WEEKLY ECONOMIC UPDATE

23 – 29 July 2018

Last week, the markets were still ruled by geopolitics, however there was still some room for central banks. At first, the zloty strengthened in reaction to the information about continued negotiations regarding putting tariffs on imported cars by the USA. The reports about signed economic partnership agreement between Japan and European Union also helped the zloty and regions' currencies. In the second half of the week, central bankers took over. The Fed's Beige Book, summarizing the economic situation in the country and Fed's boss Jerome Powell's statement about good condition of the US economy weakened the zloty and regions' currencies, reminding markets about further plans of increasing interest rates in USA. The end of the week was dominated by Donald Trump, whose remark about harmfulness of monetary tightening supported debt market and currencies of developing countries. Domestically, the data about manufacturing, wages and retail sales were published and all of them showed results over expectations, while two members of MPC pushed for an increase in exchange rates.

This week we will get to know the eurozone flash PMI reading for July and ECB decision. The risk factor for the stabilisation of the zloty may be the preliminary 2Q18 US GDP (the strong reading can strengthen demand for the USD). We estimate that in June Polish central budget was still in surplus. In our opinion, the redemption of bonds (PLN9.5bn principal and PLN5.2bn interest payments) will be the main driver of the domestic debt market. The bond auction, where the Ministry of Finance plans to offer PLN4-8bn, is not really likely to be an obstacle for yields drops. We think that solid liquidity position of the Polish budget will encourage the Ministry of Finance to lower supply and set up higher pricing criteria.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
			MONDAY (23 July)				
14:00	**PL**	**Money Supply M3**	**Jun**	**% y/y**	**7.3**	**7.3**	**6.6**
16:00	US	Existing Home Sales	Jun	% m/m	0.5	-	-0.4
			TUESDAY (24 July)				
09:30	DE	Germany Manufacturing PMI	Jul	pts	55.5	-	55.9
09:30	DE	Markit Germany Services PMI	Jul	pts	54.4	-	54.5
10:00	EZ	Eurozone Manufacturing PMI	Jul	pts	54.5	-	54.9
10:00	EZ	Eurozone Services PMI	Jul	pts	55.0	-	55.2
10:00	**PL**	**Unemployment Rate**	**Jun**	**%**	**5.9**	**5.9**	**6.1**
14:00	HU	Central Bank Rate Decision	Jul	%	0.9		0.9
			WEDNESDAY (25 July)				
	PL	**Central Budget Cumul.**	**Jun**	**bn PLN**	**-**	**5.2**	**9.6**
10:00	DE	IFO Business Climate	Jul	pts	101.5	-	101.8
16:00	US	New Home Sales	Jun	% m/m	-2.8	-	6.7
			THURSDAY (26 July)				
13:45	EZ	ECB Main Refinancing Rate	Jul-	%	0.0	-	0.0
14:30	US	Durable Goods Orders	Jun	% m/m	2.7	-	-0.4
14:30	US	Initial Jobless Claims		k	220.0	-	214.0
			FRIDAY (27 July)				
11:30	**PL**	**Bond Auction**			**-**	**-**	
14:30	US	GDP Annualized	2Q	% Q/Q	3.95	-	2.0
16:00	US	Michigan index	Jul	pts	97.25	-	97.1

Source: BZ WBK, Reuters, Bloomberg

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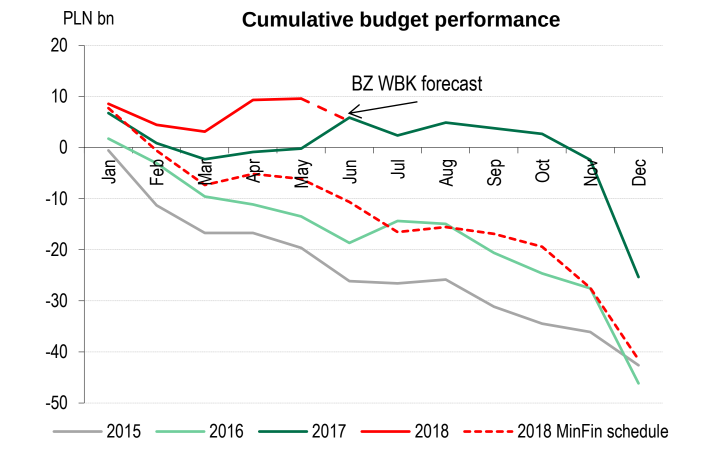
What's hot next week – Six months of budget surplus

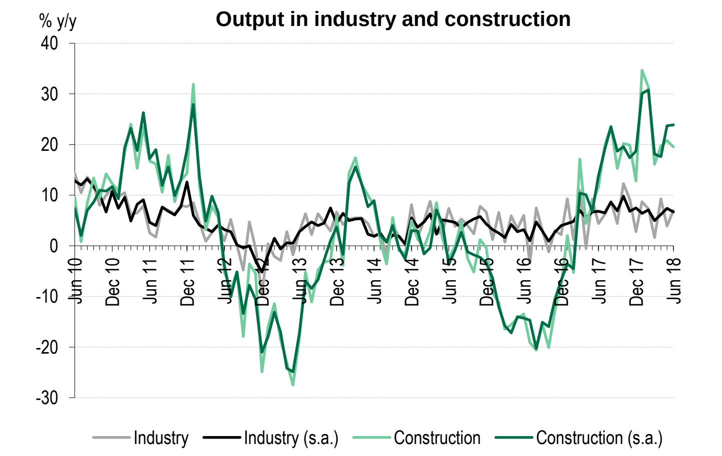


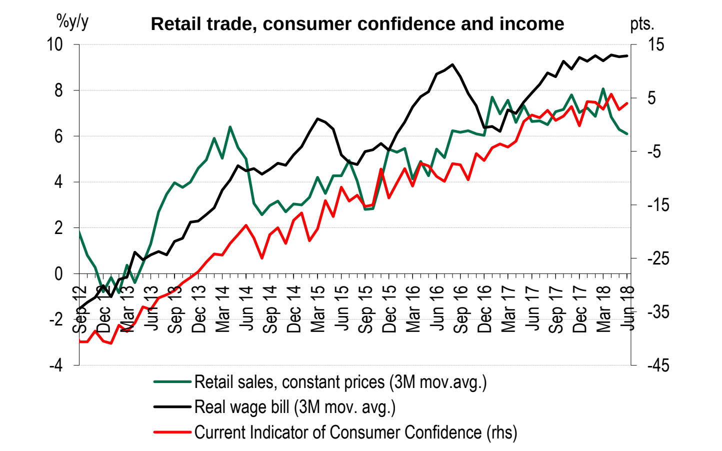
▪ In our view, the central budget balance in June was a bit worse than in May, but remained positive at about PLN5bn. This would mean that the budget remained in surplus in all months of 1H of the fiscal year (matching the calendar year in Poland) for the first time ever. We are expecting the positive fiscal situation to continue in the months to come and the deficit to reach cPLN25bn at the year-end. This time there will be no NBP profit transfer, which improved the balance last June.

▪ We expect a fall of registered unemployment to 5.9% in June. Data from the Labour Ministry confirmed our call, so a surprise is highly unlikely. We see unemployment to go down in the months to come and then to climb back to 5.9% in December.

▪ M3 money supply growth might have accelerated further in June, from 6.6% y/y to 7.3% (according to us and the market consensus). The zloty's sharp depreciation in late June likely added to the result, causing a higher revaluation of fx-denominated M3 components.

Last week in economy – Strong output and sales, rise of PPI and core CPI





▪ In June, industrial production rose 6.8% y/y and construction output soared by 24.7% y/y, both beat expectations. In SA terms output grew at a similar pace as so far this year. PPI jumped to 3.7% y/y, reflecting growing cost pressure on firms. In the past, such strong rebound of PPI was accompanied by faster increase in consumer prices, but in the nearest months the CPI growth will be under strong influence of high base in fuel and food prices, which will be dragging it down.

▪ Core CPI ex food and energy increased for the first time this year in June, to 0.6% y/y from 0.5% y/y. Other measures of core inflation also went up in June. The rise should continue, surpassing 1% y/y before the year-end.

▪ May C/A data unexpectedly showed a surplus. The trade balance surprised to the upside as well but mainly due to disappointing imports rising by only 1.7% y/y; exports up 2.7%.

▪ Consumer sentiment fell in July and was the lowest this year. The declines were mainly caused by worse assessment of ability to save and to make major purchases. We do not see it as a concern. Optimism is still close to all-time highs. Wages are rising fast (7.5% y/y in June, up from 7%, more than expected, possibly accelerating above 9% y/y by year-end). Employment still rose 3.7% y/y, but we expect a deceleration in 2H18.

▪ Real retail sales growth in June was 8.2% y/y vs 6.1% in May. The real growth easily beat the consensus of 6.8% and our above-consensus call (7.3%). There was a strong rebound of durables, from 4.5% y/y to 11.8%, possibly due to time-shift of purchases as May long weekends and weather discouraged shopping. Retail sales and output data for the final month of 2Q confirm our call for private consumption and GDP to both stick to c5% y/y in the quarter.

Quote of the week – Shift the problem to the next MPC

Kamil Zubelewicz, MPC member, PAP, July 19
The projection showed a really worrisome rebound in core CPI (…) providing strong arguments to start raising interest rates. By refraining from stepping into a restrictive cycle, we do nothing but put off the problem, or maybe simply shift it to the next MPC. The latest forecasts have already prompted more policy makers to talk about tightening.

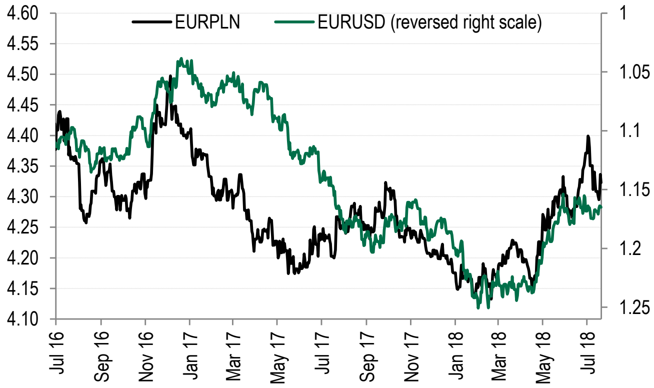
Grażyna Ancyparowicz, MPC member, PAP, July 16
If there are no external threats, and I do not see any, then monetary policy may remain unchanged for the rest of the term (2022).

Eugeniusz Gatnar, MPC member, PAP, July 19
We have room for two 25bp rate hikes, the first one in early 2019. ECB tightening could be a reason for the second one.

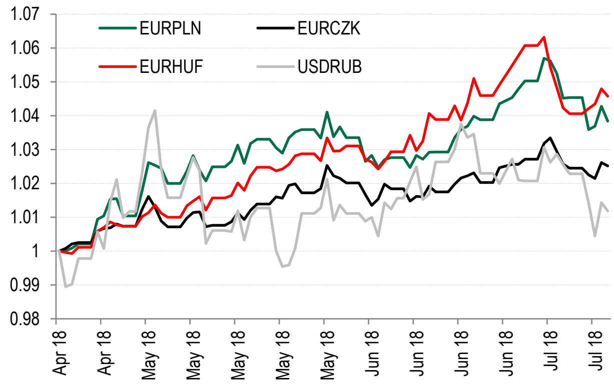
The slight downward revision of NBP inflation projection for 2018-2020 hid a noticeable cut in core CPI path, by 0.8bp, 0.5bp and 0.3bp to 0.8%, 2.1% and 2.7%, respectively. The cut was much larger than the scale of core CPI downside surprises in 1H18. In addition, NBP stressed that the underlying domestic factors remain favourable for a rebound of core CPI but there is a structural change in the response of prices, with globalisation and online purchases causing delay in domestic factors' transmission to CPI. Upon seeing the projection MPC hawks (Zubelewicz, Gatnar) became more radical in their views, while moderate Ancyparowicz claimed this MPC could refrain from rate changes at all. In our view the projection more likely cemented the majority for stable rates than caused a hawkish reshuffle.

FX and FI market – Bonds gains owing to buyback, zloty stabilises

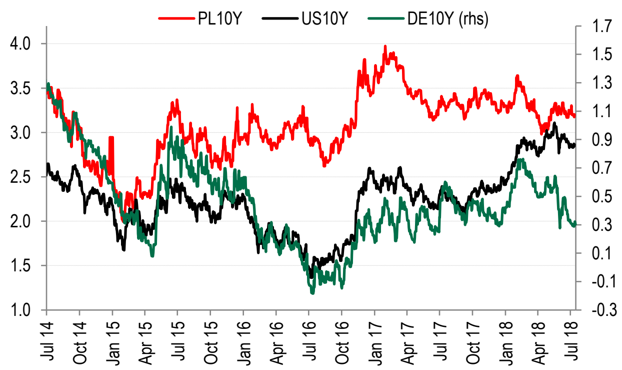
EURPLN and EURUSD



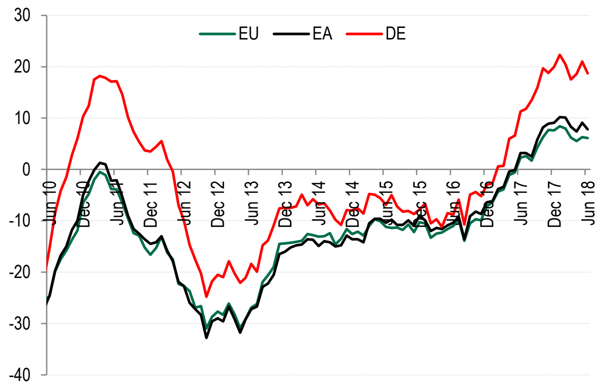
CEE currencies (17-Apr-2018 = 100)



Yields of PL, DE, US 10Y bonds



ESI Manufacturing Total Orders



Last week on the market

- **FX** Early last week, zloty reported an increase. The Polish currency was supported by information about the negotiation of the new global trade agreement. Signing of the economic partnership agreement between EU and Japan, as well as negotiations between EU and US about the car trading new tariff scheme was read as a signal of better perspectives in the global trade system. Later in the week, we saw profit-taking on the zloty, fueled by positive remarks about US economy made by the Fed chairman Jerome Powell. As a result, EURPLN came back to the level from the beginning of the week. The Czech koruna followed a similar path, while the forint and the ruble were falling over the most part of the week, reacting faster to the changes in the global mood.

- **FI** The yields of Polish sovereign bonds were slipping in the first part of the week, while later the market trend reversed and slight sell-off was reported. Over the week, the yield curve shifted down (by 2-6bp, stronger on the long end) The bond market reaction to the expected bond buy-back was stronger than to the increase of yields on the core debt markets.

What to watch for next week

- From the market point of view, the most important event this week will be the flash Eurozone PMI reading and preliminary 2Q18 GDP for the US. Investors will also be focused on the ECB press conference. For the domestic bonds market players, the crucial thing will be the bond redemptions, regular bonds auction and budget deficit data release for June (it is possible that this release will not be delivered this week).

- In our opinion, Eurozone flash PMI data release will be close to the latest reading, while the 2Q18 US GDP data release is likely to be strong (may reach 4%). The ECB conference will continue to be influenced by concerns about the effects of trade wars. However, the main message will probably not deviate much from the one passed at last press conference. On the domestic front, we expect strong results of the regular auction, where investors (in our opinion mainly local banks) will try to roll bonds. The rest of the data, as Ifo, US durable goods orders and German retail sales are unlikely to impress investors.

Market implications

- **FX** We expect EURPLN to stay close to the 4,30 amid light domestic economic calendar and the high probability that ECB will maintain their stance. Some risk could be generated by 2Q18 US GDP data release, high GDP reading may strengthen USD and push the EURPLN temporarily above 4,35.

- **FI** The bond redemptions (PLN9.5bn principal and PLN5.2bn principal) may be the main driver for the debt market. The regular auction, where the Ministry of Finance (MoF) will offer PLN4-8bn is unlikely to constrain the decreases of yields. We believe that strong liquidity budget position will encourage the MoF to reduce the offer and set up high price criteria. As a result, we expect the yield curve to decrease further (by 4-6bp on the middle and on the long end, and by 2 bp on the short end).

- At the end of the week, we expect some correction on the debt market, which will be supported by preliminary flash US 2Q18 GDP data release (we anticipate a strong reading). Flash PMI reading expected by us (close to the June release) should be limiting the perspectives for the yields increases in the short term.

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