Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

9 – 15 October 2017

Last week, the global markets were mostly affected by illegal referendum in Catalonia, which raised political uncertainty and weighed on risk appetite, as well as by US labour market data. The data on employment were worse than expected, but the market interpreted them as affected by the hurricanes, and paid attention to strong earnings data instead, seeing higher chances for a rate hike in December and selling off bonds. Moreover, the discussion about the new Fed chair got some steam, with hawkish Kevin Warsh seen as a frontrunner. In Poland, the MPC kept interest rates and rhetoric unchanged, but we see growing chances that the MPC will soon become more hawkish given the labour market squeeze and likely acceleration of wages. Polish PMI for September rebounded visibly after four months of disappointing results.

This week is not rich in key macro releases. We will get to see important data from Germany, crucial for assessment of growth outlook in Europe. Fed meeting minutes and inflation data will also be published. In Poland, CPI data for September are due for release. Analysis of reasons behind the surprisingly high reading will be affecting the projected inflation path for the upcoming quarters. Moreover, the Polish Sejm will start working on President's FX mortgages bill. In general, Polish assets may stay under pressure of good US wage data, yet some profit-taking at the start of the week is possible. A series of scheduled speeches by Fed officials could mean a risk for domestic bonds.

Economic calendar

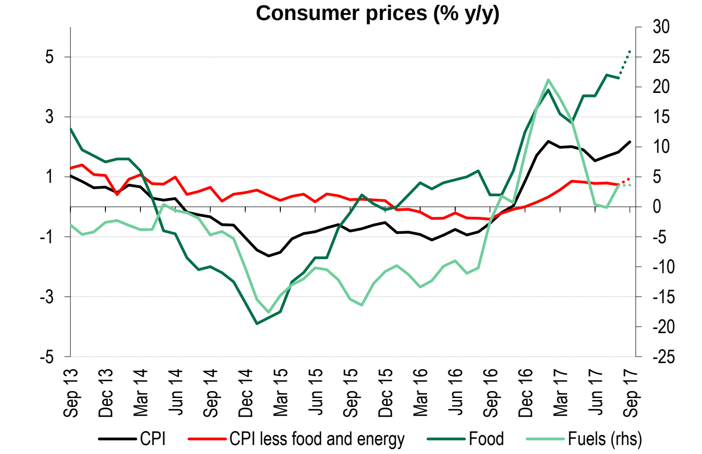
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (9 October)					
8:00	DE	Industrial output	Aug	% m/m	0.8	-	0.0
9:00	CZ	Industrial output	Aug	% y/y	4.3	-	3.3
9:00	CZ	CPI	Sep	% y/y	2.7	-	2.5
		TUESDAY (10 October)					
8:00	DE	Exports	Aug	% m/m	1.0	-	0.2
9:00	HU	CPI	Sep	% y/y	2.7	-	2.6
		WEDNESDAY (11 October)					
20:00	US	FOMC minutes					
		THURSDAY (12 October)					
11:00	EZ	Industrial output	Aug	% m/m	0.5	-	0.1
14:00	**PL**	**CPI**	**Sep**	**% y/y**	**2.2**	**2.2**	**1.8**
14:30	US	Initial jobless claims	week	k	-	-	260
		FRIDAY (13 October)					
14:00	**PL**	**Core inflation**	**Sep**	**% y/y**	**0.9**	**1.0**	**0.7**
14:30	US	CPI	Sep	% m/m	0.6	-	0.4
14:30	US	Retail sales	Sep	% m/m	1.6	-	-0.2
16:00	US	Flash Michigan	Oct	pts	95.0	-	95.1

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

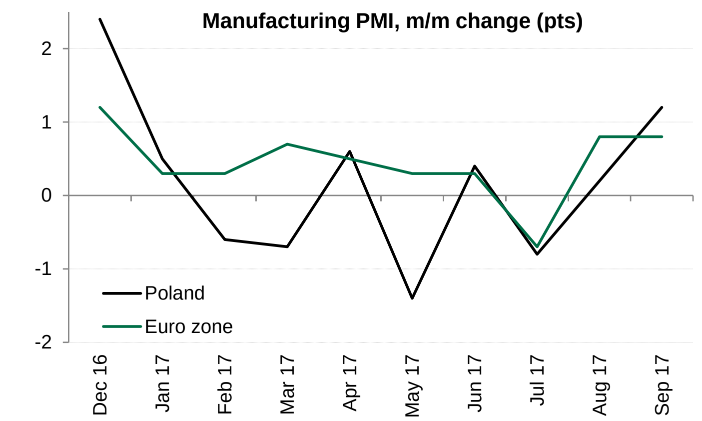
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

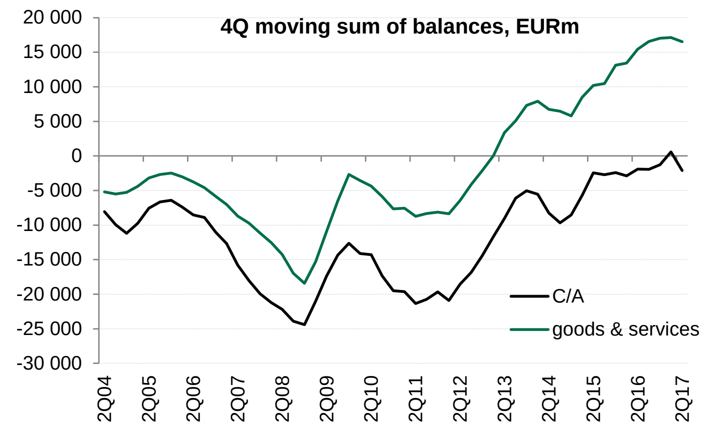
What's hot next week – CPI and core inflation



- Flash CPI for September rose to 2.2% y/y, and we expect this reading to be confirmed by the Statistics Office. We attribute the rise of the headline figure mainly to the behaviour of fuel prices and the continued high input from food as well as the base effect in health. It is also likely that air transport prices continued their upward movement started in August. We also cannot rule out that the downward move in teaching book prices triggered by the introduction of free books in two classes was less considerable than we had assumed.
- Core CPI ex food and energy prices may have risen from 0.7% y/y to 1.0%, its highest since June 2014.
- We predict inflation to remain quite stable until November, to drop in December below 2% due to high base effect, and then to go up gradually in 2018. In our view, CPI is likely to hit the 2.5% target next year, while the core inflation may climb towards 2.0% y/y.

Last week in economy – PMI finally up, balance of payments for Q2





- Polish PMI index rose in September to 53.7, its highest since April, showing a surge in external orders (the best sub-index for this category since January), stagnation in employment and acceleration of price growth. It looks like the industrial sector is facing supply constraints – the backlogs have seen the largest rise since January 2015 on labour force shortages. Suppliers' delivery time also lengthened, by most since 2011. Output prices went up at the highest pace since 2011 as well. The PMI index finally rebounded after four months of sluggishness. We had expected the Polish PMI to finally go up, given the rising divergence between the Polish and the German / Euro zone indicator. However, the Polish gauge is dragged lower by its employment subindex, given rising squeeze on the labour market.
- The NBP released their quarterly data on 2Q17 balance of payments. Compared to the monthly data, exports were revised upwards (to 8.9% y/y in Q2 and 13.8% y/y in Q1 vs. the previous 8.6% and 11.7%, respectively), which translated into improved trade and current account balance. Our estimate of 12-month current account deficit went down to 0.5% from 0.6% of GDP. The NBP also revised their earlier data, e.g. these for 2016. Outflow from the secondary income account was revised up by €1.9bn, thus largely contributing to deterioration of the balance by €1.4bn. On the financial accounts side, balance of FDIs was revised to €15.2bn from €13.1bn. Interestingly, the errors and omissions account rose to -€3.7bn from -€3.0bn.
- Ministry of Labour estimated the registered unemployment rate at 6.9% in September after the number of unemployed had fallen by 18.7k m/m. This made us revise our forecast of Statistics Office official data to 6.9% from 7.0%. We think the unemployment rate will reach 7.0% at the year-end.

Quote of the week – Inflation at 3.5% unimaginable

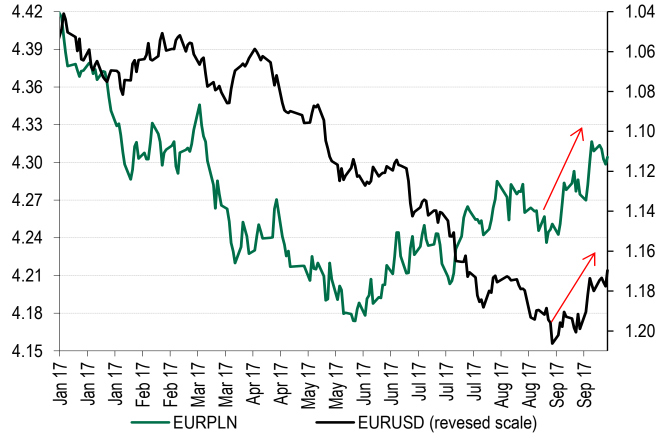
Adam Glapiński, NBP governor, NBP conference, 4 October
We have high reserves on the labour market, in each segment. Polish population, Ukrainians, Belarusians. There is much to do as regards participation rate of women and youngsters, small towns and countryside. (…) Inflation is slightly higher than we expected, but we forecast it to go down. The target will not be reached. Inflation at 3.5% is unimaginable in two years' time.
Grażyna Ancyparowicz, MPC member, NBP conference, 4 October
I am not as optimistic as Governor Glapiński. Should wages grow stronger than we expect – and there are some external shocks – we should discuss behaviour of inflation in mid-2018.
Rafał Sura, MPC member, NBP conference, 4 October
In my view, wage growth will be slowing down. I see no reasons to change our policy.

The Monetary Policy Council kept the main interest rates unchanged at 1.5% in September, as expected. The official statement has hardly changed, as the MPC maintains its claim it wants to keep monetary policy intact. This pledge is based on a belief that inflation will remain contained. In our view, the labour market squeeze is likely to contribute to higher wage growth, which may push CPI higher. NBP claimed there are buffers for the labour market. In our view, it will take time until these reserves become activated, especially given that the government policies discourage from labour participation. Moreover, before they are activated, we would need to see an important trigger for a change (most likely, significant rise in wages). G. Ancyparowicz proved quite hawkish during the press conference and in our view she may join the hawkish camp in 2018 if the next set of data confirms that tensions on the labour market are strong and persistent.

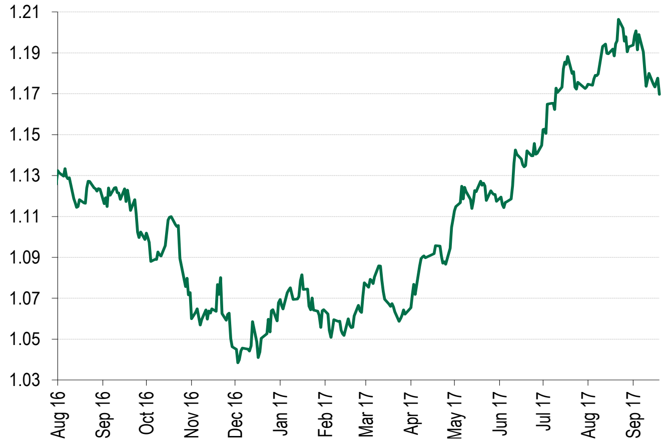
Foreign exchange market – Waiting for trigger

EURPLN

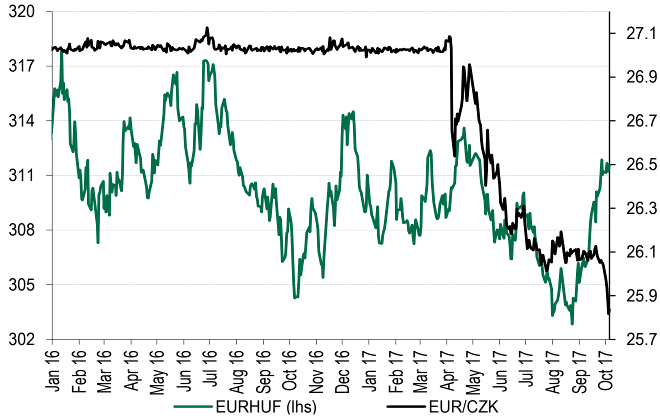
EURPLN and EURUSD



EURUSD



EURHUF and EURCZK



EURPLN stable below local peak

- Last week, EURPLN did not move much and remained just below the local peak at c4.33 reached in late September. The weekly trading range was the narrowest since early August. USDPLN held flat as well with the exchange rate staying in the 3.65-3.69 range. No big changes were seen also in the case of CHFPLN while GBPPLN plummeted to 4.80 from 4.88 as the British pound gave up part of its recent gains vs the euro and the dollar. Polish PMI surprised to the upside but this did not manage to boost the zloty. Also, the rising stock indexes did not provide significant support for the Polish currency. In our view, it was the dollar's strengthening on the global market that prevented the zloty from appreciation. In fact, a vast majority of the EM currencies lost vs the dollar last week.
- The zloty stabilized vs main currencies indicating that the global FX market is also waiting for a trigger that could initiate a sustainable directional move.
- This week does not contain a large number of important data which suggests that volatility is likely to remain low. Calm situation on the global market may be slightly positive for the zloty as investors may focus on the recently released robust Polish macro data. However, room for the zloty's appreciation may be limited by the dollar's strength on the global market.
- Important levels to watch for EURPLN are at 4.29 and 4.33.

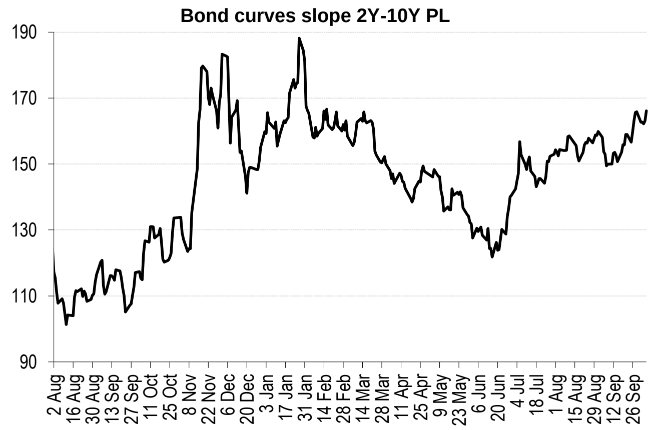
EURUSD goes lower

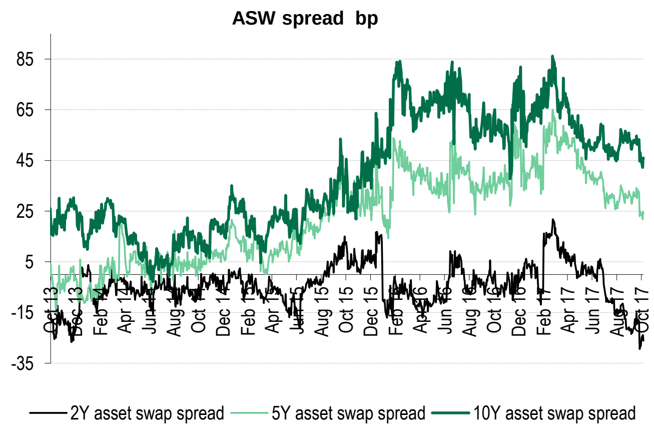
- EURUSD continued the decline started in mid-September amid rising chances for a December Fed rate hike owing to decent US macro data and expectations for a delivery of Trump's tax reform. Pressure on the euro was generated by the market concerns about the situation in Spain. As a result, EURUSD reached 1.17, nearing the August bottom at 1.166.
- It seems that the US events will stay in the spotlight this week. We will learn numerous macro data (including CPI that has eased somewhat in the recent months and now the market expects noticeable reacceleration) and FOMC minutes will be released.
- We sustain our view that EURUSD is too high given the very likely December Fed rate hike. Also, the recent Euro zone data were pretty strong and we think more positive surprises are not too likely to appear in the weeks to come.

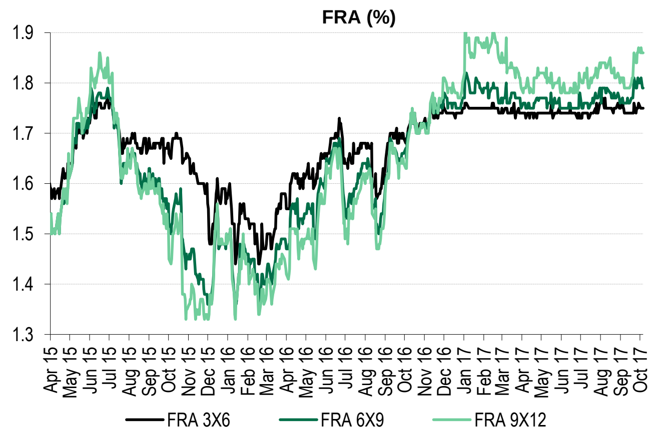
Koruna gains, forint and ruble stable

- Elsewhere in the CEE region, the koruna gained while the forint and the ruble remained stable.
- The koruna was stronger vs the euro than in early August after the rate hike in the Czech Republic. EURCZK fell temporarily below 25.8 and was at the lowest level since November 2013, when the Czech central bank announced 27.0 floor. The koruna is strong as the market is expecting one more rate hike this year to be delivered by the Czech central bank.
- This week, Czech and Hungarian inflation data are on the agenda but we do not expect these figures to influence the central bank's stance.

Interest rate market – US data pushed the yield curve up







Yield curve was pulled up by leading indicators

- Last week we observed increase of domestic sovereign bonds yields. The yield curve has risen on the belly and long end of the curve. The rise was fuelled by surprisingly high reading of leading indicators from Poland, USA and Euro zone. Much higher-than-expected US ISM reading negatively affected the longer part of the yield curve, as investors started weighing the Fed's plans to press ahead with more aggressive policy tightening. Moreover rumours about Fed chair successors affected the domestic and US bonds (rather negatively). The front-runner is Kevin Warsh, who is known as a critic of bond buying program and low rates. The front end of the yield curve decreased marginally driven by expectations for principal and interest repayments in October (cPLN17.5bn). On the switch auction the Ministry of Finance redeemed bonds maturing in January-June 2018. As a consequence, the principal and interest repayments scheduled for October remained at cPLN17.5bn. As a result the middle part of the curve rose by 9bp, the long end of the yield curve rose by 13pb, while the front end decreased by 2-3bp.

ASW curve steepened

- It is worth noting the asset swap spread increase was the main driver of upshift in long end yields. 5-10Y ASW spread rose by 4-5pb. High level of principal and interest repayments (expected this month), drove the front end of the ASW curve decrease.

FRA rates remained stable

- The FRA curve remained stable, FRA rates still fully price-in the 25-point rate hike as early as October/November 2018.

The domestic yield curve may be to steep

- At the beginning of the week we expect profit taking and temporary decrease of yields. In a few weeks perspective we anticipate boost in longer yields, as investors will start weighing the Fed's plans to press ahead with more aggressive policy tightening in the US. We expect the upward trend to continue by year-end, but not at a fast pace. In our opinion the ASW curve up to 2Y will be under the downward pressure due to the principal and interest repayments scheduled for October, while the rest of the ASW curve will be rising.

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