

WEEKLY ECONOMIC UPDATE

17 – 23 July 2017

Inflation data for June confirmed that the surprising CPI drop to 1.5% y/y was mainly due to prices of fuel and food, while core inflation stabilized at 0.8% y/y. At the nearest Sejm meeting (Tuesday-Thursday) the new “road tax” may be approved, but its impact on inflation may be softened and spread in time if the state-owned fuel companies Orlen and Lotos decide to take the burden of higher costs (at least initially), which was suggested recently by some politicians. Sooner or later the new tax will probably feed into retail prices, but we see lower risk that the impact will be imminent. As a result, the moment when the CPI growth tops 2% seems to be delaying until 2018 again.

There are several domestic data releases in the next week’s agenda. Wages and employment on Tuesday, industrial and construction output on Wednesday, money supply on Friday. The number of working days in June was again lower than last year, so the readings will be probably not very impressive, confirming that GDP growth has probably decelerated slightly below 4% y/y in 2Q17. The ECB meeting on Thursday will be probably the key event of the week. No change in monetary policy is expected, but investors will focus on the Mario Draghi’s comments at the press conference, especially after the recent controversy whether his earlier more hawkish comments were correctly interpreted by the market. It seems that lower inflation, lack of wage pressure, and especially the stronger euro, will prevent the ECB from turning towards more hawkish language too early. Thus, it seems possible that a rebound in the bond markets after the recent selloff may take place. The weaker data from the USA released recently seem to be a good prerequisite for such a rebound.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (17 July)							
11:00	EZ	CPI	Jun	% y/y	1.3	-	1.4
TUESDAY (18 July)							
11:00	GE	ZEW index	Jul	pts	88.0	-	88.0
14:00	HU	Central bank decision		%	0.9	-	0.9
14:00	PL	Wages in corporate sector	Jun	% y/y	5.0	4.6	5.4
14:00	PL	Employment in corporate sector	Jun	% y/y	4.3	4.2	4.5
WEDNESDAY (19 July)							
14:00	PL	Industrial output	Jun	% y/y	3.9	3.9	9.1
14:00	PL	Construction and assembly output	Jun	% y/y	9.8	9.5	8.4
14:00	PL	PPI	Jun	% y/y	2.1	2.1	2.5
14:00	PL	Real retail sales	Jun	% y/y	6.0	5.5	8.4
14:30	US	House starts	Jun	% m/m	5.8	-	-5.5
14:30	US	Building permits	Jun	% m/m	3.0	-	-4.9
THURSDAY (20 July)							
13:45	EZ	ECB decision		%	0.0	-	0.0
14:30	US	Philly Fed index	Jul	pts	23.4	-	27.6
14:30	US	Initial jobless claims	week	k	245	-	247
FRIDAY (21 July)							
14:00	PL	Money supply M3	Jun	% y/y	5.9	5.7	6.2

Source: BZ WBK, Reuters, Bloomberg

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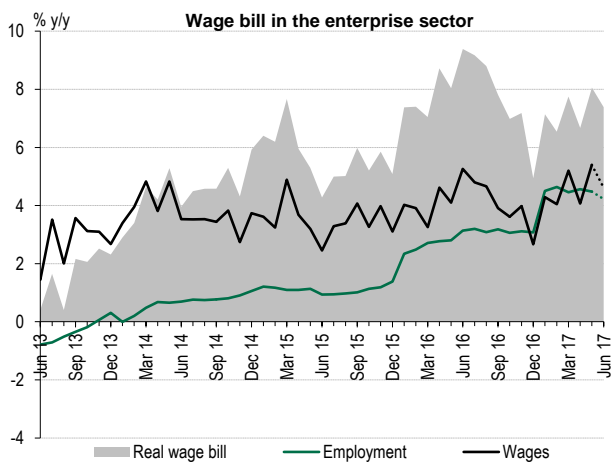
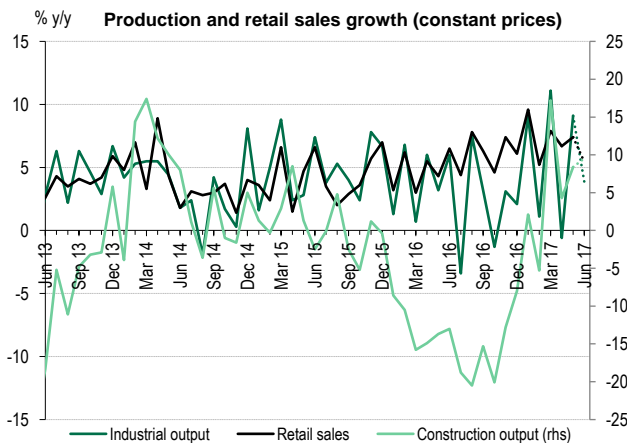
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What's hot next week – Bunch of important macro data

▪ This week will be rich in important macro releases. The working-day effect will be again negative (-1 y/y vs +1 in May) and this will strongly affect numerous statistics. Note also that one of working Fridays (16 June) followed the Corpus Christi holiday, encouraging many people to go on vacation. In our view, this has additionally lowered the effective number of working days.

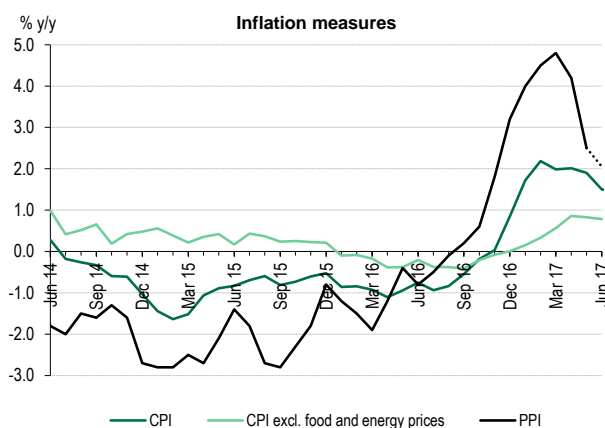
▪ We believe June's industrial output will decelerate markedly versus May and reach only 3.9% y/y, mostly due to the working-day effect. The same will weigh on real retail sales, which we expect to expand by 5.5% y/y. However, the underlying trend in both will remain intact, suggesting positive situation in consuming and producing sectors.

▪ Construction output data may prove a bit more interesting, as it is slightly less susceptible to working-day effect and it surprised to the downside in May. Situation in construction is one of the major indicators of investment, so further downward surprises would suggest the ongoing delay in investment recovery.

▪ We expect wage growth to be considerably lower in June, dropping from 5.4% y/y in May to 4.6%. Let us remind that May's results went up due to one-offs. We will surely eye employment data as recent statistics suggested that the positive tendencies on the labour market are losing steam.

▪ We estimate that PPI inflation went a little down to 2.1% y/y in June from 2.5% y/y. Low rise in producer prices comes from the decline in the commodity prices, particularly oil (10% m/m in PLN terms).

▪ According to our forecasts, M3 money supply should show a slight deceleration, changing from 6.2% y/y in May to 5.7%. We are curious whether the outflow of deposits, seen in May, will hold. This development was noted by MPC's Gatnar as an example of negative real interest rate effect.

Last week in economy – CPI down in June, May current account below expectations

▪ The CPI's June decrease to 1.5% y/y from May 1.9% was due to the change in transport prices (fuel prices dropped by 4.1% m/m plus there was a high base in June 2016), while changes in other categories were minute. Core CPI excluding food and energy prices remained unchanged at 0.8% y/y. We expect the headline CPI to stabilise near 1.5% y/y in the months to come with the risk skewed to the upside due to the risk of introducing the 'road fee'.

▪ Polish May current account balance was at -€179mn versus consensus at +€335mn. Surprise was due to lower readings in all balances, especially on the primary income balance. Trade data showed a major acceleration in exports and imports, to 14.5% y/y and 19.1% from 1.4% and 3.3%, respectively. In our view, exports and imports will continue to grow at a healthy rate this year, yet imports will be more dynamic.

Quote of the week – Negative real interest rate are an argument to hike

Grażyna Ancyparowicz, MPC member, 12 July 2017, PAP

Forecasts do not show a need to change rates. However, hikes may be implemented if core inflation goes up due to labour market tensions (...) However, even if it is the case, then probably no earlier than in 2H18.

Eugeniusz Gatnar, MPC member, 12 July 2017, PAP

If adverse effect of negative real interest rates becomes more visible, it would be an argument for considering hikes even at the end of 2017. Higher rise of CPI and exceeding the NBP target would be another factor triggering hikes.

Eryk Łon, MPC member, 10 July 2017, PAP

There is no need to change interest rates.

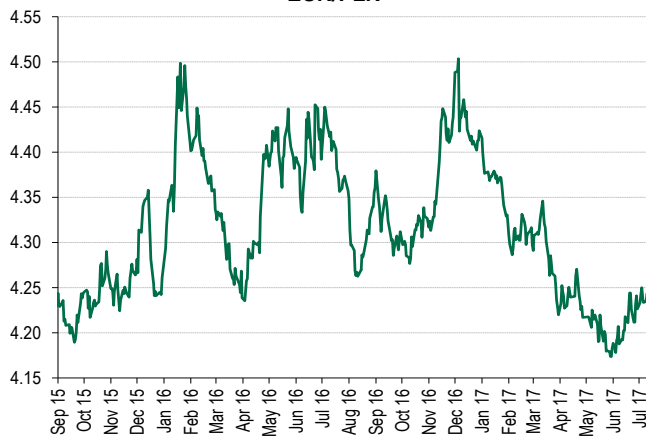
Łukasz Hardt, MPC member, 10 July, Bloomberg

If the next projections show real rates remaining negative throughout 2018, attempts to tighten policy will be taken even at the beginning of next year.

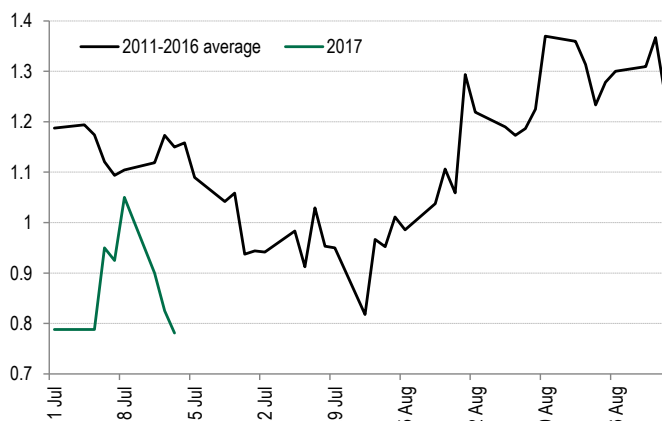
Growing divergence within the MPC is a fact. A few central bankers (Gatnar, Hardt and Zubelewicz) are fed up with negative real interest rates and are forming a hawkish camp, which in our view will be driving discussion about interest rate hikes in 2018. Hikes in late 2017, suggested by Gatnar are off the cards in our view, but higher CPI will actually encourage the MPC to hike rates in 4Q18. A bit more hawkish note in the MPC, coupled with similar signals from the FOMC and ECB moved back the market pricing of hikes in Poland to 4Q18 from 1Q19. Still, other MPC members like Ancyparowicz or Łon seem to follow Glapiński guidance there will be no need to hike rate throughout 2018.

Foreign exchange market – Still waiting for a trigger

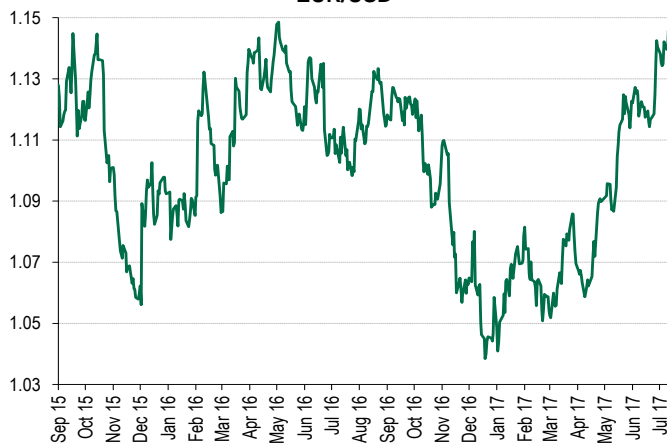
EUR/PLN



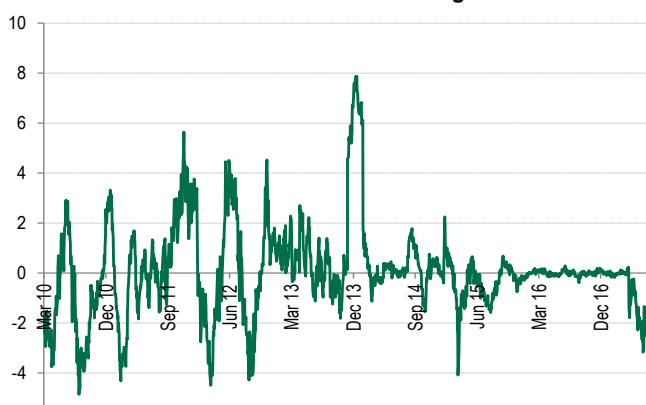
3M EURPLN risk reversal



EUR/USD



EURCZK 3-month % change



Still waiting for a trigger

▪ Last week volatility on the Polish FX market was very low. The global market sentiment was quite positive which allowed EURPLN to fall to c4.215 from 4.238 but the exchange rate stayed in the 4.20-4.26 range observed since mid-June. USDPLN held near 3.70. Please note that 4-week range for EURPLN is the lowest ever clearly showing that market is waiting for a strong impulse that could trigger a directional move.

▪ In early July we presented a seasonal pattern for EURPLN showing that the Polish currency usually gains vs the euro in July while August is a time of profit taking. The second chart shows that the same case is for the EURPLN's volatility.

▪ This week we will see many Polish monthly economic activity data that are likely to show a clear deceleration vs the previous month. Our forecasts are near the consensus so any negative impact of these releases on the zloty should be limited.

▪ On the global market the key event will be the ECB decision and we think the outcome of the central bank's meeting may be crucial for the zloty's performance. The recent weeks showed that the Polish currency is sensitive both to hawkish and dovish remarks suggesting that the Thursday's press conference may initiate some higher volatility on the PLN market.

EURUSD stays high

▪ EURUSD remained near the multi-month peak around 1.15. Similarly for the PLN, recent two weeks did not bring any material changes on the global main exchange rate.

▪ EURUSD is holding slightly below the upper band of the horizontal range observed since early 2015 and the outcome of the ECB meeting could determine whether 1.15-1.17 area will be broken soon.

Forint and ruble stronger, koruna stable

▪ Positive global market sentiment supported the forint pushing EURHUF from above 308 to 306, its lowest since mid-June. Lower than expected June inflation figure (1.9% y/y vs market consensus at 2.0%) did not prevent the forint from appreciation.

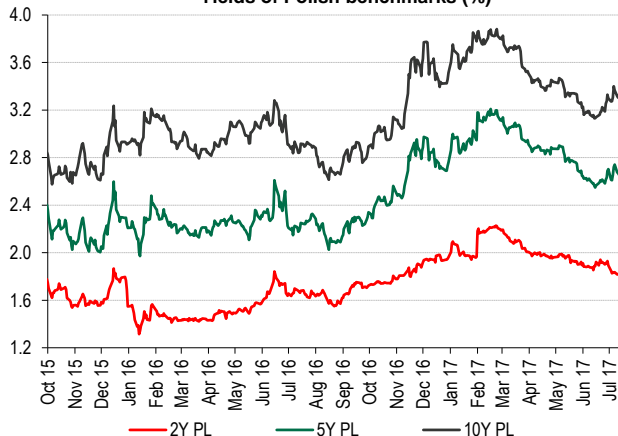
▪ Hungarian central bank announces its decision this week. The recent inflation figures should warrant that dovish rhetoric will be maintained. EURHUF has neared its local low at 305.5 and we think it may be difficult for the exchange rate to break this level given the expected outcome of the central bank's meeting.

▪ EURCZK did not move much for the second week in a row and stayed just above 26.0. The Czech koruna gained in mid-June temporarily c3% vs the euro since the Czech National Bank removed the floor at 27 in early April. The fourth chart shows that the EURCZK 3-month rolling % change has recently retreated levels historically perceived as exaggerated and this makes us cautious as regards the possibility of koruna restarting appreciation trend in the short term.

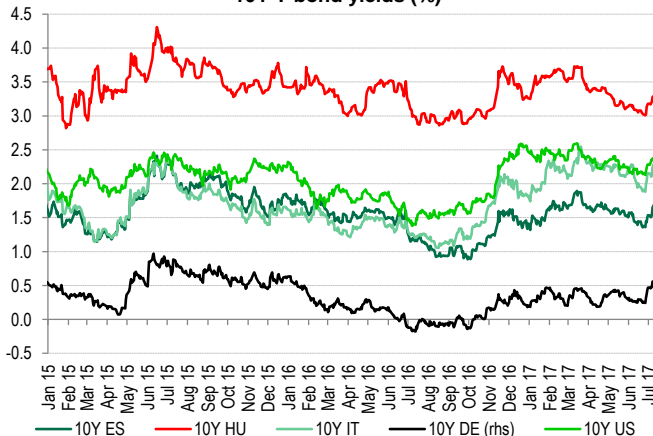
▪ Pause in oil's down trend allowed the ruble to pare part of the recent losses vs the dollar – USDRUB fell to nearly 59.5 from 61.

Interest rate market – ECB in the spotlight

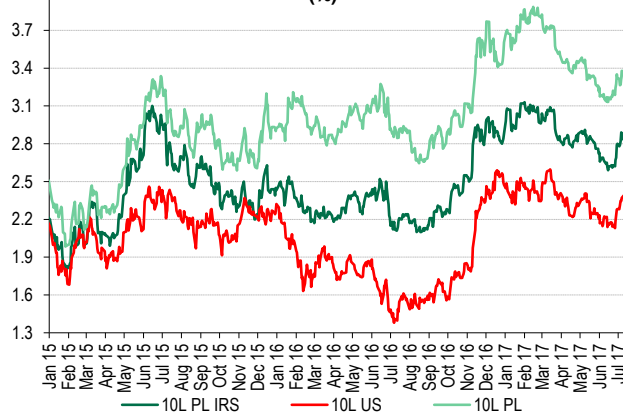
Yields of Polish benchmarks (%)



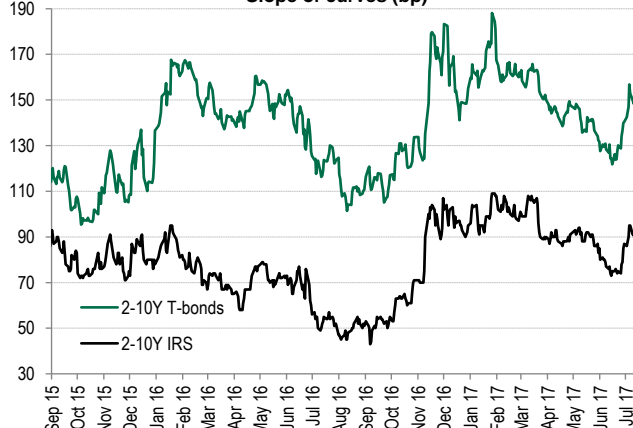
10Y T-bond yields (%)



Yields of PL and US 10Y benchmarks and 10Y PL IRS (%)



Slope of curves (bp)



Quiet week behind

▪ Last week was dominated by calmness on the Polish bond and IRS market. The movement along the bond curve was rather humped with 5Y yield down by 8bp to 2.66%. IRS curve flattened in the belly and at the long end by 6bp. As a result 10Y asset swap spread widened slightly to 51bp.

▪ Dovish comments made by Janet Yellen last week supported UST whose 10Y yield dropped by c5bp to 2.32%. The global bond strengthening resulted in lower yields of emerging market debt with 10Y Czech yield falling by 14bp to 0.977% and 10Y Hungarian by 13bp to 3.03%

ECB prepares market to announce shrinking APP soon?

▪ This week the market will focus on Thursday's ECB meeting. According to the last week Wall Street Journal news the central bank will announce in September the limiting asset purchase programme (APP) at the beginning of next year.

▪ Recent comments from ECB policymakers together with improving economic outlook in Europe have helped to prepare market participants for a monetary policy change, most likely in the form of an announcement that ECB will taper its asset purchases. The inflation outlook, however, has been recently lowered and the ECB still argues that price pressures in the Euro zone are still too weak for the central bank to unwind its monetary stimulus.

▪ According to the latest Reuters poll, 47% respondents expects the ECB to announce in September a tapering of 60 billion euros of monthly asset purchases, probably starting in early 2018.

Polish macro data and Hungarian MPC in focus

▪ Polish macro data that will be released this week, in our view, will have a limited impact on the domestic IRS/yields. We think that the long end of the curve will follow the Bund this week which remains sensitive to comments made during Thursday's ECB press conference. However, we expect that lower Polish debt supply in the primary market will limit the yield increase and narrow 10Y PL-DE spread which now oscillates close to 275bp.

▪ We expect the Hungarian central bank (MNB) to keep interest rates unchanged in July, with the reference rate still at 0.90%. Hungarian June CPI fell further to 1.9% y/y from 2.1% in May, slowing for the fourth month in a row. The inflation rate has been decreasing and the central bank is concerned that the moment of reaching CPI target of 3% may be delayed beyond early 2019. In our view, the MNB rhetoric will be dovish which may weigh on forint-denominated assets.

▪ Last week June CPI reading (2.3% y/y) in the Czech Republic strengthened market expectations for interest rate hike this year. Solid economic growth and accelerating wage dynamics support rhetoric of the CNB. We expect the interest rate hike to take place in 4Q17.

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