Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

30 October – 5 November 2017

Activity of domestic investors on the financial market may be reduced next week due to market holiday on November 1st, but there will be many important events abroad. Market attention will focus on the USA where we will see several important data releases (including labour market statistics), Fed meeting and speculation about new Fed governor, plus further work on the tax reform. Data from the euro zone (GDP, inflation) may also affect the market. Amid reduced liquidity, the Polish currency may be more volatile than usually in the week like this. Especially that the political risk may rise again after the Catalan parliament has voted to declare independence.

Key data releases in Poland include flash CPI (Tuesday) and PMI (Thursday). We expect to see a slight drop of inflation to 2.1% y/y. Although food prices are still pushing CPI up, but fuel price growth has weakened and there are no signs of strengthening pressure in other categories. As a result, core inflation may drop in October from September's 1% y/y. In case of PMI we expect an upward move to 54.4, as the index should keep on catching up with the euro zone indicators. It would be a confirmation that the GDP growth is likely to stay above 4% y/y in the final quarter of the year.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (30 October)					
13:30	US	Personal income	Sep	% m/m	0.4	-	0.2
13:30	US	Consumer spending	Sep	% m/m	0.8	-	0.1
		TUESDAY (31 October)					
11:00	EZ	Flash GDP	Q3	% y/y	2.4	-	2.3
11:00	EZ	Flash CPI	Oct	% y/y	1.4	-	1.5
14:00	**PL**	**Flash CPI**	**Oct**	**% y/y**	**2.1**	**2.1**	**2.2**
15:00	US	Consumer confidence index	Oct	pts	121.0	-	119.8
		WEDNESDAY (1 November)					
	PL	**Market holiday**					
2:45	CN	PMI – manufacturing	Oct	pts	51.0	-	51.0
13:15	US	ADP report	Oct	k	190	-	135
15:00	US	ISM – manufacturing	Oct	pts	59.1	-	60.8
19:00	US	FOMC decision		%	1.0-1.25	-	1.0-1.25
		THURSDAY (2 November)					
9:00	**PL**	**PMI – manufacturing**	**Oct**	**pts**	**54.0**	**54.4**	**53.7**
9:55	DE	PMI – manufacturing	Oct	pts	60.5	-	60.6
10:00	EZ	PMI – manufacturing	Oct	pts	58.6	-	58.1
13:00	CZ	Central bank decision		%	-	0.50	0.25
13:30	US	Initial jobless claims	week	k	-	-	233
		FRIDAY (3 November)					
13:30	US	Non-farm payrolls	Oct	k	310	-	-33
13:30	US	Unemployment rate	Oct	%	4.2	-	4.2
15:00	US	ISM – services	Oct	pts	58.0	-	59.8
15:00	US	Industrial orders	Sep	% m/m	1.0	-	1.2

Source: BZ WBK, Reuters, Bloomberg

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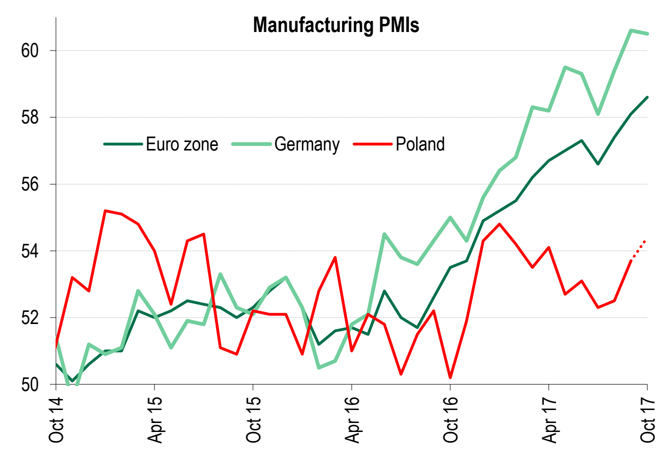
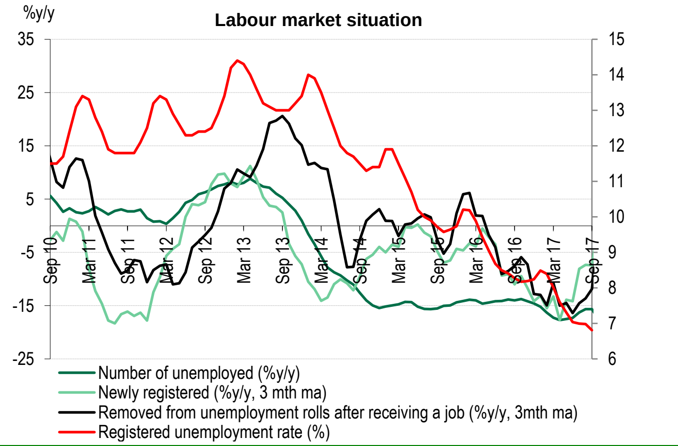
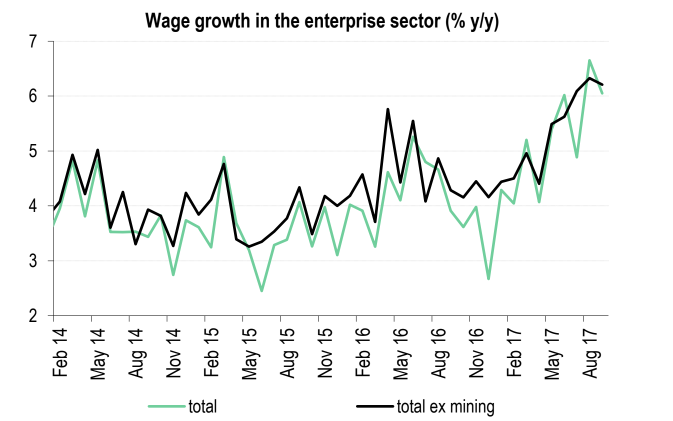
What's hot next week – Flash CPI, PMI and a holiday in between



- Inflation unexpectedly reached 2.2% y/y in September and it now looks much more likely than a month ago that the 2.5% goal might be reached somewhere in the middle of 2018. We expect the flash CPI reading for October will show 2.1% y/y. On one hand, further aggressive price hikes in some narrow food categories continue – eggs (c5% m/m) and tomatoes in October while butter, which boosted last three readings, saw a c3% m/m rise of price. On the other hand c0.06% of September CPI came from earlier shopping for warm clothes and shoes and this effect needs to be deducted from October's print.
- Polish manufacturing PMI has started gaining on Euro zone counterparts only in September, rising by 1.2 pts to 53.7, after several months of significant underperformance, and based on alternative sentiment measures we think it should post an 0.7pt higher result in October while the German index dropped by 0.1pt and the Euro zone one rose by 0.5pts.

Last week in economy – Extension of labour market trends





- Registered unemployment rate was lower than expected in September at 6.8%, but mainly due to an upward revision of the number of employed (by c1.6%) per month in 1H17. Additionally, there was an unusually big for this time of the year drop of unemployed (by 19k m/m) mainly owing to low (seasonally adjusted) number of new registrations. We expect even bigger drop of unemployed in October given the reduction of retirement age.
- Detailed data about corporate sector wages confirmed that the slowdown in wage growth in September from 6.6% to 6.0% y/y resulted to large extent from the one-off disturbance in bonus payments in mining sector. Wage growth excluding mining remained decent: 6.2% y/y in September, after 6.3% in August and 6.1% in July. If we correct for a lower number of working days y/y this is actually a stronger print. We expect further acceleration of wage growth in the coming months, amid deepening shortage of labour force.
- According to Polish Press Agency, the Ministry of Labour is working on a bill abolishing the limit on tax base for charging pension contributions, currently equal to 30 monthly average pays. The bill assumed an improvement on GG deficit by PLN5.5bn in the first year. The effect would be positive on the Social Security Fund, but negative on the central budget (PLN1bn) and local governments (PLN0.6bn) due to lower revenues from income taxes. However, in the longer run this change will result in higher pensions for people affected (350k) and higher burden for the general government sector.
- PM Beata Szydło suggested a government reshuffle "within several weeks".
- S&P analyst Frank Gill stated the agency is very comfortable with Poland's very solid BBB+ rating with stable outlook.

Quote of the week – Normalization (of monetary policy) in my mind

MPC minutes from the 3-4 October meeting, NBP, 26 October
(…) it was stressed that wage growth, even though it had accelerated, remained moderate and markedly lower than in some CEE economies. At the same time, many Council members were pointing to a risk of further intensification in wage pressure.

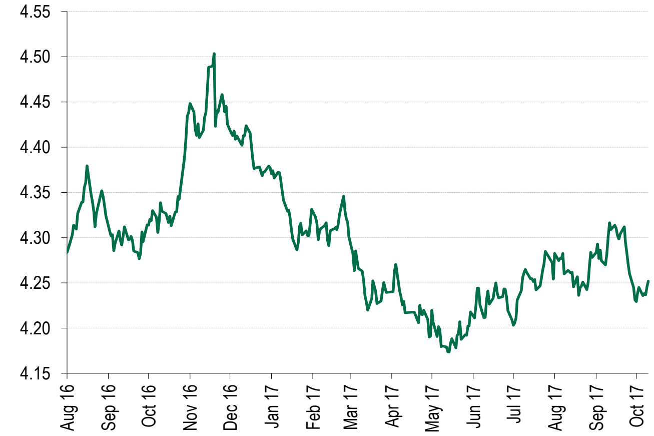
Eugeniusz Gatnar, MPC member, Bloomberg, 25 October
"Thinking that economic growth at this pace is possible without accelerating inflation and other risks is an illusion". Protest of medical professionals, who have staged a hunger strike for 3 weeks, "is only the beginning of a new phenomenon" as more and more public-sector groups "feel aggrieved" about slow wage increases. 3Q GDP growth could be around 4.5%, "probably the best quarter this year". 1Q is the time when conditions for rate increase will fall into place, including CPI breaching 2.5% target. "I have in mind a normalization of monetary policy, which means an increase by 25 basis points to ensure sustained and balanced economic growth."

According to the MPC minutes some members said inflation could be higher than currently forecasted mainly owing to rising wage and cost pressure and this might be a reason for a rate hike. The text also included a new sentence that many members noted the risk of further rise of wage pressure. Overall, we perceived the minutes as hawkish but recent comments had already suggested such evolution of view.

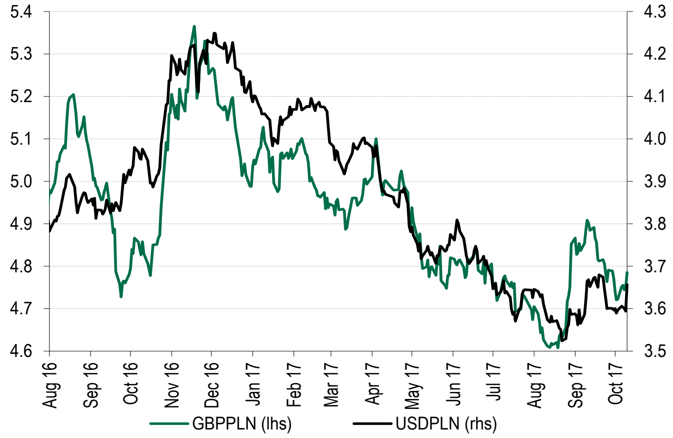
An MPC hawk Eugeniusz Gatnar said he could support a 25bp rate rise from 1Q18 as inflation could rise to 2.5% y/y in 1Q18 and settle around 2.5-3.5% later on. While many members mentioned a possibility of a rate hike in 2018, they outlined different conditions and that is why we think monetary policy could become tighter only in 2H18. Still, some of the hawks wanted to act already in 1H18, so there could be a motion to raise rates in early 2018 and we see a growing number of arguments for policy tightening.

Foreign exchange market – Attention turns to the US

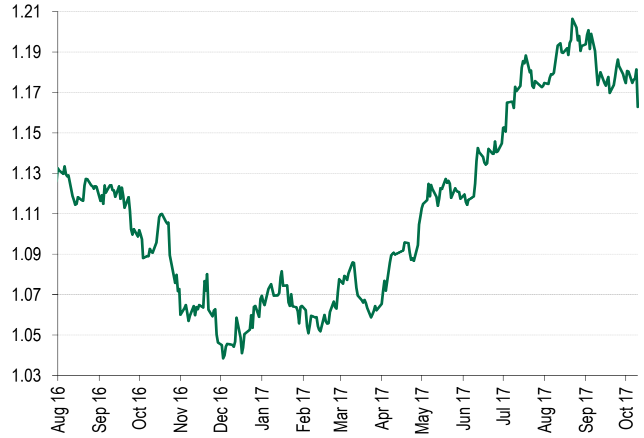
EURPLN



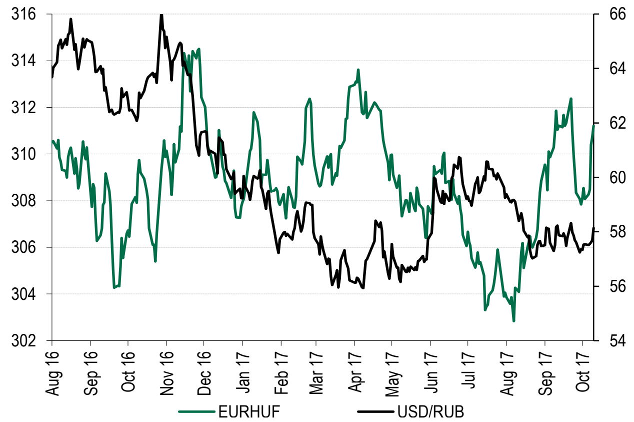
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty pressured by ECB decision

▪ In our previous weekly, report we suggested that the Polish currency could give up part of recent gains versus the euro and the last few days saw EURPLN rising to 4.26. S&P confirmed Poland's rating and outlook which did not have any significant impact on the zloty. Just like we supposed, the ECB decision to cut monthly bond buying weighed on the CEE currencies. Additional upside pressure on EURPLN was generated by the downside move of EURUSD (details below).

▪ In our view, this week market attention will switch to the US events. Next to hard data due to be released – October ISM for manufacturing and nonfarm payrolls – investors will follow the process of tax reform negotiations and tone of statement after the FOMC meeting. Actually, the issue of the next Fed governor – influencing outlook for monetary policy in 2018 – may be more important than November statement.

▪ Global market reaction to the ECB decision suggested that the changes in the bond-buying program were interpreted as a continuation of dovish monetary policy. The CEE currencies did not manage to keep their initial gains which may suggest that their appreciation potential in the short term is small. This is especially when a dollar-positive US tax reform is apparently approaching fast. Should some hawkish signals emerge from the US, zloty's negative reaction could be exaggerated as there is a market holiday on Wednesday in Poland.

EURUSD below important support

▪ Dovish outcome of the ECB meeting pushed EURUSD down below the lower end of the 1.166-1.188 range in which the exchange rate has been hovering since the beginning of October. The dollar was additionally boosted by rising chances of the US tax reform implementation. As a result, EURUSD neared 1.16, its lowest since July.

▪ Already in the previous months, we have been claiming that the dollar could gain in the remainder of the year and we stick to that view.

▪ This week will be rich in the important US events. We will learn important data (ISM, nonfarm payrolls) and the issue of the new Fed chair could drive the market as well. After falling below 1.166, EURUSD may now head towards 1.15.

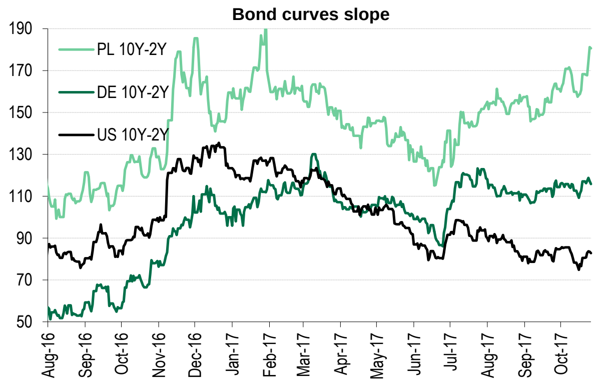
Koruna gains ahead of the CNB meeting

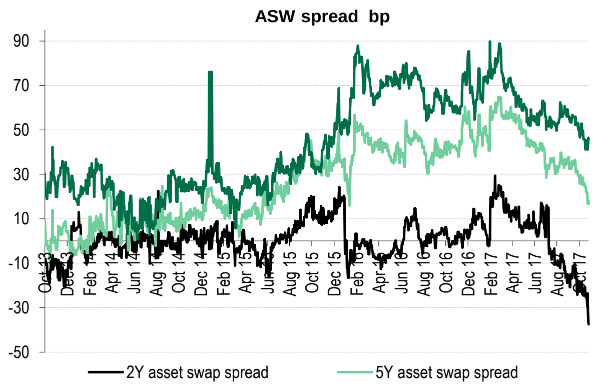
▪ Russian currency was pressured by dollar's appreciation on the global market and did not benefit from rising oil prices. As a result, USDRUB rose to 58.65 from 57.3 breaking the local peak at 58.5 established in September.

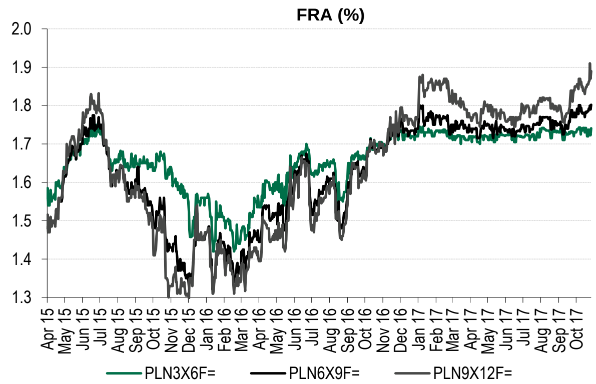
▪ The koruna ignored the outcome of the parliamentary elections (that suggest it may be difficult for form a new government fast) and was boosted by comments of local central bankers. Marek Mora said that there is a room for a 25bp rate hike in November while Tomas Nidetzky said 50bp hike could be considered at the nearest central bank meeting. As a result, EURCZK fell to 25.5, its lowest since October 2013. This week, Czech central bank meets and we think it could deliver the second 25bp rate hike this year. Koruna is gaining vs the euro for already six weeks in a row and so we think such decision of the central bank could have a limited positive impact on the koruna.

▪ Hungarian central bankers maintained their declaration that more monetary easing could be delivered if needed and said that nonstandard measures are being analyzed. Further easing of the central bank's rhetoric (and outcome of the ECB meeting) pushed EURHUF above 311 from just below 308.

Interest rate market – Credit risk curve goes down







ECB did not help long-term bonds

- Over the last week, the bonds market investors were focused on ECB decision to reduce monthly bond-buying program. As a result, for the most of the week the 10Y domestic bonds behavior was dominated by core bonds market. Therefore, the yields of Polish 10Y t-bonds were rising from Monday to Thursday following the core markets. Since Friday's morning, the price of Polish sovereign bonds started to stabilize. It was a consequence of ECB decision (to cut bond-buying program to €30bn monthly and prolonged it by 9-months), which was interpreted by investors as a continuation of dovish monetary policy. Over the last week, the 10Y bonds sell-off was supported by solid Eurozone leading indicators reading, the tax-reform discussion in the US as well as market talking about Fed chairman successor.

ASW spread decreased owing to limited supply

- The belly and the short end of the domestic yield curve behavior was determined by scheduled for Wednesday bond auction (PLN8bn) and PLN13bn redemption of principal. As a result, over the week the front end of the yield curve decreased by 7 bp. The substantial slide of the front end of the yield curve was a consequence of shortage of outstanding amount (by PLN9bn) of shortest fixed-rate and floating-rate bonds, which are preferred by banking sector ALM departments. In the auction, Ministry of Finance sold above PLN4bn shortest fixed-rate and floating-rate bonds, the rest of the were 10Y fixed-rate bonds. The middle part of the curve stayed in the narrow range over the week and dropped by 2bp on Friday. It was reflected in strong asset swap (ASW) spread decrease. The 2Y ASW spread declined to the level last seen in 2012, while 5Y-10Y ASW spreads reached the lowest levels since January 2016.

US and PMI in the spotlight

- In this week, we expect the short term bonds yield and ASW spread declines to continue. In our opinion, the downward shift on the front end of the curve will likely still be a consequence of shortage of shortest bonds. Moreover, we think that news about possibility of abolishing the limit on tax base for charging pension contributions (it could cut the GG deficit and government borrowing needs) will be a positive background for the shortest yield compression. The barrier for stronger yields declines will be the continuation of market talking about Fed chairman successor and tax reform in the US. We believe in slow growth of IRS and FRA rates, despite of expected strong PMI reading for Poland. As a result, we anticipate ASW spread compressions to continue, slightly larger at the short end of the credit risk 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