Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

2 – 8 July 2018

The main theme of the week was still global risk aversion fueled by fears of what impact the trade wars may have on the global economic activity. Thus, the market environment remained USD-supportive and bad for the EM currencies, including the zloty. EURPLN rose for the third week in a row and set a new 2018 high. While core bonds saw more demand, Polish yields rose, ignoring data on another month of strong fiscal performance.

The unexpected agreement at the EU summit about migration policy seems to remove or at least mitigate many internal EU tensions (Italian Euroscepticism, risk of a breakdown of the German ruling coalition). This could set a positive tone for this week, helping the zloty regain some of the lost ground. The expected rebound of Polish CPI to c2% y/y and only a minor decline of PMI should also offer support.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
			MONDAY (2 July)				
9:00	**PL**	**PMI – manufacturing**	**Jun**	**pts**	**53.1**	**52.9**	**53.3**
9:55	DE	PMI – manufacturing	Jun	pts	55.9	-	55.9
10:00	EZ	PMI – manufacturing	Jun	pts	55.0	-	55.0
10:00	**PL**	**Flash CPI**	**Jun**	**% y/y**	**2.0**	**2.1**	**1.7**
16:00	US	ISM – manufacturing	Jun	pts	58.0	-	58.7
			TUESDAY (3 July)				
16:00	US	Industrial orders	May	% m/m	0.0	-	-0.8
			WEDNESDAY (4 July)				
9:55	DE	PMI – services	Jun	pts	53.9	-	53.9
10:00	EZ	PMI – services	Jun	pts	55.0	-	55.0
			THURSDAY (5 July)				
8:00	DE	Industrial orders	May	% m/m	1.0	-	-2.5
14:15	US	ADP report	Jun	k	190	-	178
14:30	US	Initial jobless claims	Jun	pts	-	-	227
16:00	US	ISM-services	week	k	58.0	-	58.6
20:00	US	FOMC minutes					
			FRIDAY (6 July)				
8:00	DE	Industrial output	May	% m/m	0.2	-	-1.0
14:30	US	Non-farm payrolls	Jun	k	+198	-	+223
14:30	US	Unemployment rate	Jun	%	3.8	-	3.8

Source: BZ WBK, Reuters, Bloomberg

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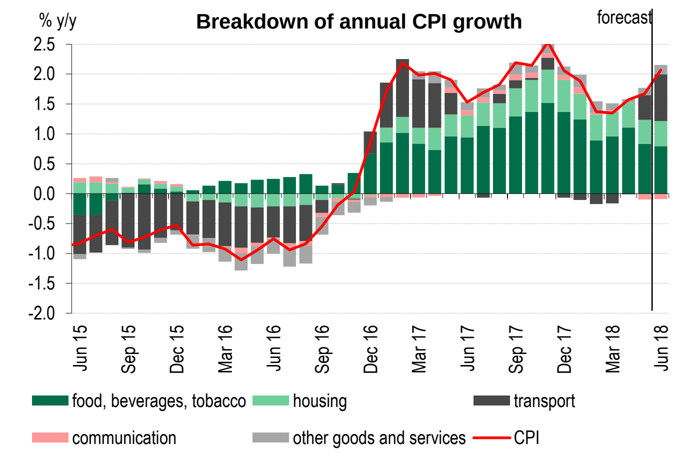
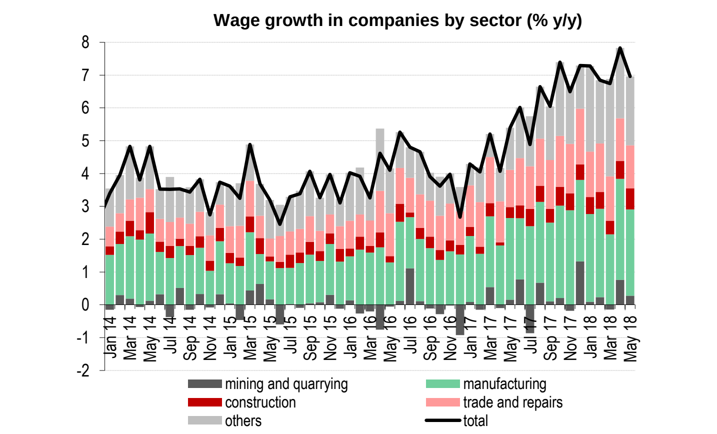
What's hot next week – Inflation back above 2% y/y, PMI could decline

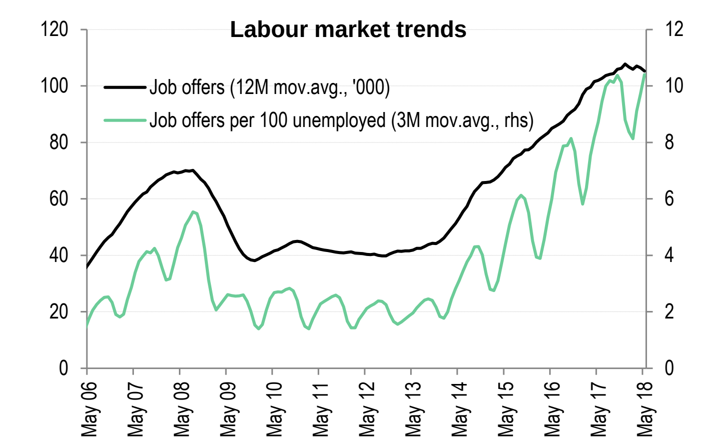


▪ CPI growth might have climbed back above 2% in June. The last four monthly readings of 2017 were higher than 2%, but this year so far inflation failed to return above this level. Instead, in February and March it dropped below the NBP tolerance band (i.e. below 1.5%). In our view the June flash reading will at 2.1%. This will be mainly due to fuel prices: the further rise of monthly average this June as well as the sudden collapse of fuel prices by 4.1% m/m in June 2017 which made the whole transport part of CPI inflation sink from 4.2% y/y to 0%. Depending on further developments on global oil markets and the response of food prices to the severe drought, inflation could stay at or above 2% for only a month or through almost all the remaining months of 2018.

▪ Business sentiment worsened slightly in June according to Statistics Poland measures, amid declines in flash manufacturing PMIs for Germany and euro zone. We think the PMI for Poland also dropped vs May, to 52.9 pts.

Last week in economy – Business sentiment and wage growth remain solid





▪ Wage growth in the corporate sector ex mining declined in May from 7.3% y/y to 6.9%. Such scale of slowdown is comparable to the negative effect of working day differences, so the May reading does not mean wage pressure is diminishing. The construction sector, where enterprises are most often signalling labour shortages, saw wage growth accelerating from 8.6% y/y to 10.2% (the highest pace since 2008). There was however no acceleration in services sector where wage growth has already been around 7% for the last nine months.

▪ The registered unemployment rate decreased in May from 6.3% to 6.1%. In the post-crisis years the decline between April and May was 0.3-0.5pp, which suggests that it is already hard to pick new employees from the remaining unemployed. On the other hand, job offers statistics seem to have peaked. We also saw the third decline in a row of seasonally adjusted index of employment expectations in industry.

▪ Statistics Poland synthetic business sentiment index stayed at a historically high level of 109 pts in June while main business tendency indicator decreased for the third time in a row, but remained well above its 2017 readings. Despite some minor negative elements (lower industrial production trend index and business situation in services), the June business sentiment report looks positive and does not signal risk of a sharp slowdown in the economy in the coming quarters.

▪ M3 money supply rose in May by 6.6% y/y, more than expected (5.9% y/y). The acceleration vs April (5.7% y/y) was triggered mostly by higher rise of in cash in circulation (9.5% y/y vs 7.0% y/y in April) and household deposits (5.9% y/y vs 4.5% y/y in April). Partly, this quick rise of deposits was due to weaker zloty, raising the value of FX holdings.

Quote of the week – Unemployment-inflation link evades standard theories

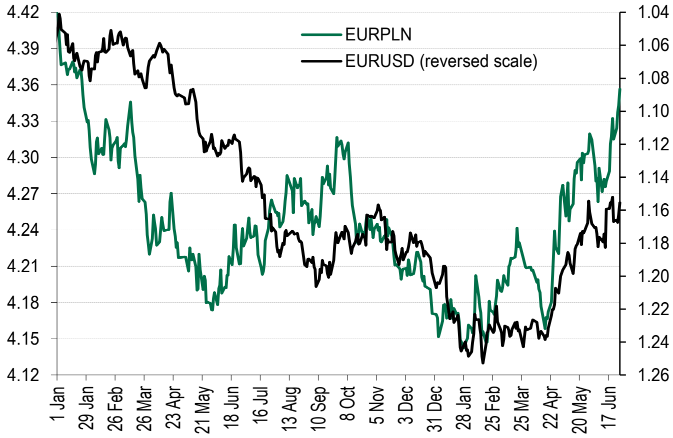
Łukasz Hardt, MPC member, forsal.pl, June 22

The relation of inflation and unemployment is evading standard theories. Recent research shows that wages and CPI became more rigid, less responsive to changes in the business environment. Inflation is also weakened by globalization, global production and delivery chains. It may be that the scale of unused resources in the economy is higher than one assumes – the unemployment gap is larger than current estimates. The change of retail sales channels, leading to higher price competition, also plays a role in Poland.

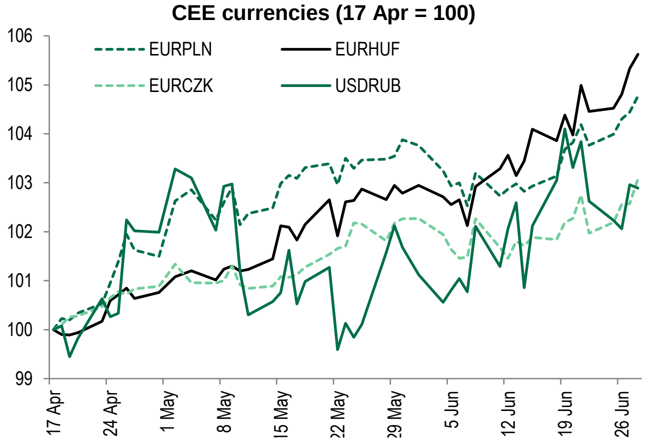
With the puzzle of low inflation still waiting for a broadly accepted solution, central bankers may remain relatively cautious, and act with delay in periods when CPI growth should be rising, only once a lasting rebound of inflation is confirmed. MPC's Hardt also seems to follow this approach. Despite being seen as one of the hawks in the Council he is not pressing for rate hikes, and always expresses in conditional terms his claims about future monetary policy actions. We still assume there could be a rate hike in late 2019, while the consensus among analysts is moving towards 2020.

FX and FI market – Still politics-driven

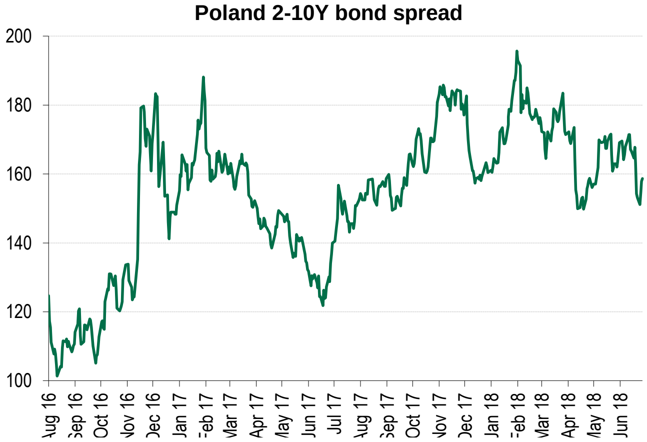
EURPLN and EURUSD



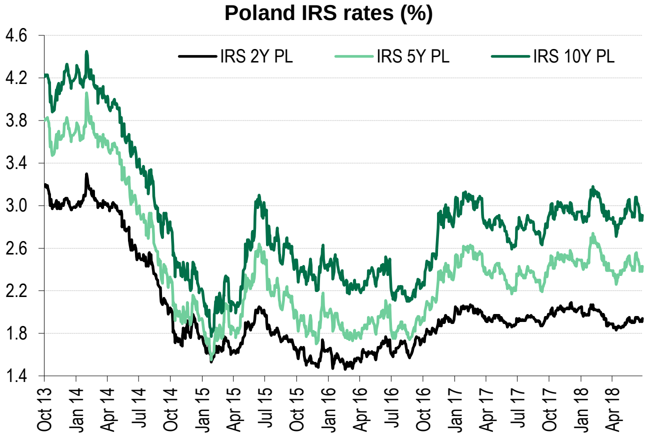
CEE currencies (17 Apr = 100)



Poland 2-10Y bond spread



Poland IRS rates (%)



Worries over economic growth hit zloty and bonds

- **FX** Global risk aversion fueled by fears of what impact the trade wars may have on the global economic activity and the dollar appreciation hit the zloty. EURPLN rose for the third week in a row reaching its fresh 2018 high at above 4.36, its highest since early 2017. USDPLN rose above 3.78 to its highest since mid-2017. Polish currency lost also vs the pound and franc but GBPPLN and CHFPLN stayed below their 2018 peaks.
- The other CEE currencies depreciated as well with EURCZK and EURHUF also reaching their new 2018 peaks at above 26 and above 328, respectively. The Czech central bank raised interest rates by 25bp while the market expected a no-change decision but this provided only temporary support for the koruna. The ruble outperformed its CEE peers benefiting from a rebound in oil prices.
- **FI** Poland bond yields and IRS rate were under an upside pressure despite falling yields on the core markets. This was accompanied by rising 5Y-10Y asset swap spreads and bond curve steepening. The Ministry of Finance canceled the June regular auction possibly thanks to the extremely good liquidity condition.

What to watch for next week

- Market is likely to remain driven mainly by the trade war issue. Any next comments will help to judge how far this can go and to what extent the global economy may suffer.
- Later this week, the market attention could shift to the US labour market data. Recently, the FOMC has added one 25bp rate hike and now two are expected to be delivered later this year and the coming non-farm payrolls could help assess how likely this scenario is in the light of the trade wars issue.
- In Poland, we will see flash June CPI which we expect to rise a touch above 2%. June PMI should be of less importance for the market.

Market implications

- **FX** Global sentiment is likely to remain the core driver for the zloty. EM currencies are under pressure of the stronger dollar and risk for slower economic growth. EURPLN broke the local resistance and peak from March 2017 which implies EURPLN could stay at an elevated level at least in the short term. Factor that may stop/slow zloty depreciation is a chance that EURUSD will not fall below 1.15 as the risk for slower growth might imply there will be fewer rate hikes in the US.
- **FI** In our view, Polish bond yields and IRS could rise in the days to come if the global market sentiment remains poor due to concerns about the impact of the trade war. In the previous months, the domestic debt received a solid support from the exceptionally strong state budget performance. If the market continues to price in slower growth worldwide, this could weigh on the Polish bonds as there will be higher risk that state budget might deteriorate amid slower growth. We think this could be accompanied by rising asset swap spreads.
- Also, note that the 2-10Y bond yield spread rebounded from the 150bp support level which could mean that we could see a bearish steepener on the Polish debt curve. The 10Y bond yield did not manage to stay below 3.20% support for longer and in our view now it may return to the c3.20-3.35% range.

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