Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

9 – 15 July 2018

A week full of market thrills is behind us, and this time the triggers came from Germany - at first from its politicians, then from its economy. The tension within the German ruling coalition due to migration policy rose to the extent that there was a risk of government collapse. This had a strong negative impact on CEE currencies. EURPLN reached the highest level this year, above 4.41. When the political risk subsided, attention turned to the German data: new orders in industry and industrial output grew much more than expected, breaking the long streak of disappointing readings and allowing the euro to rise above 1.17 vs the dollar. During the time of increased market volatility, investors watched further actions of the European Commission against Poland in the conflict about judiciary reform, but it is difficult to assess if this had any particular influence on trade.

This week should be calmer. Donald Trump is currently eyeing oil-producing countries, so markets will have some time to recover, but USA-EU-China talks on new trade framework are on, and we cannot exclude another round of retaliatory measures for the already introduced tariffs. Macro calendar is not really rich. We will get to see some data on inflation, new NBP projection and MPC decision.

Economic calendar

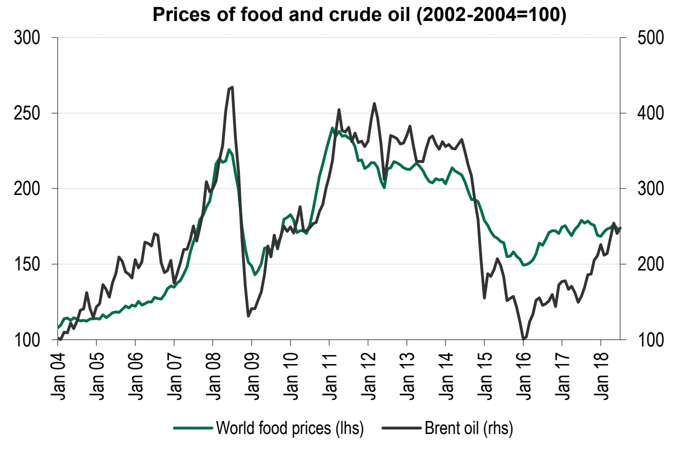
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (9 July)					
08:00	DE	Exports SA	May	% m/m	0.3	-	-0.3
09:00	CZ	Industrial Production	May	% y/y	-	-	5.5
		TUESDAY (10 July)					
09:00	HU	CPI	Jun	% y/y	3.1	-	2.8
11:00	DE	ZEW Survey Current Situation	Jul	pts	78.1	-	80.6
		WEDNESDAY (11 July)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
09:00	CZ	CPI	Jun	% y/y	2.5		2.2
		THURSDAY (12 July)					
08:00	DE	HICP	Jun	% m/m	0.1	-	0.1
10:00	**PL**	**Trade balance**	**May**	**€ mn**	**-**	**-**	
11:00	EZ	Industrial Production SA	May	% m/m	0.7	-	-0.9
11:30	**PL**	**Bond Switch Auction**					
14:30	US	CPI	Jun	% m/m	0.2	-	0.2
14:30	US	Initial Jobless Claims		k	225	-	227
		FRIDAY (13 July)					
09:00	CZ	CNB minutes	Jun-18		-	-	
10:00	**PL**	**CPI**	**Jun**	**% y/y**	**1.9**	**1.9**	**1.7**
16:00	US	Michigan index	Jul	pts	98.2	-	98.2

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

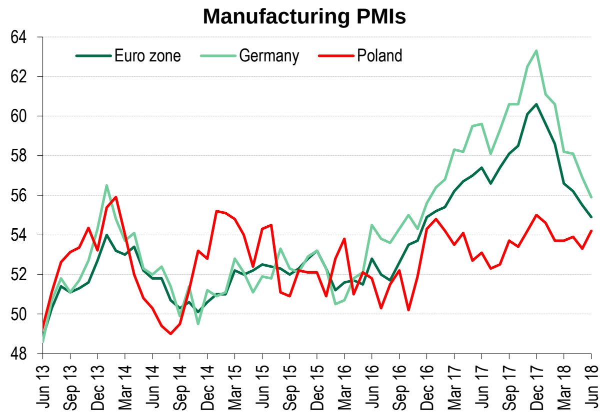
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

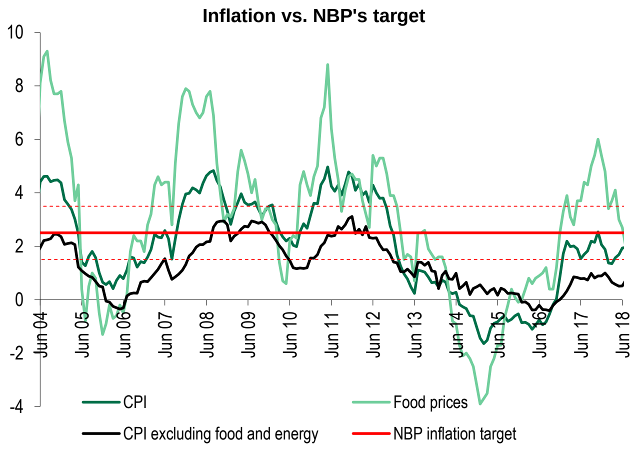
What's hot next week – NBP projection, MPC decision, CPI and foreign trade data



- The final MPC decision before summer break is coming (no decisive meeting in August) together with the results of the new NBP's economic projection. NBP governor Adam Glapiński signalled he expects to see a lower path of CPI vs. March edition (given that, so far, the actual path deviated down from the last projection and that, in his view, wage pressure is not significant). While in the short run it may be indeed the case, we have doubts if the projection would really drop notably in longer horizon. Moreover, we think that even a large swing in projection is not very likely to destabilise the strong conviction of the majority of MPC members to keep rates stable for long.
- Statistics Poland will release May foreign trade data. Calendar effects suggest a visible slowdown of y/y growth of exports, but the rebound of German new orders makes room for some positive surprise here.
- CPI data on Friday are likely to confirm the flash estimate at 1.9% y/y (see below).

Last week in economy – PMI beats forecasts, unlike CPI





- Manufacturing PMI unexpectedly climbed in June to 54.2pts from 53.3pts, driven by higher output, new orders and employment components. New export orders also improved a bit, yet from a low level recorded in May. Output costs index was at the highest level since 2011, indicating rising price pressure.
- According to a flash estimate, CPI climbed in June to 1.9% y/y from 1.7% y/y in May, less than expected (consensus at 2.0%, our forecast at 2.1%). The downward surprise was mostly due to a weaker-than-expected increase in fuel prices, which rose 1.1% m/m, while data from gas stations suggested a rise of more than 2% m/m. Trends in core categories remained subdued. According to our estimates, core inflation ex food and energy remained unchanged at 0.5% y/y. In our view, we are close to this year's peak in inflation, although a further increase is possible in July. Oil prices rose again recently, and the zloty weakened substantially (4.39 vs. the euro at the start of July, the highest level since January 2017), which could translate into higher prices of imported goods. Additional upward pressure on consumer prices may come from the effects of the drought, in our view. After summer, however, we believe inflation may start moving lower, to end the year around 1.5%.
- Poland's gross external debt fell to 66.8% of GDP in 1Q18, the lowest since 2011. In annual terms, debt-to-GDP fell by 7.8 percentage points, mostly thanks to strong GDP growth and a low current account deficit. The governmental sector contributed most to this decline (-3.3 pp). A further decline in gross external debt could encourage rating agencies to improve Poland's score (currently, S&P: BBB+, Fitch: A-, Moody's: A2). The net international investment position also improved, to -59.2% of GDP from -64.0% of GDP in 1Q17.

Quote of the week – Urgent launch of infringement procedure

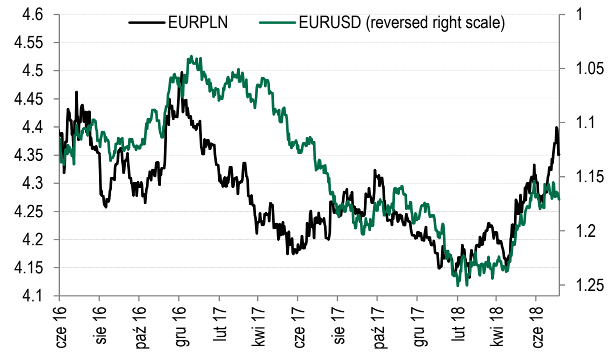
European Commission, July 2

Commission launches infringement procedure to protect the independence of the Polish Supreme Court. Given the lack of progress through the Rule of Law dialogue, and the imminent implementation of the new retirement regime for Supreme Court judges, the Commission decided to launch this infringement procedure as a matter of urgency. The Polish government will have one month to reply to the Commission's Letter of Formal Notice.

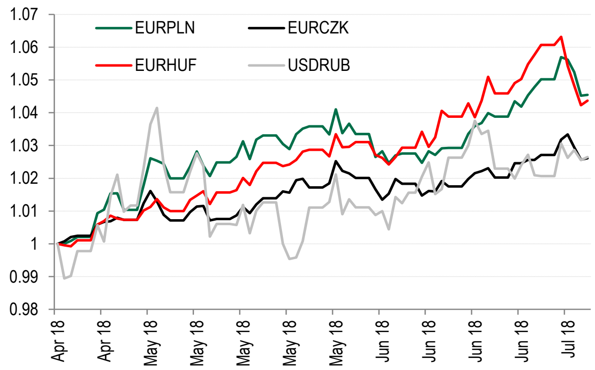
The European Commission's rule-of-law procedure vs. Poland continues (next hearing of Poland in EU Council likely in September) but it seems a cul-de-sac given the likely veto of Hungary when it comes to sanctions. It looks like the Commission has changed the strategy and now focuses on EU law infringement procedure, with the European Court of Justice, instead of EU politicians, to decide on penalties. The new procedure and the changes in the Polish Supreme Court have caught investors' attention, especially that it took place at the time of heightened market volatility. But it is hard to say if it really affected market significantly. The zloty was the weakest year-to-date on the day of the launch of the new infringement procedure, but has appreciated in the following days.

FX and FI market – Market was dominated by geopolitics and trade war

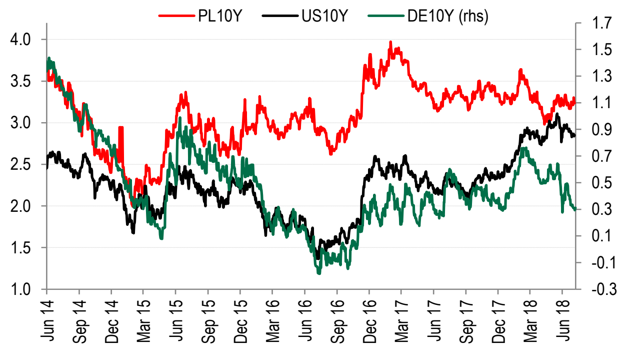
EURPLN and EURUSD



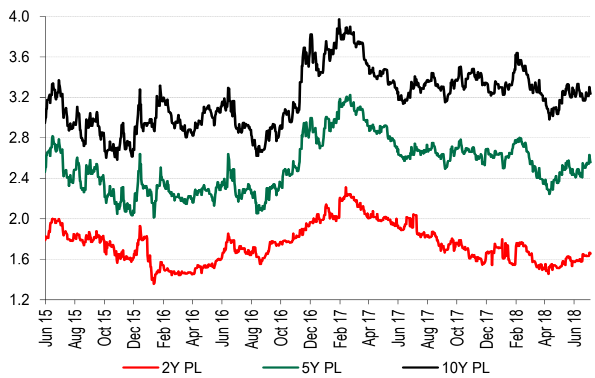
CEE currencies (17 Apr = 100)



Yield of the Polish, German and US 10Y bonds (%)



Yields of Polish benchmarks (%)



▪ **FX** Early last week, the zloty and CEE currencies depreciated against the euro fueled by the threat of German government crisis and (the resulting) depreciation of the euro. As a consequence, EURPLN hit 4.41, EURHUF 330.70 while EURCZK 26.17, the highest levels this year. The Russian Ruble was relatively immune to the sell-off and it was stabilised by high oil prices. The local economic data were ignored by CEE currencies.

▪ In the second half of last week, signals of softening of US trade rhetoric toward EU carmakers and easing of political tension in Germany boosted sentiment and fueled rebound on the CEE currencies market. Moreover the CEE currencies were supported by better-than-expected Germany industrial orders release. As a result, most CEE currencies have recovered from the loss from the beginning of the last week.

▪ **FI** The CEE yield of bonds rose early last week, negatively reacting to stock markets sell-off (this time the sell-off was dominated by euro politics).In the middle of the week, the local debt sell-off was supported by the surge of yields on the core markets (following the oil markets turbulences). Moreover, the dark background for Polish t-bonds was painted by a further wave of tensions between the Polish government and EC (however the behavior of the CEE assets suggested that the impact of this factor was negligible). In the second part of the last week, we saw a rebound, as a result the yields of bonds slid by 1-4bp.

▪ Ministry of Finance announced, they are to sell PLN4-8bn bonds on the July auction and PLN8-18bn in the 3Q18.

What to watch for next week

▪ Market is likely to be driven mainly by the information about the negotiation of new trade regime (between the USA and the rest of the world).

▪ On the data front, the market will be focused on the US non-farm payrolls (we expect above-the-consensus reading) as well as EZ industrial production and HICP data (to be released late next week).

▪ On the domestic front, investors are likely to focus on the switch auction (Thursday). We are still waiting for the final CPI reading – we do not expect any surprises. MPC conference is scheduled for Wednesday (the Council is likely to remain in the dovish stance). However, it will not be treated as an important thing by investors.

Market implications

▪ **FX** Some improvement of the global mood (as a consequence of the increased chances to the more clear negotiations process of the new global trade regime) will likely to support the zloty. Temporarily our currency will likely to suffer this Friday - US non-farm payrolls data release will likely negatively affect PLN (as a reaction for appreciation of US dollar). However, at the end of the week, the better market mood will likely to push EURPLN down below the 4.33.

▪ **FI** We believe that expected market mood improvement should support Polish t-bonds. The US non-farm payrolls data (even if surprising to the positive side) will likely not affect the domestic bonds. EZ inflation data release, a bigger chance for clearer negotiations process of the new global trade regime and expected bonds buy-back (PLN13.5bn principal, at the end of the month) should help domestic sovereign bonds. The most important point of this week calendar will be the Thursday's switch auction when the market will be closely monitoring (in our opinion high) demand. As a consequence, we expect the yields to decrease to 3.15% in the 10Y segment and 2.48% in the 5Y segment.

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