

# WEEKLY ECONOMIC UPDATE

## 24 –30 July 2017

The outcome of the ECB meeting triggered higher volatility on the FX and fixed income market. As we had suspected, the tone of the statement remained dovish, pushing bond yields in Europe down. At the same time, the euro resumed its appreciation trend vs the dollar because Mario Draghi did not comment much on the exchange rate during the press conference. In the investors' opinion, this means a lower risk of verbal intervention the ECB could take to limit the potential for further euro gains. Macro data released in Poland showed a deceleration vs the previous month but this was mainly due to the unfavorable effect of the number of working days. Seasonally-adjusted figures confirmed that Polish economy is growing at a pace only a touch weaker than in 1Q. Polish currency and bonds did not benefit much from the dovish rhetoric of the ECB which may have partly resulted from protests in response to the governmental plans to introduce changes in the judicial system.

This week, the market attention may turn to the US where FOMC will announce its decision on the interest rates. No change in monetary policy parameters is broadly expected this month so the tone of the statement should be crucial. The recent US economic activity data was rather mixed but the June non-farm payrolls surprised to the upside. That is why we think the July FOMC statement will leave the door open for the third 25bp rate hike this year. According to Bloomberg, the market is not pricing in such a scenario so the tone of the statement may be received by investors as rather hawkish. As a result, the outcome of the FOMC meeting may put a negative pressure on the zloty and Polish long-term bonds.

Although we think that political developments may have some short-term impact on domestic assets, for the time being we do not expect this events to have any material impact of Poland's perception by foreign investors. It would be more difficult to win a rating upgrade but we do not expect any downgrades either as long as the economic growth is sound and fiscal balances are safe.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (24 July)</b>							
9:30	GE	Flash PMI – manufacturing	Jul	pts	59.2	-	59.6
9:30	GE	Flash PMI – services	Jul	pts	54.3	-	56.4
10:00	EZ	Flash PMI – manufacturing	Jul	pts	57.2	-	57.4
10:00	EZ	Flash PMI – services	Jul	pts	55.5	-	55.4
16:00	US	Home sales	Jun	m	5.56	-	5.62
<b>TUESDAY (25 July)</b>							
<b>10:00</b>	<b>PL</b>	<b>Unemployment rate</b>	<b>Jun</b>	<b>%</b>	<b>7.1</b>	<b>7.2</b>	<b>7.4</b>
10:00	GE	Ifo index	Jul	pts	114.9	-	115.1
16:00	US	Consumer confidence index	Jul	pts	116.0	-	118.9
<b>WEDNESDAY (26 July)</b>							
16:00	US	New home sales	Jun	k	615	-	610
20:00	US	FOMC decision		%	1.0-1.25	-	1.0-1.25
<b>THURSDAY (27 July)</b>							
14:30	US	Durable goods orders	Jun	% m/m	3.0	-	-0.8
14:30	US	Initial jobless claims	week	k	-	-	233
<b>FRIDAY (28 July)</b>							
14:30	US	Advance GDP	Q2	% y/y	2.5	-	1.4
16:00	US	Michigan index	Jul	pts	93.0	-	95.1

Source: BZ WBK, Reuters, Bloomberg

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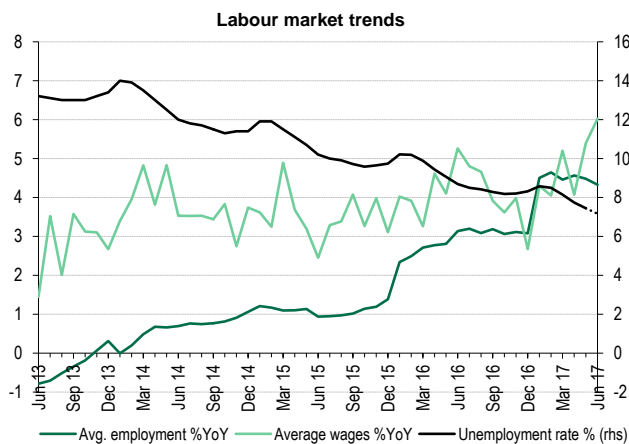
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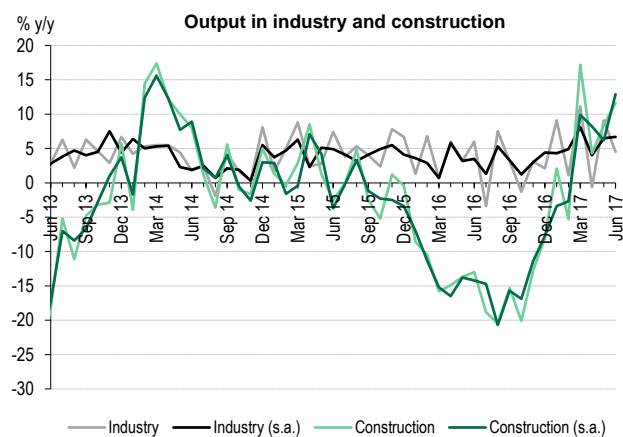
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**What's hot next week** – Statistical Bulletin to show detailed data on labour market

Statistical Bulletin is the only Polish macro release this week. In our view, registered unemployment rate fell to 7.2% in June from 7.4% in May. Risk for our forecast is skewed downwards. We think that the downward march of unemployment is slowing down and June's data are likely to confirm that.

Detailed data on wages will be particularly interesting, as we will get to know what was behind the surprising acceleration of wages to 6.0% y/y in June. The sudden nature of the move suggests that one-off factors, such as bonus payments in mining or mining-related branches of manufacturing, were in the play.. It cannot be ruled out, however, that the wage pressure has been intensifying in Poland.

On Friday the Statistics Office will release its assessment of 2017 harvest of main crops. Data on fruit and vegetables will be crucial in assessing price tendencies.

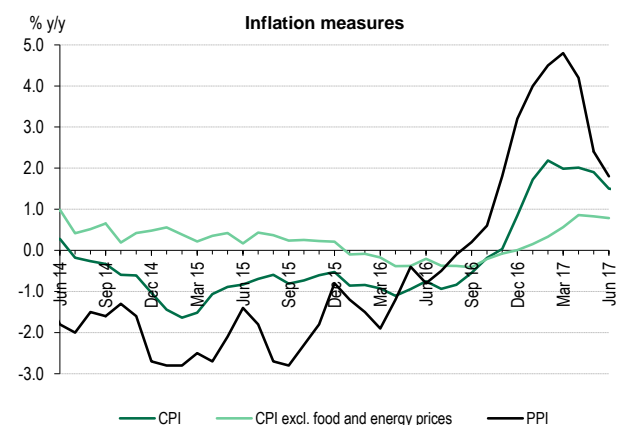
**Last week in economy** – 2Q data confirm slight slowdown in GDP growth

In June industrial output growth slowed to 4.5% y/y and real retail sales to 5.8% y/y mainly due to the negative working days effect. However, aside from the calendar effects, trends in industry and retail trade are still positive, in our view. Construction output is also showing a gradual recovery (in June 11.6% y/y), which may signal a growing investment activity. We think that 2Q data suggest a very slight slowdown in GDP growth in this quarter to 3.8-3.9% y/y.

Employment in the corporate sector reached 6mn in June after an increase of 4.3% y/y. On a monthly basis, employment went up by 11k, quite solidly, though less than last year (19k). Wage growth in the corporate sector accelerated sharply to 6.0% y/y in June, much above forecasts, and was the highest since January 2012. Real wage bill in the corporate sector rose 8.9% y/y in June, the fastest pace since July 2016. Solid rise in wages should have supported private consumption in 2Q and this should work later in the year. Rising wage pressure was mentioned by some of the MPC members as a factor bringing the decision to hike rates forward and we think these data will be watched closely by Polish central bankers. We expect the first hike in late 2018.

PPI inflation decreased in June to 1.8% y/y from 2.4% in May. Compared to May, the prices fell by 0.4%, mainly due to a drop in commodity prices and PLN strengthening vs USD.

M3 money supply rose by 5.0% y/y in June, the slowest pace since January 2013. Slowdown versus May (6.3% y/y) was due to slower growth in households' and corporate deposits. In monthly terms, household deposits increased by PLN3.4bn, while corporate declined by PLN5.4bn. This development was partially a reversal of the surprising move seen in May (households -PLN3.9bn, corporates +PLN7.3bn).

**Quote of the week** – MPC should implement a cautious hike this year**Kamil Zubelewicz, MPC member, 17 July 2017, PAP**

We should implement a cautious hike this year, and the earlier it will be, the better, to avoid trespassing 2.5% inflation, and then wait until mid-2018 to see what happens. I would like most members required to make such a raise to gather before it is too late. Inflation is going towards the target, which I find too high anyway. My arguments in favour of this year's hike are independent from the risks associated with negative real interest rates.

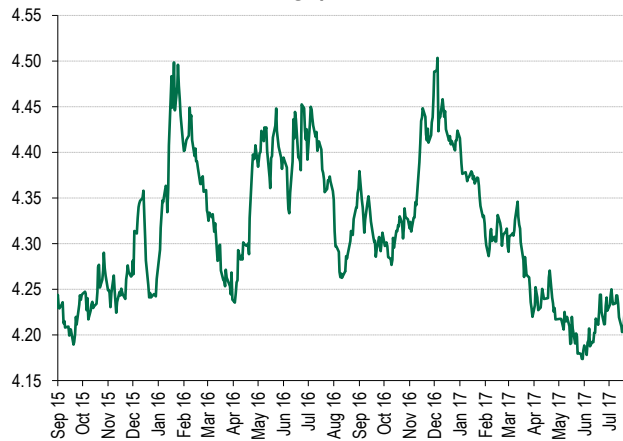
**Eugeniusz Gatnar, MPC member, 18 July 2017, Parkiet**

In my opinion, inflation will accelerate more than the NBP forecast assumes. (...) If inflation got back to the target at the end of 2019, interest rates would need to be raised in 1H 2018. Perhaps even at its beginning.

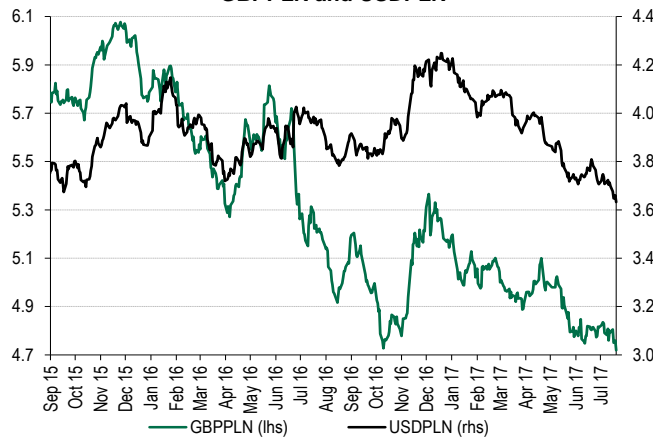
The MPC's hawkish squad clearly wants to stay in vanguard of the monetary policy tightening in Poland. Zubelewicz put forward a 'cautious hike' idea. In his view, the MPC is dragging its heels in monetary tightening and may end up in dire straits if rates do not go up soon enough (even in 2017). Gatnar, on the other hand, sticks to the forward-looking mode and argued that rates should go up soon if inflation is expected to hit the target in late 2019. In our view, hawks will not assemble majority to support hikes in 2017. However, they will be providing a fillip for the linchpin MPC member Adam Glapiński, who will finally prod other central bankers to hike rates in late 2018.

## Foreign exchange market – Attention turns to Fed

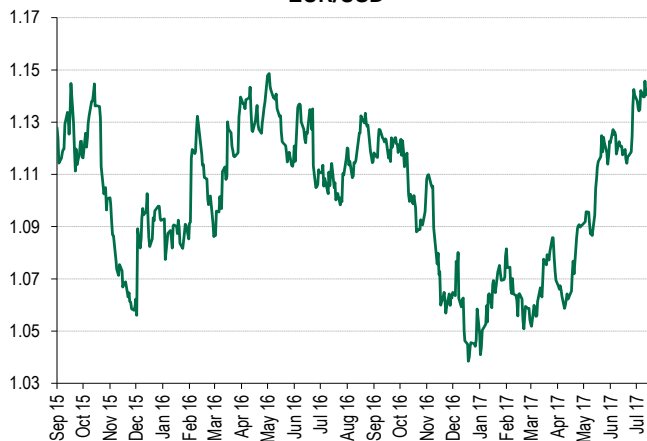
### EUR/PLN



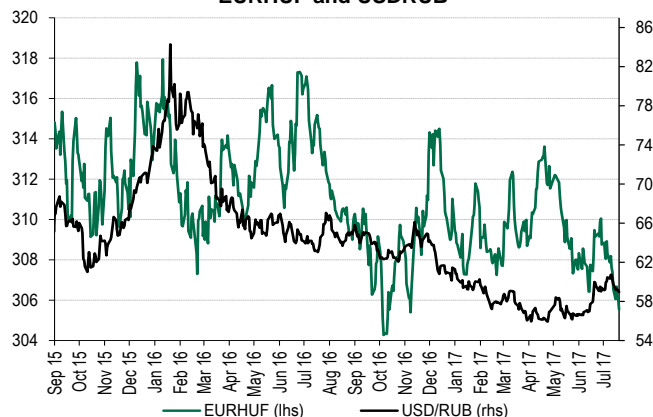
### GBPPLN and USDPLN



### EUR/USD



### EURHUF and USDRUB



### EURPLN holds range

■ In the last days, the intraday volatility on the Polish FX market was higher than in the past weeks but EURPLN remained in the 4.20-4.26 range. The exchange rate was testing the lower end of this range but did not manage to stay below for good. At the end of the week, EURPLN was near 4.25 despite the dovish rhetoric of the ECB and, to some extent, probably due to protests in Poland. At the same time, the zloty appreciated noticeably vs the dollar and USDPLN plummeted to 3.61, its lowest since May 2015. The Polish currency gained also vs the pound (GBPPLN fell to 4.70) and remained strong vs the franc (CHFPLN stayed near 3.80).

■ This week we will learn important euro zone and US data but it seems that it is the FOMC statement that will be in focus. The recent US economic activity data was rather mixed but the June non-farm payrolls surprised to the upside. That is why we think the July FOMC statement will leave the door open for the third 25bp rate hike this year. According to Bloomberg, the market is not pricing in such scenario so the tone of the statement may be received by investors as rather hawkish. As a result, the outcome of the FOMC meeting may put negative pressure on the zloty.

■ Last week the zloty underperformed its CEE peers which, at least to some extent, may have been caused by both the inability to break psychological level 4.20 and government plans to change the judicial system that may trigger a reaction of the European Commission. We think that political developments may have some short-term impact on the zloty.

### EURUSD rally continues

■ EURUSD resumed the rally and jumped above 1.165, its highest since August 2015, despite the dovish signals from the ECB. The euro gained vs the dollar because Mario Draghi did not comment much on the exchange rate during the press conference which in the investors' opinion means a lower risk of verbal intervention the ECB could take to limit the potential for further euro gains.

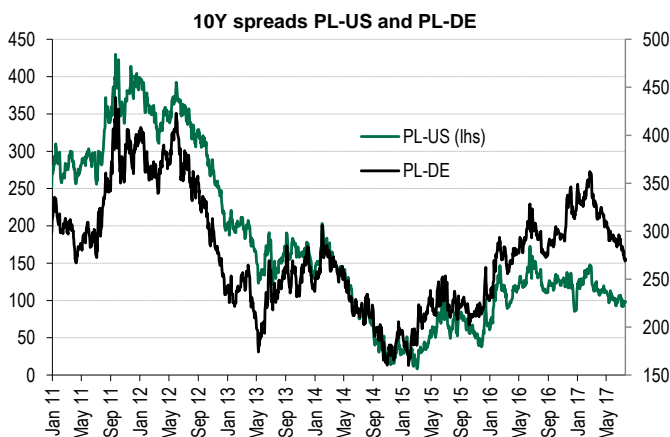
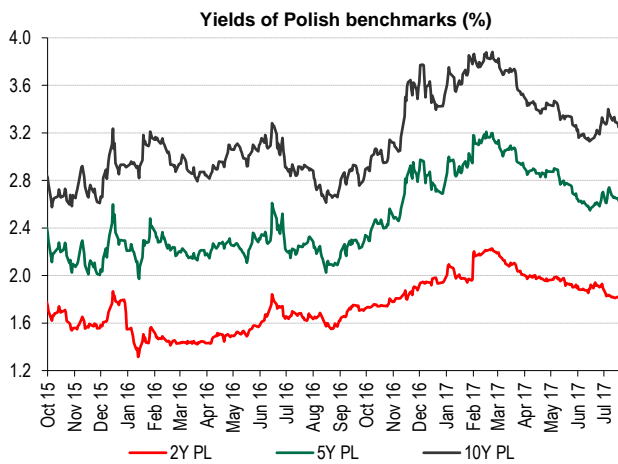
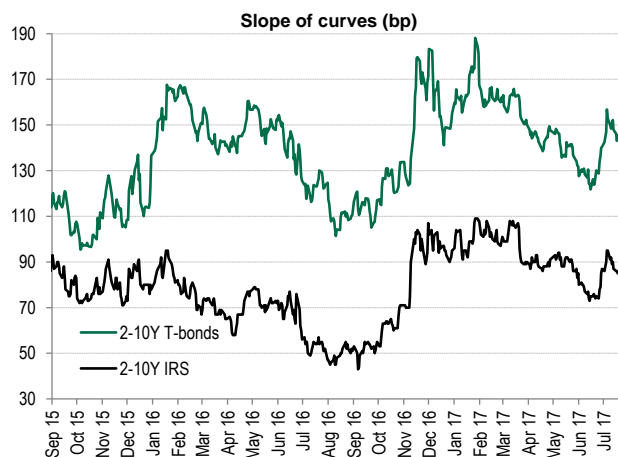
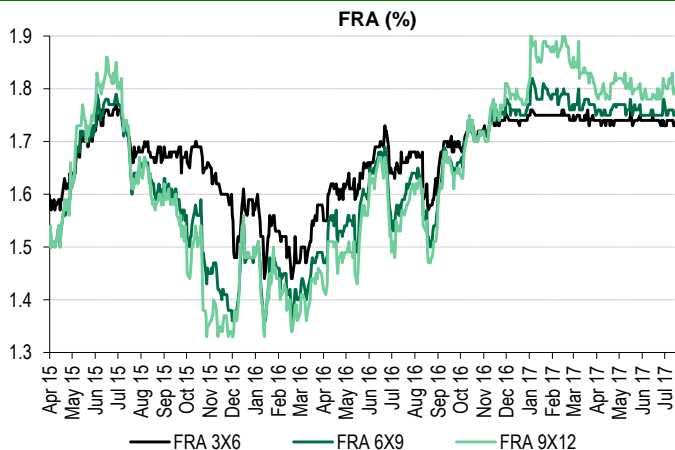
■ EURUSD neared the August 2015 peak that was reached in reaction to the dovish FOMC minutes which, in the market's view, had been postponing the Fed rate hike. The following decline was fueled by some strong US data. This week will also see important US figures and FOMC will announce its decision on the interest rates. As we have mentioned above, we think the July statement will be likely interpreted as somewhat hawkish and this could allow the dollar to recover at least slightly vs the euro.

### Forint and ruble gain, koruna stable

■ Forint benefited from the ECB dovish rhetoric and EURHUF fell to 305 from 307 and reached its fresh 2017 low. Dollar's weakening on the global market and a rebound in oil prices supported the ruble: USDRUB fell slightly below 59. Koruna remained fairly stable as EURCZK stayed just above 26.

■ This week on Friday the central bank of Russia (CRB) will announce its decision on the interest rates. We do not expect any changes this time but the bank is likely to maintain the dovish bias and signal that rate cuts are on the agenda for the coming months.

## Interest rate market – Local factors crucial this week



## Peace and quiet on bond market

- July seems to be very quiet on the Polish debt market. Both bond and IRS curves remained stable last week and clearly underperformed Bund and UST.
- Dovish rhetoric of the ECB supported the euro zone's bonds, in particular Spanish and Italian ones. Polish bonds weakened with rising 10Y PL-DE spread to above 270bp.
- FRAs remained fairly stable, but we saw some upward move (by 2bp) at 15x18 and 18x21 rates. FRAs at the moment imply the first 25bp rate hike in Poland to take place in next 15-18 months. We still think the first rate hike will come in 4Q18.

## ECB still dovish, but will Fed be hawkish?

- This week the key event for the investors will be the Wednesday's FOMC meeting. We do not expect any Fed monetary policy change, however the rhetoric of the statement may indicate a forthcoming hike in September or December. The market prices in neither of these scenarios, so we think the hawkish signal could support UST with 10Y yield to increase to 2.75% by year-end.
- The last week's ECB meeting did not change much. The bank expects to keep interest rates at the current level for a longer period after the asset purchase programme ends. Mario Draghi said that the APP will be run until inflation rate is on the path towards its target. He stressed that inflation is low due to energy prices and the bank will wait for the core inflation rise, which is expected to take place in medium term. ECB will discuss deeper the next stage in its QE programme in the autumn but the date has not been fixed yet due to significant uncertainty on the markets. The dovish tone of the statement and during the press conference pushed bond yields down in Euro zone with 10Y Bund close to 0.5%.

## High demand for short end bonds

- On Tuesday this week, the Polish bond OK0717 will mature. The outstanding amount is PLN7.63bn of which c70% is held by domestic banks. Additionally coupon payments of cPLN5.6bn will be transferred. Taking into account the fact that domestic banks need to pay banking tax unless they hold Treasury bonds, we think that inflow of cPLN13.3bn on the market will support the Polish bond market, especially on the short end.
- Recent political turmoil in Poland regarding the judicial system poses, in our view, significant risk on the long end. The domestic unrest and comments from international institutions may weaken, in our view, bonds with 5-10Y maturity. In the past week 10Y bonds in developed markets strengthened (Bund by 8bp, UST by 7.7bp) while Polish 10Y benchmark clearly underperformed and the yield dropped by only 1.5bp.
- We think that the front end of the bond curve should anchor close to 1.75-1.77%. The belly and the long end will remain more sensitive to both internal and external factors, including macro data releases abroad and FOMC decision, which can increase market volatility.
- We think that Fed rhetoric may evoke market reaction on the debt market and globally affect yields, including the Polish assets. We see the risk of widening asset swap spread and 10Y PL-DE spread from the current 270bp.

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