

# WEEKLY ECONOMIC UPDATE

## 7 – 13 August 2017

Last week, EURPLN and bonds did not move much despite the surprising drop of manufacturing PMI, higher-than-expected flash July inflation and comments from the three rating agencies on the consequences that conflict with EC could have on the rating. Globally, volatility was higher as the euro continued to gain vs the dollar amid next decent economic activity data from Europe and next wave of political turmoil in the US weighing on the dollar. Bank of England cut its GDP growth forecasts which hit the pound.

This week, macro calendar is rather light so the market could remain under the impact of the US strong monthly jobs report. Recent US data was not too encouraging, so the impact of Friday's positive surprise might persist in the days to come halting the upside trend in EURUSD and generating upside pressure on the market interest rates. On the other hand, several FOMC members who will speak this week seem to belong to the dovish camp and they could neutralize at least part of the hawkish signal sent by the US non-farm payrolls. In Poland, we will learn final July CPI that is rather unlikely to deviate much from the flash estimate. Our forecast for the June C/A assumes deficit much larger than the market expects and this could weigh on the zloty.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (7 August)</b>							
8:00	GE	Industrial output	Jun	% m/m	-	-	1.2
9:00	CZ	Industrial output	Jun	% y/y	7.0	-	8.1
<b>TUESDAY (8 August)</b>							
8:00	GE	Exports	Jun	% m/m	-	-	1.4
9:00	HU	CPI	Jul	% y/y	2.0	-	1.9
<b>WEDNESDAY (9 August)</b>							
9:00	CZ	CPI	Jul	% y/y	2.3	-	2.3
<b>THURSDAY (10 August)</b>							
14:30	US	Initial jobless claims	week	k	-	-	240
<b>FRIDAY (11 August)</b>							
14:00	PL	CPI	Jul	% y/y	1.7	1.7	1.5
14:00	PL	Current account	Jun	€m	-750	-1496	-179
14:00	PL	Exports	Jun	€m	16 577	16 854	16257
14:00	PL	Imports	Jun	€m	16 457	16 862	16457
14:30	US	CPI	Jul	% m/m	0.2	-	0.0

Source: BZ WBK, Reuters, Bloomberg

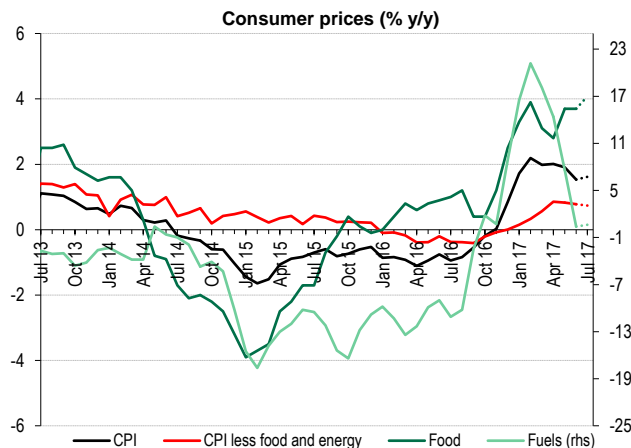
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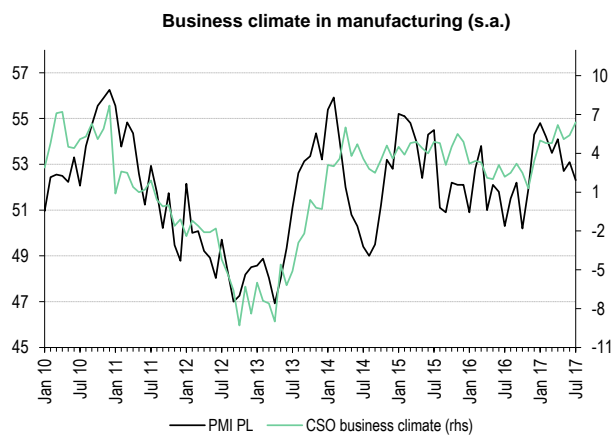
## What's hot next week – Source of higher inflation



July's preliminary CPI reading surprised to the upside with inflation accelerating to 1.7% from 1.5% y/y while we and the market expected 1.6%. There could have already been some impact of limited supply on retail fruit prices and future months might be even more affected (spring freeze caused massive losses in apples and stone fruit crops). Another reason for higher than expected inflation might be the ongoing large rise of pork and butter prices (the former is a EU-wide phenomenon, the latter is observed globally). Locally, the rise in the price of butter so far did not spread to all dairy products and could lead to higher demand for substitutes – causing this CPI component to ease.

In our view, C/A deficit increased in June to EUR1.5b – the largest gap in two years. The trade deficit most likely stayed close to zero while growth of exports and imports remained robust (we expect 10.1% y/y and 15%, respectively).

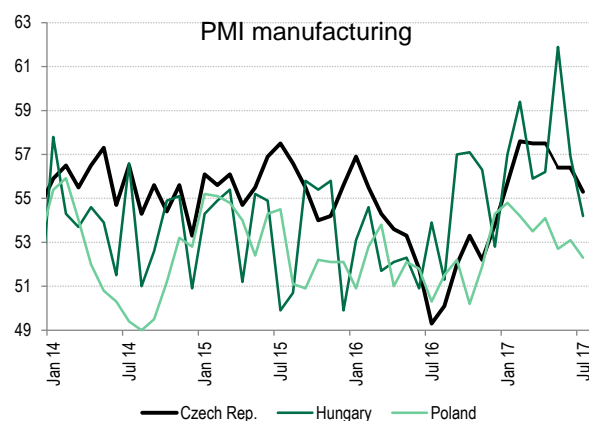
## Last week in economy – Business optimism fades, rating agencies eye PL-EU dispute



Polish manufacturing PMI surprisingly fell in July to 52.3pts, its lowest for eight months and well below consensus at 53.5pts and our forecasts at 54.0pts. This release looks pretty poor given the improving moods in Europe and rising climate indices for Poland (ESI, Statistics Office measures). Note, however, that readings of PMI for Czechia and Hungary also disappointed. Breakdown of Polish PMI is not coherent with analogous indices computed by the Statistics Office and the European Commission. Output index fell to the lowest level in nine months. Total new orders rose at the slowest pace for eight months but export orders remained robust growing faster than domestic orders. Employment index remained at a healthy level. Given the broad sentiment improvement seen abroad and measures for Poland calculated by other entities, we view July PMI reading as a one-off.

The European Commission (EC) launched infringement procedure against Poland. EC gave the Polish government a one month deadline to answer all charges. Given further steps the EC can take (combined with the support of other members states that is necessary for sanctions), we think that possibility of severe economic sanctions is low. Meanwhile, the Polish Parliament is on vacation, so until September important political changes are unlikely.

Three main rating agencies referred last week to the political dispute between Poland and the EU. Moody's considered the current tensions a credit risk as they have undermined the investment climate (which could possibly lead to a rating downgrade) while Fitch and S&P suggested that this issue might limit changes for a rating upgrade in the medium term due to a risk of lower EU funds inflow to Poland.



## Quote of the week – Hyper-optimism required for rate hikes

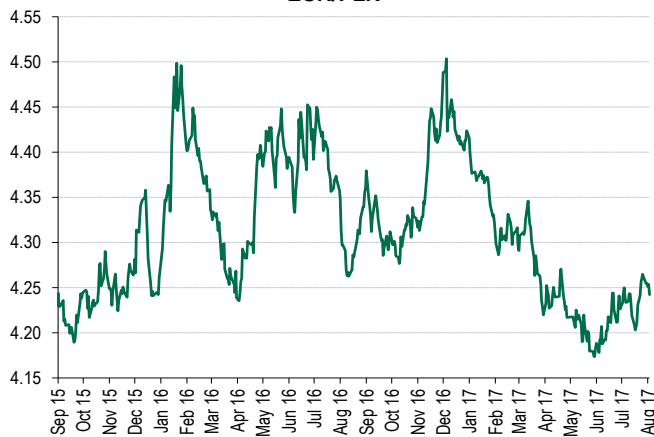
**Eryk Łon, MPC member, 29 July 2017, "Parkiet"**

I see it as quite likely, but obviously not sure, that rates will remain unchanged until the end of 2018. Watching core CPI is important but there are other equally important factors to watch, like PMI and its components. I do not see any symptoms of overheating or signs the economy could overheat next year. Thus, monetary policy should not be suppressing business sentiment yet. However, if mood gets worse, and PMI drops below 50 pts, I could reconsider rate cut, but it does not seem to happen anytime soon. As for the issue of negative (real) rates my view is multifaceted.

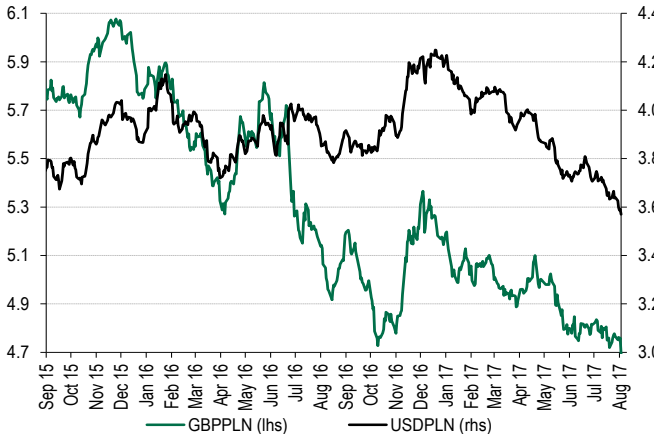
Prof. Eryk Łon's quote shows that he remains a supporter of a very accommodative and cautious monetary policy. An opinion he expressed before the July flash CPI release that inflationary pressure is "not very significant," is in stark contrast with worries of another MPC member, prof. Eugeniusz Gatnar, who told "Parkiet" newspaper on 18 July 2017 that in his opinion "inflation will accelerate more than the NBP forecast assumes". Gatnar also said that "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". We think that the view of the majority in the MPC is still closer to the approach of Łon and NBP governor Adam Glapiński and as a consequence a rate hike could only come around 4Q 2018.

## Foreign exchange market – EURPLN in a new, narrower range

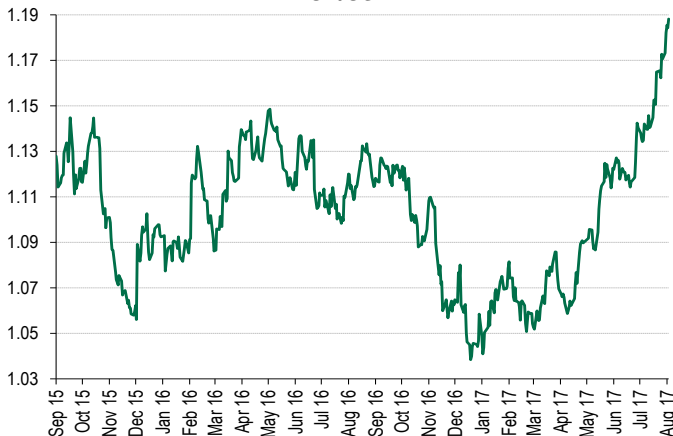
### EUR/PLN



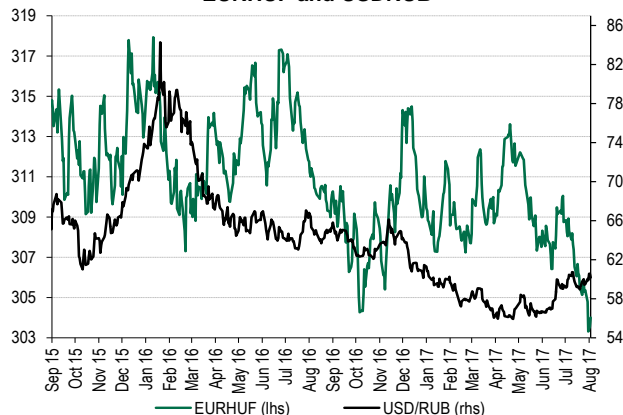
### GBPPLN and USDPLN



### EUR/USD



### EURHUF and USDRUB



### EURPLN in a new, narrower range

▪ Last week did not bring any breaking changes on the EURPLN market. The exchange rate settled in a narrow 4.23-4.27 range after a sharp jump seen in late July in reaction to protests against planned changes in judicial system. At the same time, the zloty continued to gain vs the dollar (USDPLN fell below 3.57, its lowest since May 2015) and franc (CHFPLN plunged below 3.68, its lowest since January 2015 when SNB dropped EURCHF floor).

▪ August has started and historically this month brings zloty's weakening. More detailed analysis of this pattern may be found in our [analysis](#) released on Monday.

▪ This week we will learn Polish June C/A deficit. Our forecast points to a much bigger deficit than the market expects and this could potentially weight on the zloty at least slightly. Final July CPI should not differ much from the flash estimate and is likely to be neutral for the zloty.

▪ Several FOMC members will speak this week and most of them seem to belong to the dovish camp. Since the market is not pricing any Fed rate hikes this year, such comments might have only a limited positive impact on the CEE currencies.

### Euro rally continues

▪ EURUSD continued the strong upside trend and the last week was already fourth in a row of euro gaining vs the dollar. Last time the equally long series was seen in March. As a result, the exchange rate reached a fresh this year's peak at c1.19. The single currency benefited from solid macro data (manufacturing and services PMIs) while the dollar was under pressure of US politics. In our opinion, the move from 1.14 to 1.19 was largely fueled also by stop-loss orders and low market liquidity.

▪ We see that the EURUSD upside trend has accelerated sharply in late June and the 6-week percentage change of the exchange rate reached >6%. Last time EURUSD was rising at a similar pace within that time frame in 2012.

▪ This week the macro calendar is pretty light so speeches of a several FOMC members might be in the center of attention. We think that it may be difficult for EURUSD to keep rising that fast and we think that correction is looming. This could be particularly the case after the strong US July jobs report.

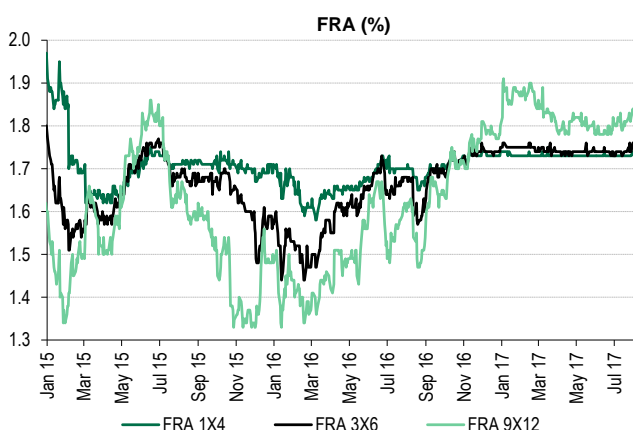
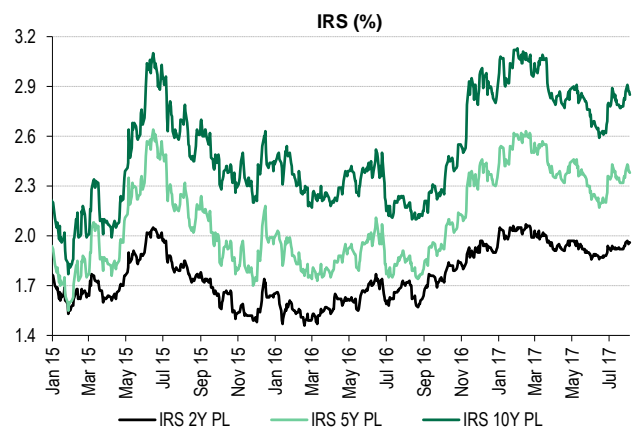
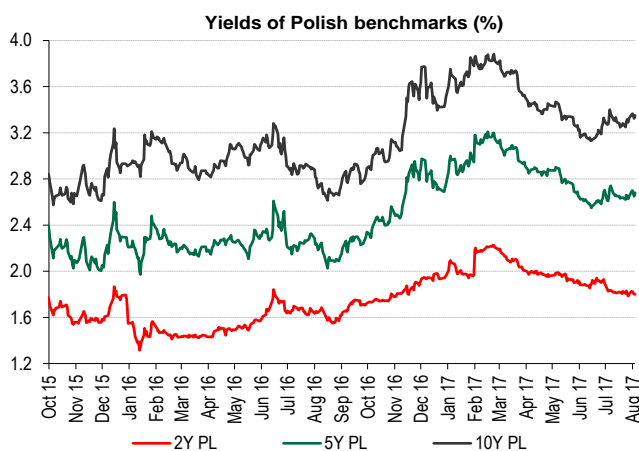
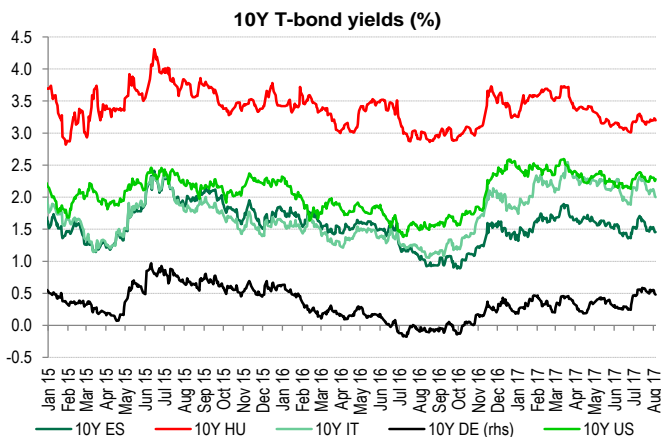
### Rates up in Czechia

▪ The Czech Central Bank (CNB) hiked the main refi rate by 20bp to 0.25%. This decision came as a surprise to the market, which anticipated monetary policy tightening, however not so soon since CNB finished its intervention on the koruna market. The koruna reaction was sharp but relatively insignificant, as once EURCZK reached 25.9, the exchange rate climbed back again above 26.0. CNB revised its economic growth projections upwards, but at the same time lowered the expected CPI path. CNB's President stressed that further hikes will be dependent, among others, also on the scale of koruna appreciation.

▪ This week we will learn July inflation data in the CEE region. After the CNB hiked interest rates, Czech koruna gained only temporarily and in our view only a higher-than-expected CPI print could generate a downside pressure on EURCZK.

▪ Hungarian central bank maintains a dovish bias and this week's inflation data are rather unlikely to cause any changes in this area.

## Interest rate market – Yields down, sale on the horizon



## Yields down, sale on the horizon

Lower-than-expected CPI as well as Bank of England lowering its GDP projection pushed yield curve and asset swap spread down on the core and CEE markets. Polish bonds yields fell by c6bp on the long end and middle part of the curve, while short end fell by c4bp. Polish sovereign asset swap spread remained stable. Domestic and local data and switch bond auction result, rise of political tension between Polish government and EC and interest rates hike by CNB were neutral for the market.

In one week horizon, we expect stabilization on the Polish and core debt markets. This scenario will likely be supported by this week's speeches by Fed dovish members (Neel Kashkari, William Dudley and James Bullard – who will be voting members in 2018). We think that dovish bias of those members will not upset the bond market as it would go in line with the last FOMC statement.

In our view, a rebound after the recent decline of yields may come only in 2H of August, once we see domestic data on output and GDP (2Q flash) which should confirm the high level of economic activity. As a result we expect the spread of the Polish 10-year benchmark to Bund to grow above 300bp and above 120bp vs Treasuries. The decompression of the spreads should also be supported by a drop in German and US yields on the long end in response to weaker data on US consumption.

## Polish debt, less Asian investors

According to the Ministry of Finance data, in June foreign investors purchased Polish PLN marketable bonds for PLN2.2bn taking the nominal value of their portfolio to the fresh all-time high at cPLN211.8bn. In 2Q, nonresidents bought bonds for PLN6.8bn vs. PLN12.4bn in 1Q.

Foreign commercial banks bought debt for PLN2.5bn (and the nominal value of their holdings rose to PLN8.5bn, the highest level since February). Central banks (mainly from Asia excluding Middle East) sold debt for PLN2.4bn and their total portfolio ended the 2Q at the lowest level since March. Foreign pension funds bought bonds for cPLN1.2bn and hedge funds added PLN730mn. As regards HFs, this was the biggest monthly purchase since comparable data are available (April 2014). Still, their share in total Poland PLN marketable debt is at mere 0.2%. Under the geographical criteria, entities from the euro zone purchased debt for PLN4.2bn while Asia was on the offer side (-PLN2.2bn).

Polish banks bought bonds for PLN3bn and the nominal value of their portfolio reached fresh all-time-high at PLN251bn. Domestic insurance companies disposed of PLN3bn of Polish debt.

## Switch auction

Ministry of Finance sold OK0419, WZ1122, PS0123, WZ0126, DS0727 and WS0447 bonds for PLN5.76bn on yesterday's switch auction. Almost 40% of the debt sold was OK0419. After the auction, the Ministry said Poland has already financed 72% of its this year's gross borrowing needs.

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