Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

25 September – 1 October 2017

Last week we learned more encouraging economic data from Poland giving strong evidence that GDP growth in 3Q will probably be well above 4%. Above-consensus domestic macro figures proved supportive for the zloty and weighed on the bonds. Polish debt was under additional pressure of hawkish outcome of the FOMC meeting while the domestic currency remained resilient to rising chances for Fed rate hike this year and increase in tension between the US and North Korea.

This weekend parliamentary elections are held in Germany. Ruling coalition leads in polls and if there is no surprise on this front, any adverse market reaction could be triggered by the surprisingly high support for far-right AfD party. Next week we will learn many US data, including consumer confidence index and final 2Q GDP estimate. The market is pricing higher chances for the 25bp Fed rate hike in December but so far this did not have much negative impact on the zloty. We can say the same about tensions between the US and North Korea which suggests that EURPLN could now near the lower end of the 4.23-4.30 range. At the same time, we think global and internal factors may push Polish IRS and yields further up.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (25 September)					
10:00	DE	Ifo index	Sep	pts	115.9	-	115.9
16:30	US	Dallas Fed index	Sep	pts	13.0	-	17.0
		TUESDAY (26 September)					
16:00	US	New home sales	Aug	% m/m	3.3	-	-9.4
16:00	US	Consumer confidence	Sep	pts	119.5	-	122.9
		WEDNESDAY (27 September)					
13:00	CZ	Czech central bank decision		%	0.25	-	0.25
14:30	US	Durable goods orders	Aug	% m/m	0.9	-	-6.8
16:00	US	Pending home sales	Aug	% m/m	-0.3	-	-0.8
		THURSDAY (28 September)					
14:00	DE	Flash CPI	Sep	% y/y	1.8	-	1.8
14:30	US	GDP	2Q	% q/q	3.1	-	3.0
14:30	US	Initial jobless claims	week	k	-	-	259
		FRIDAY (29 September)					
11:00	EZ	Flash CPI	Sep	% y/y	1.6	-	1.5
14:00	**PL**	**Flash CPI**	**Sep**	**% y/y**	**2,0**	**1.9**	**1.8**
14:30	US	Consumer spending	Aug	% m/m	0.1	-	0.3
14:30	US	Personal income	Aug	% m/m	0.3	-	0.4
15:45	US	Chicago PMI index	Sep	pts	57.5	-	58.9
16:00	US	Michigan index	Sep	pts	95.2	-	95.3

Source: BZ WBK, Reuters, Bloomberg

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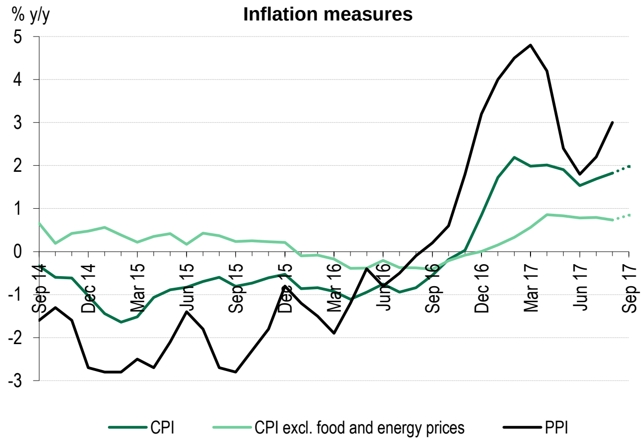
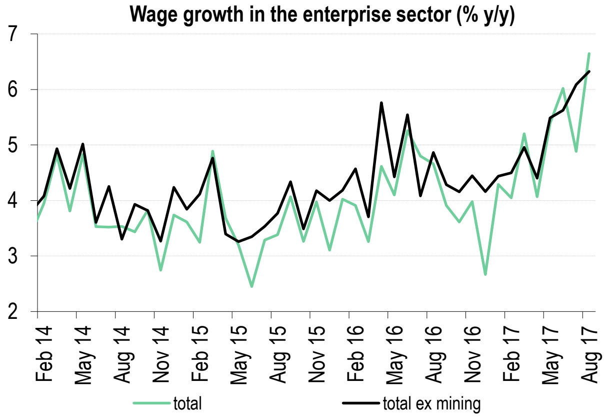
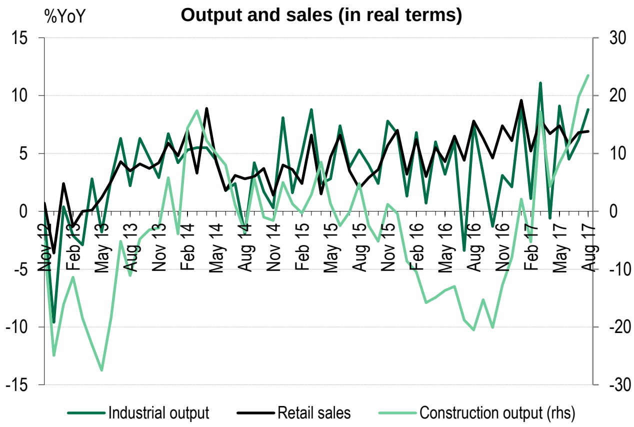
What's hot next week – Flash CPI, presidential draft on the judiciary



- Inflation might have crept from 1.8% y/y to 1.9% y/y in September. Still, this rise would be based on non-core items plus a base effect in health-related prices. That would be the strongest print since April, but in our view inflation will struggle to get any higher from 2% until at least March.
- On Monday president Andrzej Duda is to publish draft legislation on the two judiciary bills he blocked in summer – on the top court and on the National Council of the Judiciary. His version will be scrutinized by the European Commission if the systemic risk to the rule of law it found in the originally proposed bills is not mitigated. In July Moody's expressed disbelief the president could come up with something materially different from the vetoed bills. The EC will refer the rule of law issue to EU General Affairs Council on Monday and Bloomberg claims there could also be a discussion on Poland on Friday when EU leaders gather for Tallinn Digital Summit.

Last week in economy – Wage growth, output and sales beat estimates





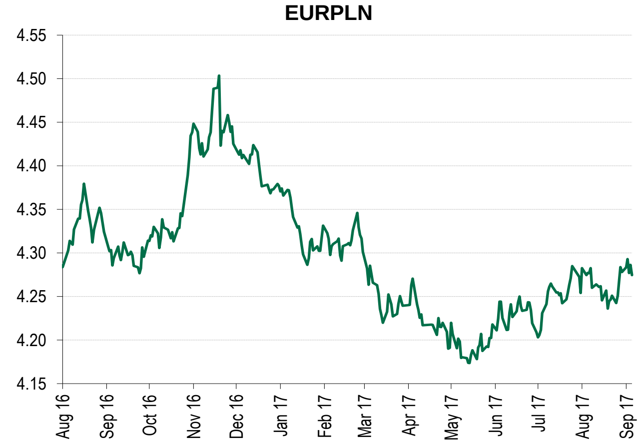
- Wage growth in the enterprise sector reached 6.6% y/y in August and beat expectations by a wide margin (market expectations were at 5.7%, our call was 5.9%, the previous reading was 4.9%). We read this as a confirmation that the shortage of labour force is having a quicker-than-expected influence on the actual process of wage bargaining. The labour market is very tight now as reported by enterprises in business surveys. Wage growth was once again visibly affected by a change in the month when bonuses were paid out in the mining sector, but even correcting for this factor we can still see a strong uptrend. Real wage bill grew 9.6% y/y in August – the highest pace since September 2008. This should help private consumption maintain the c5% y/y growth rate also in 3Q.
- In August, pace of industrial output growth accelerated to 8.8% y/y from 6.2% y/y while the market expected a marginal slowdown. Consensus was at 5.9% and our forecast at 6.1% y/y. This time the figure was not distorted by the number of working days. After seasonal adjustment output rose 8.1% y/y which is the highest since December 2011. Construction output rose 23.5% y/y, somewhat below consensus (24% y/y) and our forecast (27,9% y/y) but this was still quite strong and it does not put into question the assumed rebound of investments in 3Q. Retail sales grew 6.9% y/y in real terms (market expected 6.7% y/y, we forecasted 7.5%) – similar result to what we have seen in 1H17 and confirms our view of private consumption growth staying around 5% in 3Q. These strong August economic activity numbers could result in a wave of upward revisions of GDP forecasts for 2H17. We see a possibility that GDP growth went significantly above 4% y/y in 3Q.

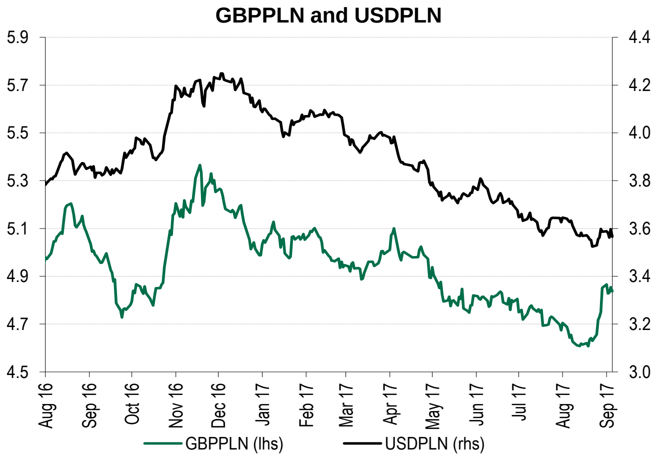
Quote of the week – Interest rates to be raised in 1Q18

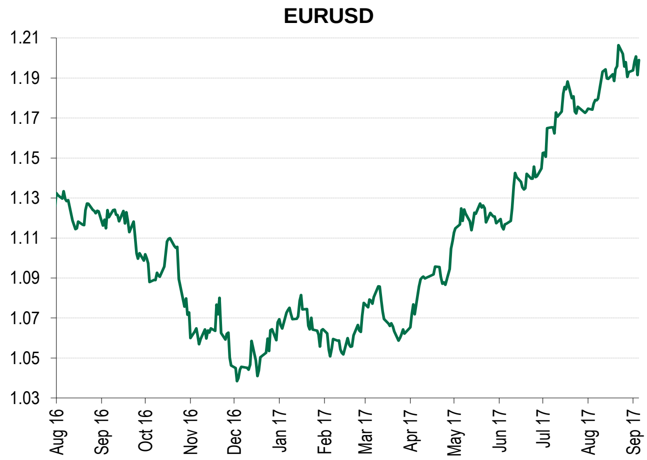
Eugeniusz Gatnar, MPC member, Reuters, 21 September
There is no economic growth without wage pressures, without inflation. If wage pressures rise in line with my expectations and inflation comes near the target then I would expect interest rates to be raised in the first quarter of next year. There is a growing awareness among the Monetary Policy Council of the adverse effects that come from real interest rates staying negative for a long time. This is visible even in the monthly 'minutes'. If the decision to raise interest rates is taken too late ... this could harm the economy. All these factors [further labour market compression due to pension reform, food inflation] will make inflationary pressures stronger than they have been so far. That means that lending rates could stay below inflation for some time, which encourages indebtedness and "irrational consumption".

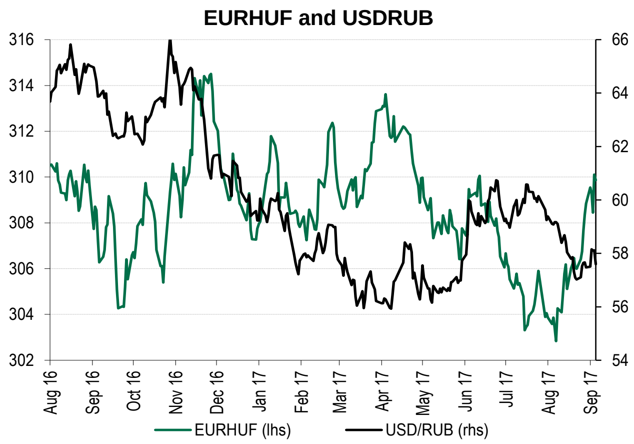
In our view, the positive results of Polish economy and stronger labour market tension will trigger a broader discussion about interest rate hikes in the MPC. The conclusion of September MPC minutes is the same as in July: inflation pressure remains limited and no imbalances are growing in the economy, so the risk of exceeding the target permanently is low and the MPC can stay in wait-and-see mode. However some expressions were added to the text that suggest an increase of internal tensions: some members feared food price inflation in the quarters to come, wage growth was not described as 'gradual' anymore, but as 'continuing to exceed nominal productivity growth' (a more pro-inflationary emphasis). A paragraph was also added about a possibility of a rate cut in case of worse business climate. In our view, this remark came from Eryk Łon and is not shared by other members.

Foreign exchange market – EURPLN still in a range









EURPLN still in a range

- Last week, EURPLN retreated slightly from the upper end of the 4.23-4.30 range in which the exchange rate remained since early August. Hawkish outcome of the FOMC meeting did not have much impact on the exchange rate while another comment of the Polish MPC member (Gatnar) supported the zloty. At the same time, volatility of USDPLN was much bigger due to sharp changes seen on the EURUSD market. The zloty lost vs the dollar after the FOMC decision but at the end of the week exchange rate remained comfortably below the local peak at 3.62. GBPPLN stabilized around 4.83 after significant rise seen in the previous week while CHFPLN resumed the down move and fell to 3.68 from 3.72.
- This weekend parliamentary elections are held in Germany. Ruling coalition leads in polls and if there is no surprise on this front, any adverse market reaction could be triggered by the surprisingly high support for far-right AfD party.
- Numerous US data are on the agenda this week, including consumer confidence index and final 2Q GDP estimate. The market is pricing higher chances for the 25bp Fed rate hike in December but so far this did not have much negative impact on the zloty. We can say the same about tensions between the US and North Korea which suggests that EURPLN could now near the lower end of the 4.23-4.30 range.

North Korea keeps EURUSD high

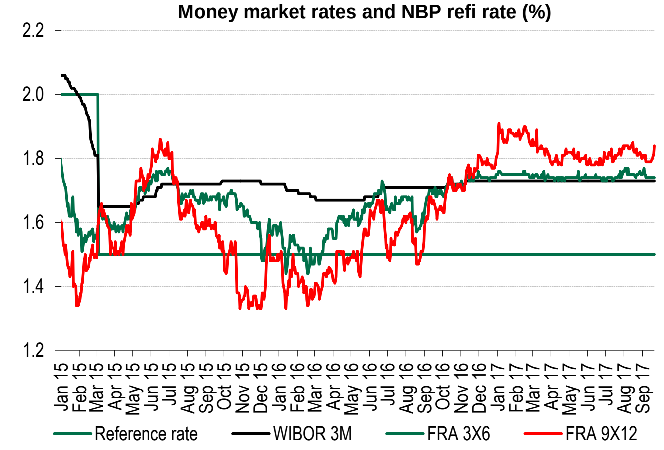
- The market interpreted the outcome of the FOMC meeting as hawkish which boosted the dollar – EURUSD plummeted to 1.186 from c1.20. Although the scale of intraday change was significant, EURUSD remained in the range 1.182-1.21 observed since the end of August. Room for bigger decline was limited by much better than expected flash PMIs for euro zone and Germany.
- Hawkish outcome of the FOMC meeting supported the dollar but the increase in tension between the US and North Korea limited the room for the greenback appreciation. We still think EURUSD could correct after the recent rally but the ongoing geopolitical issue could keep the exchange rate high in the short term. This week we will learn plenty of the US data that may trigger some volatility.
- After the weekend, results of German parliamentary elections will be released but we do not expect this event to trigger any persistent changes as long as there is no surprise. Ruling coalition is leading the polls and any negative impulse for the euro could emerge if AfD wins support higher than expected.

Forint underperforms its CEE peers

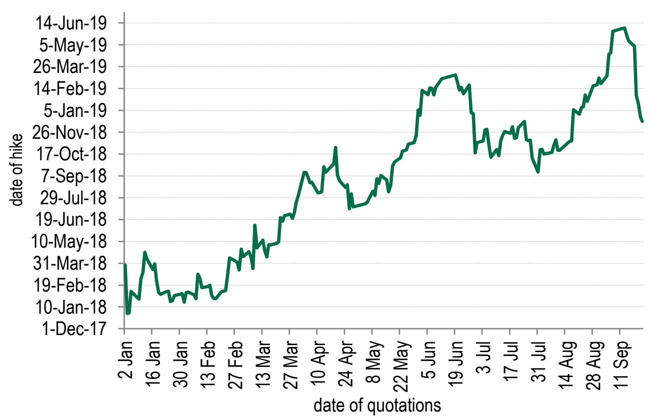
- The Hungarian central bank cut its one-day deposit rate by 10bp to -0.15% and the reference rate was left unchanged at 0.90%. The bank maintained its declaration that further monetary easing is possible if necessary. Cautious step in monetary policy easing taken last week provided only temporary relief for the forint. Hawkish outcome of the FOMC meeting pushed EURHUF up above 310 from below 308 and the last week was already fifth in a row of forint's depreciation vs the euro.
- EURCZK eased slightly ahead of the this week's Czech central bank decision. Many Czech central bankers have recently said that the next hike could take place this year. The head of the central bank Jiri Rusnok said that he would like to have an updated economic forecasts before he votes for a hike, and in our view, this would convince his colleagues to wait until November before making the decision. As a result, koruna could weaken if there is no rate hike this week.

Interest rate market – Resistance levels getting closer

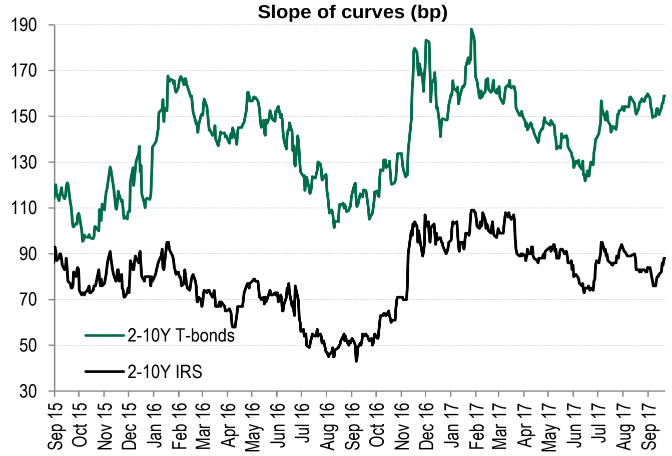
Money market rates and NBP refi rate (%)



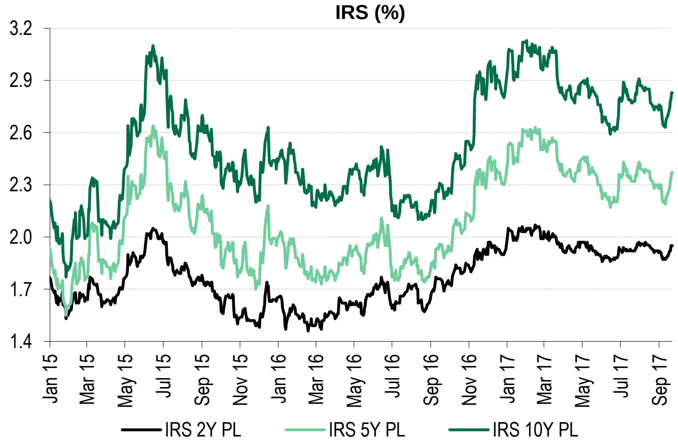
FRA-implied timing of rate hikes by the Polish MPC



Slope of curves (bp)



IRS (%)



Polish data and FOMC push market rates up

- In the first part of last week the domestic and core markets investors were focused on Wednesday's FOMC decision. Yields and IRS were rising as the market was anticipating that the Federal Reserve would announce a roll-off of its balance sheet and suggest that next rate hike this year is still likely. The upside trend started already in the previous week when chances for Trump tax reform became more likely after talks in the US Congress. Additional upside pressure on domestic rates was generated by the Polish robust macro data. The industrial output and retail sales figures confirmed solid growth of consumption and manufacturing in 3Q17. The bright picture of Polish economy was confirmed by the high reading of consumer confidence (on the highest level ever) and statistical office's business surveys.
- As a result, when compared to last Friday, Polish yield and IRS curve shifted up by c5bp on the front end and by c15bp on the belly and the long end. US yields rose 5-7bp while German bond curve remained stable. Polish 10Y asset swap spread did not change much last week while both curves steepened quite noticeably.
- Strong Polish macro data and hawkish comment of MPC member had impact on the FRAs. Rates rose by 2-3bp in the 6X9 segment, and by 12-14bp in the 21x24 segment. As a result, the market timing for the first NBP 25bp rate hike got closer (see chart 2).

Resistance levels getting closer

- Last week, Polish IRS and yields continued to rebound from the this year's bottoms reached in June and neared the local peaks. We think the upside impulse could continue as there is still some room to reach these resistance levels. Resistance for the 2Y IRS is at 1.98%, for 5Y rate at 2.43% and for the 10Y IRS at 2.92%.
- Recent signals from the Polish economy were on the hawkish side. After the dovish outcome of Jackson Hole symposium and last ECB meeting, the market was hoping to see more dovish FOMC rhetoric and bigger down revision of the "dot chart". However, the US central bankers maintained the tone from the previous months and the market has started to price in higher chances for a December 25bp rate hike. We think this process should continue and generate an upside pressure on Polish rates as well.
- On Friday the Ministry of Finance will publish debt supply plan for October and the structure of Polish PLN marketable bonds holders at the end of August.

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