underlined the negative impact of labour force scarcity on output. While a slowdown of economic growth in 2H is widely expected, July output data suggest the descent from 5.1% y/y in 2Q (according to flash estimate) will be gradual.
- Retail sales in July rose 7.1% y/y. This result was also below June's level (8.2% y/y), but exactly in line with the average for the first half of the year. The monthly change in July retail sales (0.2% m/m) clearly departs negatively from the seasonal pattern, but the two previous months were unusually strong, so we would not draw strong conclusions from this slight disappointment. In our opinion, the pace of retail sales growth remains decent, supported by rapid growth of households' disposable income. We think private consumption should continue growing at c.5% y/y, remaining one of the main engines of Poland's economic growth.



- In 2Q18, revenues of Polish companies employing at least 50 people rose 8.3% y/y, while costs increased 9.0% y/y. The wage bill rose 11.2% y/y, the fastest pace in at least five years. Costs rose faster than revenues for the second quarter in a row (the last time we saw a similar situation was in 2013), which triggered a decline in profitability to 5.4% from 6.0% in 2Q17. We think that the cost pressures will persist and that a further drop in profitability will ultimately translate into higher growth of final prices.
- Investments in the largest companies showed growth of 13% in 2Q18 (twice as fast as in 1Q18), while investment of local governments rose almost by impressive 90% y/y. This creates upside risk to our estimate, suggesting that in 2Q18 total investment growth in the national economy was slightly below the 1Q18 figure.

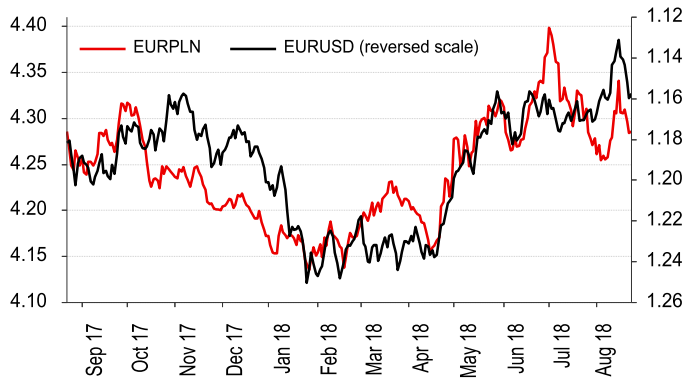
Quote of the week – 2019 deficit lowest in a decade**Draft of central budget for 2019, Finance Ministry, 23 August**

	2018 expected, PLNbn	2019 planned, PLNbn	% y/y
Deficit	23.8	28.5	19.7
Total revenues	367.4	386.9	5.3
VAT	167.3	179.6	7.4
PIT	60.3	64.3	6.6
CIT	34.0	34.8	2.4
Spending	391.2	415.4	6.2

The 2019 budget deficit is planned at PLN28.5bn, the lowest since 2008-09. The GG deficit was earmarked at 1.8% of GDP. The budget expenses have been planned at a moderate level, given circumstances: elections calendar (parliamentary elections in 2019), and additional discretionary spending costs, i.e. pay rise for teachers (PLN1.8bn), revaluation of pensions (cPLN7bn), minimum pensions for women with at least 4 children (cPLN0.35bn). Planned income neither seems excessive. Even though the planned VAT growth seems overly optimistic, assumptions for PIT and CIT are rather conservative. To sum up, the main assumptions of the budget seem feasible and should meet with a positive reaction of the investors. This year, the planned realisation of the deficit is PLN23.8bn, which is in line with our projection and below the statutory limit of PLN41.5bn. Let us remind you that only 2 weeks ago, the Deputy Minister of Finance, Leszek Skiba, said that "one should not expect that the deficit would be by PLN20bn lower than planned, as speculated by some".

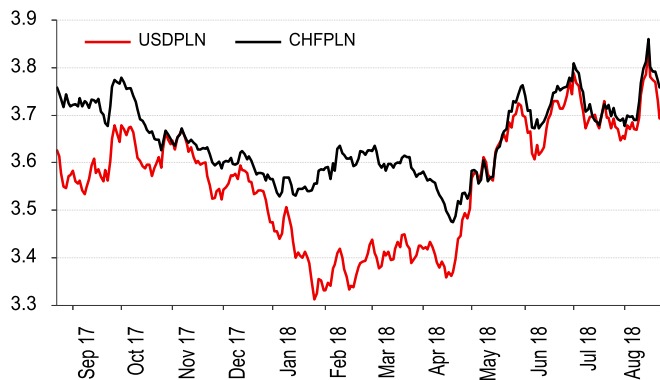
FX and FI market – Zloty gains, bonds stable

EURPLN and EURUSD



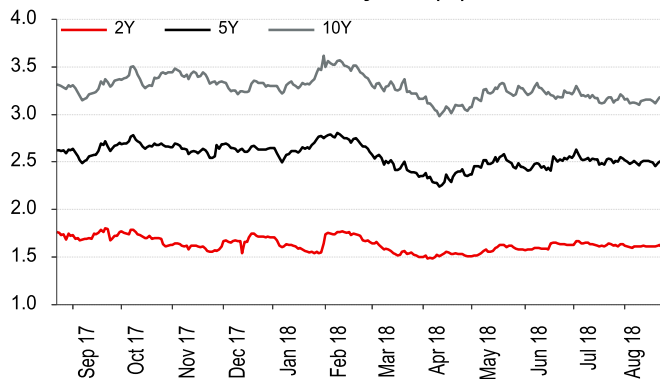
Source: Thomson Reuters Datastream, Bank Zachodni WBK

USDPLN and CHFPLN



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Poland bond yields (%)



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Last week on the market

▪ **FX** The zloty gained second week in a row vs the euro, dollar, and Swiss franc amid a fairly positive global market sentiment and decent Polish macro data. As a result, EURPLN fell below 4.30, USDPLN reached 3.70, CHFPLN neared 3.74 and GBPPLN broke 4.76.

▪ **FI** Situation on the Polish fixed income market has not changed significantly with the yields holding the horizontal trends despite the bond switch auction and government releasing the 2019 budget draft. UST yields fell while Bund yields rose.

What to watch for next week

▪ Next week we will see some important US data. In our view, these releases should be viewed in the context of the Fed's Powell speech at the Jackson Hole symposium that will take place later this Friday.

▪ We think Polish data should be of a secondary importance. Final 2Q GDP is likely to be close to the flash estimate and the breakdown that will be published shall not be a meaningful impulse for the market at the end of the week. Flash August CPI will show a decline vs July, in our view. Our forecasts is below market consensus.

▪ Last week, the market was quiet as regards Turkey owing to market holiday in the country. This week, trading will resume.

Market implications

▪ **FX** Number of important US data releases suggests that the correlation between EURPLN and EURUSD could be the key factor driving the Polish market in the coming days. September 25bp Fed rate hike is priced in by the interest rate market and the upcoming macro figures may help assess whether the US interest rates could go up in December as well. At the same time, however, EURUSD is hovering at the level seen in June when the FOMC hiked rates and showed for the first time that two more hikes were likely later this year. Thus, it appears there is limited room for rate hikes expectations to push EURUSD lower in the short term.

▪ Last week, the Turkish market was closed and the lira has stabilized. Attempts by Turkish officials to calm the financial markets provide hope that this issue should stop generating negative pressure on the other EM markets, at least in the short term. Still, the political conflict looks far from resolved and any rise in tension between the US and Turkey could again spur worries about contagion from the Turkish crisis.

▪ Overall, we think EURPLN could stay somewhere near 4.30 in the days to come. The euro should not depreciate vs the dollar but the Turkish case might limit the scope for zloty appreciation.

▪ **FI** Yield of the Polish 10Y benchmark neared the upper end of the range in which it had been holding since mid-July. We think yields could rise moderately in the days to come with the biggest part of the move concentrating at the end of the week when the Ministry of Finance will release its September bond auction plan. In our view, there will be two auctions scheduled with higher supply than in the previous months. Also, deputy finance minister Piotr Nowak said that in 4Q bonds' supply will be close to 2Q levels (PLN21.5bn).

▪ Yield of the 10Y US Treasury has neared its July bottom at c2.80%. In our view, Jerome Powell should not taper market expectations for rate hikes during his speech at the Jackson Hole symposium (if he only refers to this issue) and this might be a reason for the UST yields to rise in the days to come which could generate an upside pressure on the Polish rates.

▪ We think Poland August flash CPI could be below consensus but this might only limit the yield's rise, in our view.

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