WEEKLY ECONOMIC UPDATE

5 – 11 September 2016

The past week was mostly driven by expectations about US monetary policy. At the start of the week, the market was under impact of Janet Yellen's speech in the Jackson Hole. Then, strong reactions were triggered by ISM in manufacturing and non-farm payrolls. In Poland, data on GDP showed that investment fell more than expected in 2Q, CPI inched up and PMI rebounded after a strong fall in July. In general, these numbers show that the GDP growth is likely to stabilise near 3% in the upcoming quarters. Worries about economic growth in Poland and the Fed monetary policy, as well as the upcoming bond auction and uncertainty prior to the Moody's decision hit Polish assets, both PLN and bonds.

This week will be a bit lighter as regards the US data, but we will see more data from the euro zone which will prove crucial for the Polish economic prospects. Moreover, the ECB meeting is on schedule and further stimulus in the euro zone cannot be ruled out. Also, the Polish MPC will be holding its decision-making meeting, but we expect rates to remain flat. However, the MPC members were quite optimistic about the GDP growth in 2016, and recent data should affect their assessment. On Friday, the Moody's agency will review Poland's credit rating. Recently, the agency has issued a statement warning that the escalating conflict with the Constitutional Tribunal is credit-negative. However, in our view the balance of new information (since last update in May) is neutral, so we expect Poland's rating to stay at A2 with negative outlook. What is interesting (and a bit surprising), according to Polish Press Agency, during the meeting with investors in London deputy PM Mateusz Morawiecki did not exclude a rating change by Moody's.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (5 September)					
	US	Market holiday					
9:55	DE	PMI – services	Aug	pts.	53.3	-	54.4
10:00	EZ	PMI – services	Aug	pts.	53.1	-	52.9
11:00	EZ	Retail sales	Jul	% y/y	1.9	-	1.6
		TUESDAY (6 September)					
8:00	DE	Industrial orders	Jul	% m/m	0.5	-	-0.4
9:00	HU	GDP	Q2	% y/y	2.6	-	0.9
11:00	EZ	GDP	Q2	% y/y	1.6	-	1.7
16:00	US	ISM services	Aug	pts.	55.4	-	55.5
		WEDNESDAY (7 September)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
8:00	DE	Industrial output	Jul	% m/m	0.2	-	0.8
20:00	US	Fed Beige Book					
		THURSDAY (8 September)					
9:00	HU	CPI	Aug	% y/y	0.1	-	-0.3
13:45	EZ	ECB decision		%	0.00	-	0.00
14:30	US	Initial jobless claims	week	k		-	263
		FRIDAY (9 September)					
8:00	DE	Exports	Jul	% m/m	0.4	-	0.3
9:00	CZ	CPI	Aug	% y/y	0.7	-	0.5
16:00	US	Wholesale inventories	Jul	% m/m	0.1	-	0.0
	PL	**Moody's decision**			**A2 (n)**	**A2 (n)**	**A2 (n)**

Source: BZ WBK. Reuters. Bloomberg

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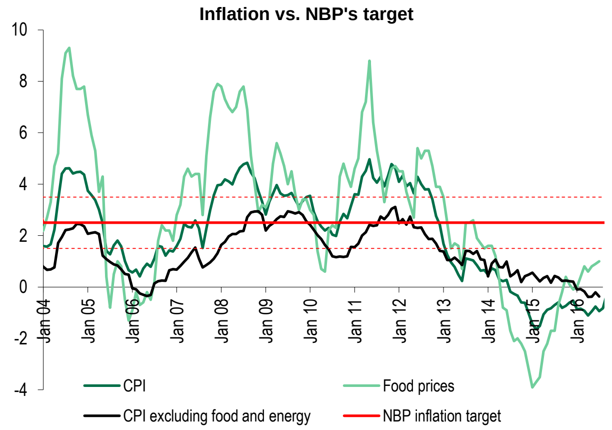
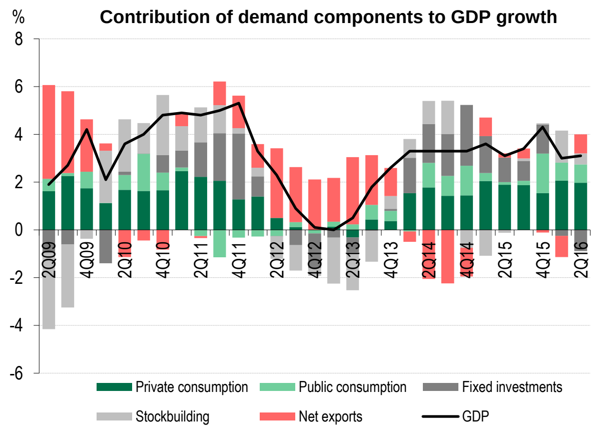
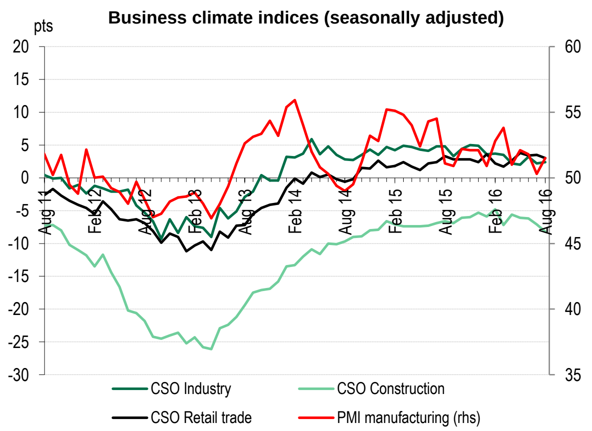
What's hot this week – MPC and Moody's



- We expect no change in rates on MPC meeting in September. We are eager to hear the MPC members' comments on the last GDP data. Let us remind that Polish central bankers thought that GDP slowdown to 3.0% y/y in 1Q was only temporary and they described the NBP projection as too pessimistic (3.2% in 2016, 3.5% in 2017). We think that worse macroeconomic data from the Polish economy should make the MPC members' views evolve.
- On Friday, the Moody's agency will present an assessment of Poland's credit rating. The information incoming since the last update in May was positive (less harmful FX loan bill, no major spending rise in the 2017 budget) as well as negative (escalating conflict with Constitutional Tribunal, more likely lowering of retirement age, weaker macro data). We think that the balance is neutral and expect no change (A2, negative).

Last week in the economy – Weak investment, rebound in PMI and CPI





- Poland's GDP growth in 2Q16 amounted to 3.1% y/y (slightly up from 3.0% in 1Q), in line with the flash estimate. Seasonally-adjusted GDP rose by 0.9% q/q and 3.1% y/y. Economic growth was driven mainly by private consumption (contribution of 2pp) and net exports (0.8pp). The positive surprise was connected with exports, which increased in real terms by 10.9% y/y, the highest rate in the last five years. On the other hand, fixed investments disappointed, falling by almost 5% y/y, the fastest pace since 4Q12, which was below the lowest market forecast). Overall, GDP data did not change our assessment of the outlook for the Polish economy. Consumption is very likely to accelerate further in the second half of the year. However, on the other hand, positive impact of net exports might be difficult to maintain, as in our view export will decelerate (while imports might accelerate). We do not change our forecasts for GDP growth or c3% in the second half of the year and 2016 as a whole.
- August's Flash CPI climbed to -0.8% y/y from -0.9% y/y in July, above expectations. Detailed data are due on 12 August, but it seems that the upward move in inflation will be supportive for keeping interest rates flat in 2016.
- PMI index for Polish manufacturing rebounded in August to 51.5 from 50.3 in July, driven by higher orders, especially export ones, output and employment. We were expecting a rebound, as we thought the July's reading was a pessimistic one-off, but its scale surprised us. Solid data on export orders give some hope that Polish exports may revive in 3Q16 (after significant slowdown in H1). However, it is worth noting that the PMI is a volatile indicator and in the recent quarters its strong fluctuations have not necessarily reflected trends in manufacturing output.

Quote of the week – Lower inflation target not considered

Eryk Łon, MPC member, 29 August, PAP

Persisting deflation tendencies are not positive for the Polish economy. I see a correlation between real interest rates and future real investment. Thus, I'm still thinking about monetary policy easing, although it is not warranted there will be a need to cut the rates this year.

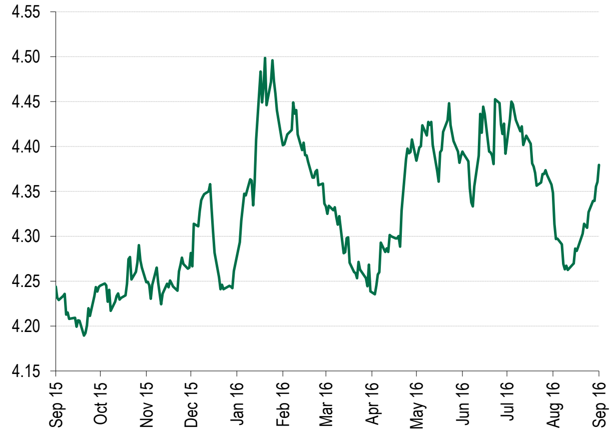
Grażyna Ancyparowicz, MPC member, 29 August, PAP

In my view, lower inflation target is off cards . . . Based on what we know and expect, inflation will accelerate. This will happen in one year's time, at most, when CPI should reach the lower bound of tolerance range around the target.

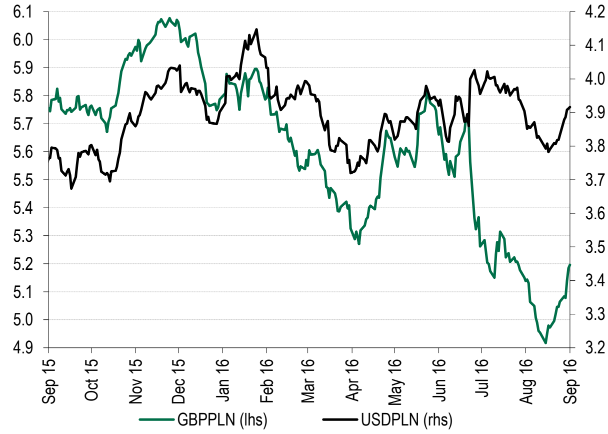
After the recent comment made by MPC's Zubelewicz who said he was concerning lowering the inflation target, now Grażyna Ancyparowicz is strongly rejecting this idea and we are supporting such an approach. As we wrote last week, such a move could weigh on the Council's credibility. However, recently Jerzy Żyżyński said that he felt most comfortable with inflation running at 1.0-1.5%, so we cannot rule out potential ideas to change the inflation target. On the other hand, Eryk Łon said that low investment may encourage him to consider cuts. Thus, data on fixed investment in 2Q16 can be a strong incentive for him. Let us remind that Żyżyński was suggesting earlier he might file a motion for a cut after summer. We cannot rule out this to happen in September, given the last weak data from the Polish economy. However, we think it is unlikely to be backed by anyone else, maybe only Eryk Łon.

Foreign exchange market – Awaiting Moody's decision

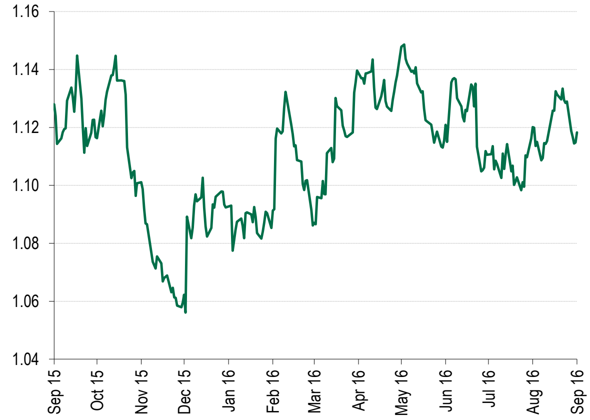
EURPLN



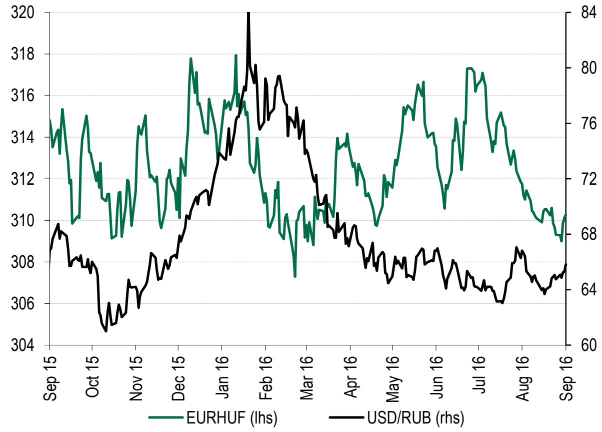
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty may remain under pressure

- The zloty has been gradually depreciating all week long and the weakening outpaced most of other currencies in the region (except the ruble). A combination of factors contributed to this trend: disappointing GDP data (especially falling investments) which worsened investors' predictions about the future growth, uncertainty ahead of Moody's rating decision, worries about a possible Fed rate hike and its negative impact on the emerging markets' assets. Prior to the US payrolls data release, EURPLN rose on Friday to 3.38 (c1.1% weekly gain), USDPLN soared by 2.2% to 3.92, and GBPPLN by 2.6% to nearly 5.20. The weaker-than-expected publication triggered a rebound on Friday afternoon and EURPLN ended the week below 4.37 and USD near 3.91.
- Last week, we argued that the risk of PLN depreciation seems higher than of its strengthening, and we think this statement will also remain valid in the coming week. Two most important factors for the Polish currency will be the US monetary policy outlook and uncertainty before the Moody's rating decision. Although the number of important news releases from the USA is quite limited, with the non-manufacturing ISM and the Fed's Beige Book being the most important ones, they may have a material impact on the market sentiment. Any signs of higher probability of rate hikes by the Fed may weaken the zloty.
- We think that the first meeting of the Polish Monetary Policy Council after the summer holidays will bring no breaking change in the policy stance and thus should be neutral for the zloty.

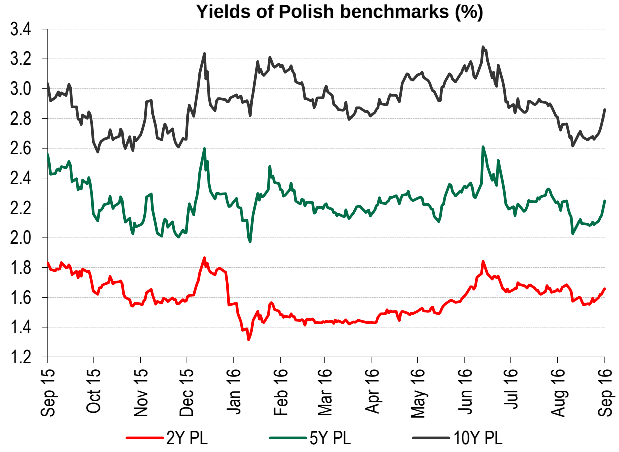
EUR/USD swinging

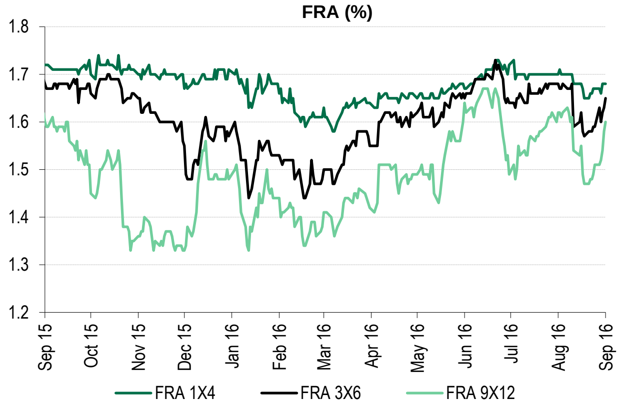
- The US dollar was strengthening against the euro for the better part of the week, supported by growing expectations for the Fed interest rate hike this year. The trend reversed on Thursday on the surprisingly weak data on manufacturing ISM, and the release of lower-than-expected employment growth in August even reinforced the dollar weakening on Friday afternoon.
- This week, there will be quite a lot of potentially important news from the euro zone (PMIs, GDP, German production and exports, ECB meeting), and only a few significant publications in the USA (ISM services, Beige book). We do not rule out that the combination of relatively weak data from Europe, ECB's concerns about low inflation and investments, and new signs of economic recovery in the USA may trigger another wave of dollar strengthening the coming days.

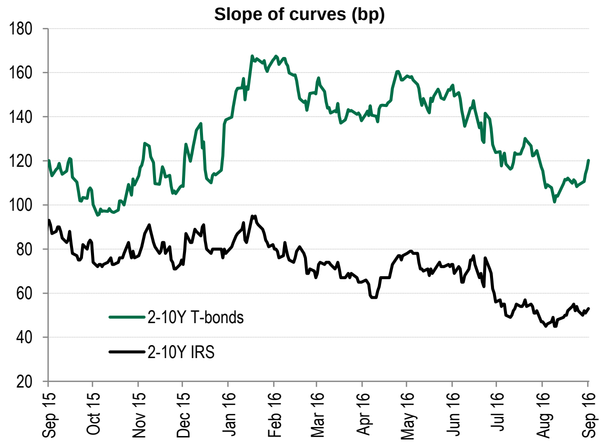
Ruble weaker again on lower oil prices

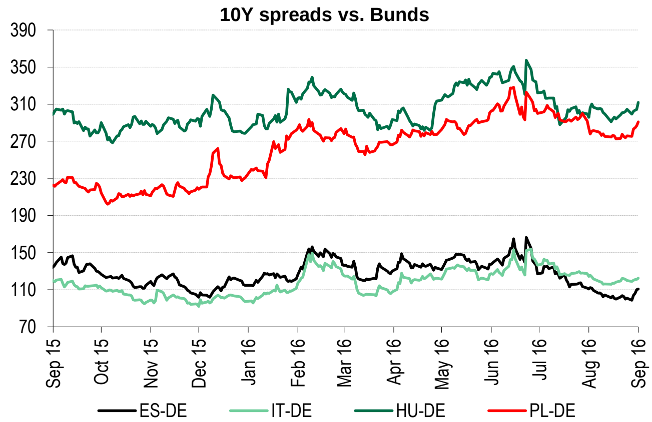
- The situation of other CEE currencies was mixed last week. The forint lost c0.5% vs. the euro, while the Czech koruna and Romanian leu were roughly unchanged. The Russian ruble was the biggest loser, as the USDRUB soared temporarily to 66.0 in the wake of a significant oil price drop.
- This week, the Fed policy outlook will remain important for the currencies in the region, plus there will be several local data releases: Hungarian GDP, inflation in Czechia and Hungary. The Czech GDP data beat market expectations, as the economy rose 0.9 q/q and 2.6% y/y in 2Q thanks to the contribution of foreign trade and a lower-than-expected drop in investments. If the Hungarian GDP shows a similar surprise, the forint may get some support.

Interest rate market – Polish debt leading selloff in Europe









Polish debt sold off before the US data

- Polish bond yields surged last week, rising to their highest levels since early August. The selloff was triggered by PLN weakness, information about sizeable bonds supply plan for September, worries about looming Moody's decision and expectations for strong US labour market data on Friday. The curve steepened, with 10Y benchmark yield going up c.19bp in one week (the biggest weekly surge in European debt markets) and 2-10 spread rising c.8bp. Lower than expected US non-farm payrolls data triggered only temporary relief and yields quickly returned to their weekly highs.
- Despite disappointing 2Q16 GDP data (particularly investments), WIBORs remained stable, while FRA rates increased, so the scale of interest rate cut priced in by the market decreased quite markedly – to merely 17bp in the 12-18 months horizon. The FRA rise was probably a reaction to higher than expected CPI and PMI, less dovish comments of MPC members, and zloty depreciation (weaker zloty = lower probability of interest rate cuts).
- At Thursday's auction the Ministry of Finance sold bonds worth PLN 7bn at the demand of PLN10.7bn. At the top-up auction, bonds for additional PLN606m were sold. Yields reflected the levels from the secondary market. We estimated that after the Thursday auction the gross borrowing needs for this year have been covered in ca. 86%.
- According to the Ministry of Finance, in July the portfolio of Polish T-bonds held by foreign investors fell by PLN3.7bn (which resulted mainly from redemption of bonds worth PLN2.2bn – majority of those funds were reinvested at the auction on July 28 and will be visible in data for August). The portfolio of bonds held by Polish banks shrank by PLN1.6bn. Deputy finance minister Nowak said that in August the ministry observed rising foreign investors' involvement in medium- and long-term Polish bonds, while they reduced portfolios of short-term bonds.

Strong rebound unlikely before Moody's decision

- We see quite limited room for Polish debt strengthening before the next Friday's Moody's rating decision. The fact that yields' rebound just after the weaker US data release was very short-lived suggests, in our view, that investors' sentiment is bearish and the market may need really strong argument to change it. More significant decrease of Polish bond yields is possible after September 9th, if Moody's keeps Poland's rating unchanged on (which we expect). In case of the rating downgrade, the reaction of both PLN and bonds will be negative, but probably also temporary, as investors may see weaker yields and exchange rate as attractive buying opportunity.
- Even though recent GDP data confirmed that the MPC's optimism regarding economic growth outlook was probably excessive, we doubt if the tone of the Council's statement will change dramatically at the first meeting after the summer break. Thus, the result of the central bank meeting is not likely to boost market expectations for interest rate cuts, in our view.

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