WEEKLY ECONOMIC UPDATE

13 – 19 August 2018

Volatility on the EM markets soared last week, triggered by sharp depreciation of the ruble and lira. Both currencies lost ground after Russia and Turkey relations with the US deteriorated further. USDTRY skyrocketed to its all-time high boosting concerns about the tensions in Turkish economy spreading to the other emerging markets. As a result, the zloty and its CEE peers lost last week. At the same time, Polish bonds remained fairly stable.

Next week, we will see important Polish and US data. Flash estimate of Poland 2Q GDP growth should confirm that the domestic economy is still expanding at a c5% pace. We assume the final July CPI to be confirmed at 2% y/y and the June C/A deficit to be smaller than the market expects. In the US, we will see important economic activity data that could verify if the Fed's scenario of two more rate hikes this year is still likely.

We think there is little room for a stronger zloty in the short term, given the poor sentiment on the EM market and strong dollar. Low debt supply in August could stabilise POLGBs but the US data and EM sell-off could generate upside pressure on yields.

Economic calendar

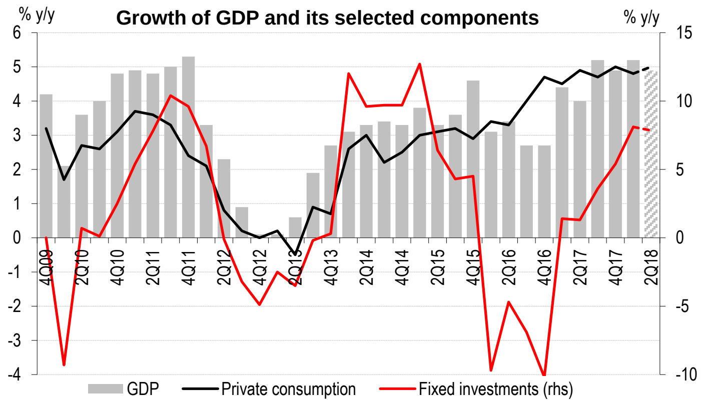
TIME CET	COUNTRY	INDICATOR	PERIOD		MARKET	BZWBK	LAST VALUE
		MONDAY (13 August)					
14:00	**PL**	**Current account**	**Jun**	**€m**	**-476**	**-174**	**42**
14:00	**PL**	**Exports**	**Jun**	**€m**	**17 810**	**17 787**	**17 251**
14:00	**PL**	**Imports**	**Jun**	**€m**	**17 827**	**17 736**	**17 153**
		TUESDAY (14 August)					
9:00	CZ	Flash GDP	Q2	% y/y	-	-	4.2
9:00	HU	Flash GDP	Q2	% y/y	-	-	4.4
10:00	**PL**	**CPI**	**Jul**	**% y/y**	**2.0**	**2.0**	**2.0**
10:00	**PL**	**Flash GDP**	**Q2**	**% y/y**	**5.0**	**4.9**	**5.2**
11:00	EZ	Industrial output	Jun	% m/m	-	-	1.3
11:00	DE	ZEW index	Aug	pts	-	-	72.4
		WEDNESDAY (15 August)					
	PL	**Market holiday**					
14:30	US	Retail sales	Jul	% m/m	0.2	-	0.5
15:15	US	Industrial output	Jul	% m/m	0.3	-	0.6
		THURSDAY (16 August)					
14:00	**PL**	**Core inflation**	**Jul**	**% y/y**	**0.6**	**0.6**	**0.6**
14:30	US	House starts	Jun	k	1270	-	1173
14:30	US	Building permits	Jun	k	1310	-	1292
14:30	US	Initial jobless claims	week	k	-	-	213
14:30	US	Philly Fed index	Aug	pts	22.3	-	25.7
		FRIDAY (17 August)					
10:00	**PL**	**Wages in corporate sector**	**Jul**	**% y/y**	**7.7**	**7.3**	**7.5**
10:00	**PL**	**Employment in corporate sector**	**Jul**	**% y/y**	**3.6**	**3.5**	**3.7**
11:00	EZ	CPI	Jul	% y/y	2.0	-	2.0
16:00	US	Flash Michigan	Jul	pts	98.0	-	97.9

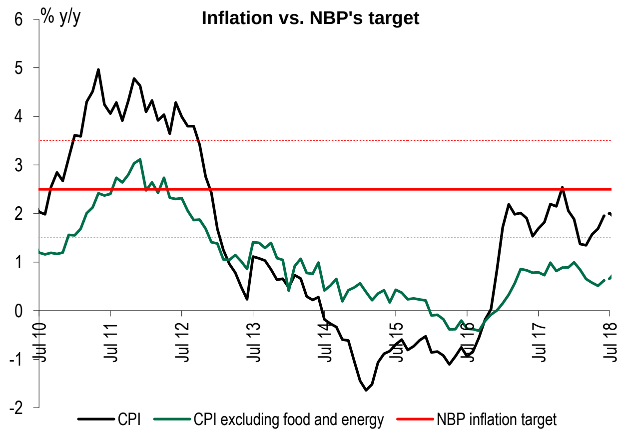
Source: BZ WBK, Reuters, Bloomberg

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

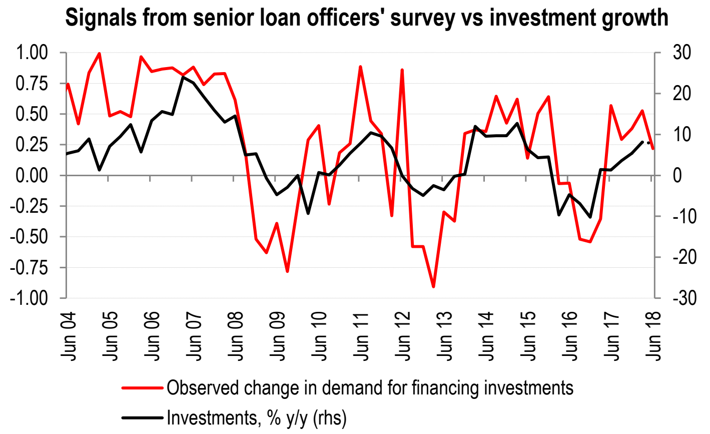
What's hot next week – Flash 2Q GDP, CPI, C/A and labour market data





- Flash GDP data for 2Q may show growth sticking close to 5% y/y (our forecast is 4.9% y/y, 1Q result was 5.2%). Gradual slowdown should be seen only from 2H18. While no details will be available at this time, we assume private consumption stayed at c5% y/y and investments at c8% y/y. The surprisingly high input to growth from inventory changes in 1Q in our view almost disappeared in 2Q, to the benefit of investments and export growth.
- Final inflation reading rarely differs from the stats office flash release. The preliminary reading for July was 2.0% y/y, unchanged versus June and in line with market expectations. This most likely meant that core inflation remained at 0.6% y/y. In our view, 2.0% in June and July is this year's peak in inflation and in the upcoming months CPI growth will be going down to 1.6% y/y at the year-end.
- C/A balance probably turned slightly negative in June while trade balance stayed almost flat. Y/y working day difference, better than in May, should lead to acceleration in both export and import, but we are slightly less upbeat on this than the market consensus (our forecast is 7.3% y/y vs 2.7% previously for export and 5.7% y/y, up from 1.7% for import), observing that in y/y SA terms output actually slowed down vs May.
- We have doubts if the market consensus is right expecting corporate wage growth to have accelerated in July from 7.5% y/y to 7.7%. While we agree that the labour market remains tight and is generating wage pressure, the June outcome was pushed up by one-off extra payments in mining. We think wages grew 7.3% y/y in July. Significantly higher pace may come in the final months of 2018. We think corporate employment may also come a bit lower than expected, at 3.5% y/y vs 3.7% previously.

Last week in economy – Unemployment rate stayed below 6%



- According to the Ministry of Labour, in July the number of unemployed persons fell by 6.4k and the registered unemployment rate stayed flat at 5.9%, in line with our expectations. This year, unemployment fell significantly less than in the previous year (declining by 120k unemployed persons between December and July, vs. 195k unemployed persons in the corresponding period of 2017) and over the last few months we may have seen that the downward tendencies were losing steam. In our view, the registered unemployment rate is likely to fall a bit further in the months to come, but will generally remain close to the current level.
- According to the NBP Senior Loan Officers' Survey for 2Q18 Assessments of the general business environment and households' economic situation remained very good. The indicator that tracks credit demand linked to enterprises' investment plans remained positive, but was the lowest in the last five quarters marked by its rebound.

Quote of the week – Deficit after six months of surplus

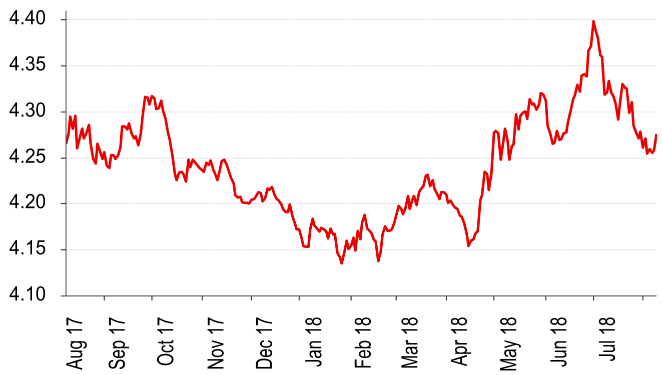
Leszek Skiba, deputy finance minister, PAP/Bloomberg, August 9
Poland had budget deficit after July. It will deepen in the following months. Budget surplus from 1H was a result of not only the income side, but also postponing expenses like those linked to programs co-funded by the EU funds. 2018 budget spending may be PLN6-13bn lower than plan. Full-year budget gap will be less than PLN20bn lower than the PLN41.5bn goal, contrary to what some people speculate. 2017 tax collection dynamics is impossible to repeat.

Teresa Czerwińska, finance minister, PAP/Reuters, August 6
July central budget result will not be as optimistic (as in June). I wish this year's deficit would be unrealized in the same proportion as in 2017, that is in 50%.

Central budget surplus hit PLN9.5bn after June and we were expecting this number to go down to cPLN6bn after July. However, the recent remarks from MinFin top officials leave little doubt if the result turned negative. This would clearly be a weak outcome, given that in recent years (2010-2017), in July alone the budget deficit was at a mere cPLN0.3bn, staying more less within +/-PLN4bn band. It is likely that the government booked the new school-age child subsidy worth cPLN1.5bn and started new infrastructural projects. Our full-year budget forecasts are similar to Czerwińska's view, but at the same time we cannot rule out that the budget act will be amended at the year-end (as happened in 2017) in order to allow higher spending. We are expecting year-end central budget deficit at cPLN25bn and GG deficit at 1.7% of GDP.

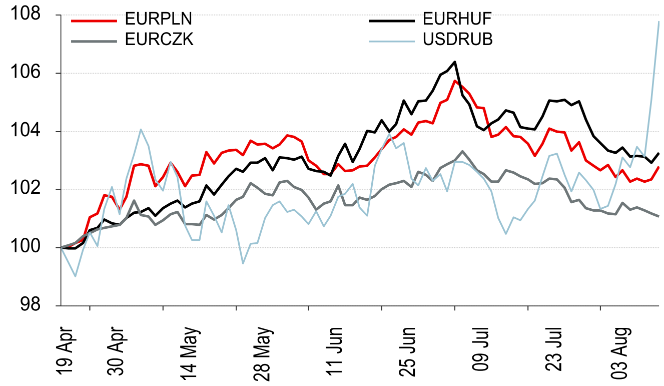
FX and FI market – Zloty pressured by lira and ruble

EURPLN



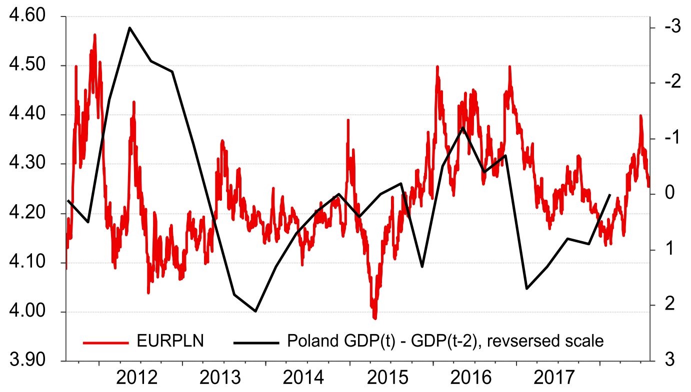
Source: Thomson Reuters Datastream, Bank Zachodni WBK

CEE currencies (April 17 = 100)



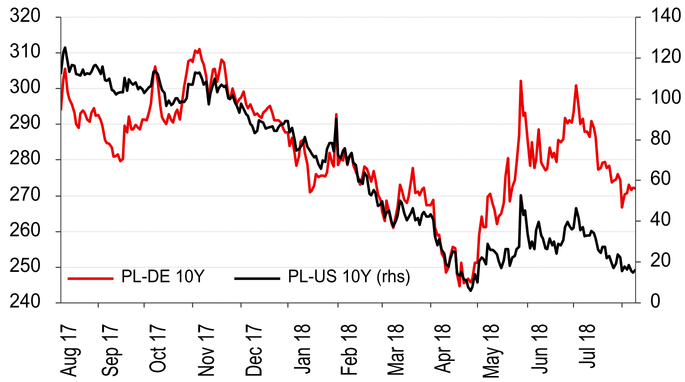
Source: Thomson Reuters Datastream, Bank Zachodni WBK

EURPLN and change in GDP pace of growth



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Bond yield spread



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Last week on the market

- **FX** Our last week's call that EURPLN down move could pause proved correct and the exchange rate rose slightly after the two consecutive weeks of decline. The zloty depreciated versus the euro amid the deterioration of the market mood on the emerging markets triggered by sharp depreciation of the Turkish lira and the Russian ruble. USDPLN and CHFPLN jumped as well while GBPPLN fell as the pound was under pressure of rising risk for a hard Brexit.
- Among the other CEE currencies, the ruble underperformed its peers amid signals about likely consequences of the new US sanctions imposed on Russia. USDRUB skyrocketed from 63.27 to above 67.15, its highest since July 2016.
- **FI** Polish bond yields and IRS remained fairly stable on the weekly basis while the core debt gained marginally, leading to a slight correction after the recent yield spread narrowing.

What to watch for next week

- Next week, we will see important Polish and US data.
- Flash estimate of Poland 2Q GDP growth should confirm that the domestic economy is still expanding at a c5% pace, well above the EU average and faster than many of its CEE peers. We assume the final July CPI to be confirmed at 2% y/y and the June C/A deficit to be smaller than the market expects.
- In the US, we will see important economic activity data that could verify if the Fed's scenario of two more rate hikes this year is still likely.

Market implications

- **FX** Our forecast of Poland 2Q GDP is a touch below the market consensus so we do not expect it to have any meaningful positive impact on the zloty. Also, note that for the zloty not only the pace of economic growth is important but also the trend of this change. The GDP growth deceleration to below 5% could be the first below-consensus reading for this figure since 4Q17 release. The C/A and CPI data should be of a less importance.
- Investors are already pricing the September Fed 25bp rate hike but currently is not fully discounting the December hike. Thus, any positive surprises in the US data could support the dollar generating a negative pressure on the EM currencies.
- We keep our view that there is little room for the zloty to resume its appreciation trend given the poor sentiment on the emerging markets. At the same time, we do not expect EURPLN to rise significantly above 4.30.
- USDRUB terminated the horizontal trend observed since April and this is a strong signal that the ruble could be weak in the weeks to come.
- **FI** The 10Y bond yield has stabilized since it broke the 3.20% support in July. In the short term, we think there is a limited room for the yields to rise thanks to the low debt supply planned for August. However, the US market is currently not pricing the December Fed rate hike in full so any strong US data could weigh on the Polish bonds. Also, the weaker than in 1Q GDP print could make the market start discounting that the budget performance could deteriorate in the months to come (see Quote of the week on the previous page). Also, we could see yields climbing after summer as the amounts of bonds offered at auctions rise.
- Also, the PL-DE and PL-US 10Y spreads have narrowed markedly in the recent weeks and there could be a correction on this front as well.

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