Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

30 July – 5 August 2018

Last week, surprisingly strong euro zone flash PMIs, fairly dovish rhetoric of the ECB and chance for a pause or at least a slowdown in the pace of new tariffs implementation by the US administration improved global market sentiment. Higher demand for the risky assets provided clear support for the zloty that reached its new strongest level vs the euro in July. Core bond yields rose but Polish debt again outperformed, leading to further contraction of spreads.

This week, we will get to see Poland flash July CPI. We are expecting inflation to inch down vs June owing to lower food prices. We assume the July PMI has not risen much. In our view, Polish data should be market-neutral.

Numerous US data will be released, with manufacturing ISM and monthly non-farm payrolls being of particular importance. Any positive surprises in the US numbers might weigh on the zloty. However, note that the market is already pricing in, to a large extent, the scenario of two more 25bp Fed rate hikes this year, so the zloty negative response to solid data may be limited. Still, we think there is little room for a stronger zloty and lower yields.

Elsewhere in the CEE region, the Czech central bank will decide on interest rates. In June, investors were surprised with a 25bp rate hike. Rhetoric of the CNB after the June rate hike sounded rather neutral, but last week two members said that rates may rise already in August. We do not expect this to happen so EURCZK could rise this week if our scenario materializes.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (30 July)					
14:00	DE	HICP	Jul	% m/m	0.4	-	0.1
16:00	US	Pending Home Sales	Jun	% m/m	0.4	-	-0.5
		TUESDAY (31 July)					
10:00	**PL**	**Flash CPI**	**Jul**	**% y/y**	**2.1**	**1.9**	**2.0**
11:00	EZ	Flash HICP	Jul	% y/y	2.0	-	2.0
11:00	EZ	GDP SA	2Q	% y/y	2.2	-	2.5
14:30	US	Personal Spending	Jun	% m/m	0.4	-	0.2
14:30	US	Personal Income	Jun	% m/m	0.4	-	0.4
14:30	US	PCE Deflator SA	Jun	% m/m	0.1	-	0.2
16:00	US	Consumer Conference Board	Jul	pts	126.0	-	126.4
		WEDNESDAY (1 August)					
09:00	**PL**	**Poland Manufacturing PMI**	**Jul**	**pts**	**54.5**	**54.5**	**54.2**
10:00	EZ	Eurozone Manufacturing PMI	Jul	pts	55.1	-	55.1
14:15	US	ADP report	Jul	k	180	-	177
16:00	US	ISM manufacturing	Jul	pts	59.2	-	60.2
20:00	US	FOMC decision		%	2.0	-	2.0
		THURSDAY (2 August)					
13:00	CZ	Central Bank Rate Decision		%	1.25	-	1.0
14:30	US	Initial Jobless Claims	week	k	215	-	217
16:00	US	Factory Orders	Jun	% m/m	1.7	-	0.4
		FRIDAY (3 August)					
03:45	CH	Caixin China PMI Services	Jul	pts	0.0	-	53.9
10:00	EZ	Eurozone Services PMI	Jul	pts	54.4	-	54.4
14:30	US	Change in Nonfarm Payrolls	Jul	k	190	-	213
14:30	US	Unemployment Rate	Jul	%	3.9	-	4.0
16:00	US	ISM services	Jul	pts	58.6	-	59.1

Source: BZ WBK, Reuters, Bloomberg

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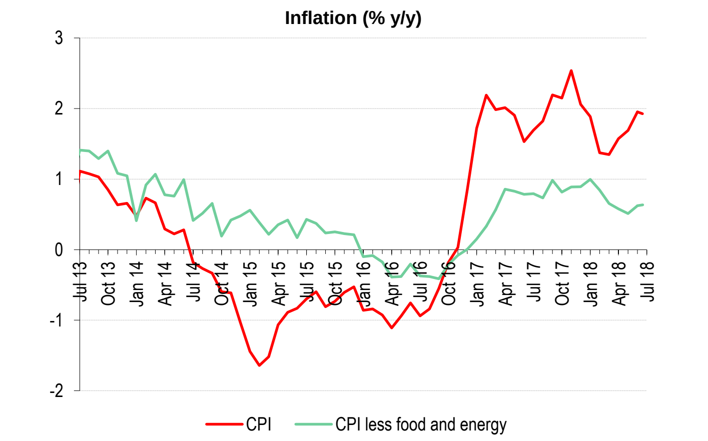
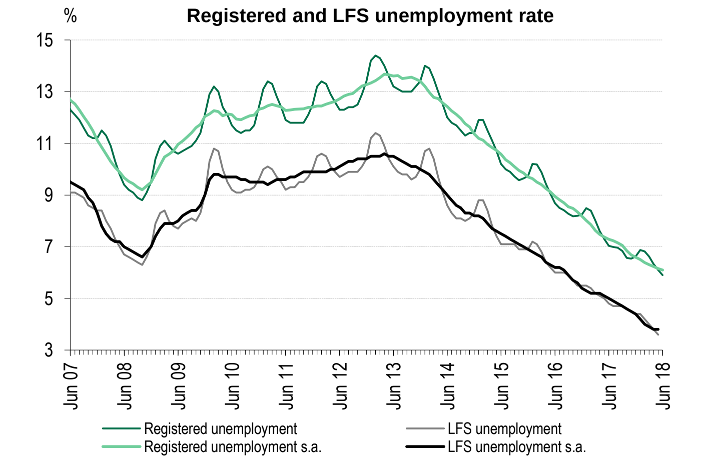
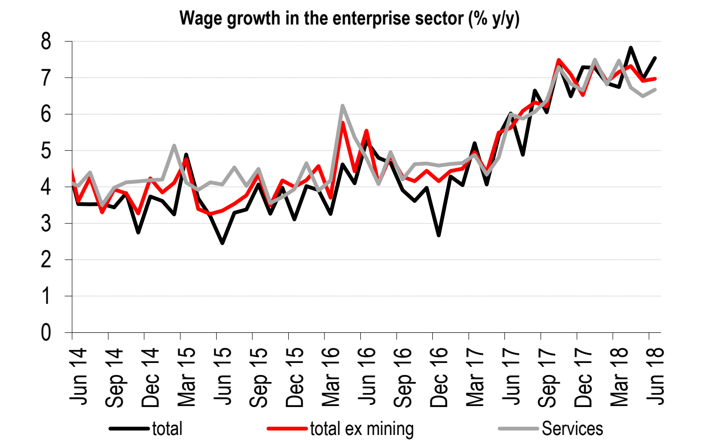
What's hot next week – Flash CPI and PMI



- We are expecting July CPI to inch down versus June, with core inflation excluding food and energy prices staying flat. CPI will be dragged lower by food prices, which we estimate to go down by 1% m/m thanks to lower fruit and vegetable prices that offset the upward tendencies in butter and poultry. Fuel prices will be the main factor supporting inflation close to the June level thanks to low annual statistical base (they rose only by about 1% m/m in July). In the following months, we are expecting some more pressure from food prices due to drought effects, higher core inflation and energy prices (on Thursday, the regulator approved the higher gas tariff, raising gas prices for households by 3.6%, adding slightly below 0.1pp to headline CPI in December). However, in general, CPI will be trending down until the end of the year.
- In our view, good data releases from the euro zone should be positive for Polish companies' moods, so we see PMI to go a bit up in July.

Last week in economy – Quick Monitoring suggests some slowdown, wages boosted by mining





- Poland's M3 money supply increased in June by 7.3% y/y vs 6.6% y/y in May. Loans for households rose by 5.2% y/y (after FX adjustment), roughly unchanged vs May (5.1%), also as regards the breakdown by products. Loans for companies slowed from 6.5% to 5.6% y/y. The reason behind this was lower growth of investment loans (-1.0% y/y against 4.3% y/y last month) which resulted mainly from a very high base, as in June 2017 the loan level was boosted by bank's takeover. Total deposit growth accelerated from 5.7% to 6.4% y/y, mainly triggered by corporate deposits, which, after a temporary May slowdown to 3.0% y/y, rebounded to 5.9% y/y. Term deposits fell by mere 0.2% y/y and it seems likely that the downward trend observed since December 2016 will soon come to an end.
- The registered unemployment rate fell to 5.9% in June, in line with expectations. The number of the unemployed went down to below 1mn for the first time since the early 1990s.
- Detailed data on wages confirm that the June acceleration to 7.5% y/y from 7.0% y/y was mainly driven by the wage increase and bonus payments in mining (+23.9% y/y). Wage growth excluding mining stayed flat at 7.0% y/y and in services wages went up 6.7% y/y vs 6.5% y/y in May. NBP Quick Monitoring suggested that wage pressure eased somewhat in 2Q18.
- According to NBP Quick Monitoring, in 1H18 Polish companies were positive about their situation, but recorded some weakening of their financial results and profitability, fast growth of labour costs and further escalation of issues with finding staff. The economy was also struggling with high level of capacity utilisation, a problem which was especially acute in construction. The results of the survey are in line with our forecast of slight GDP deceleration in the quarters to come.

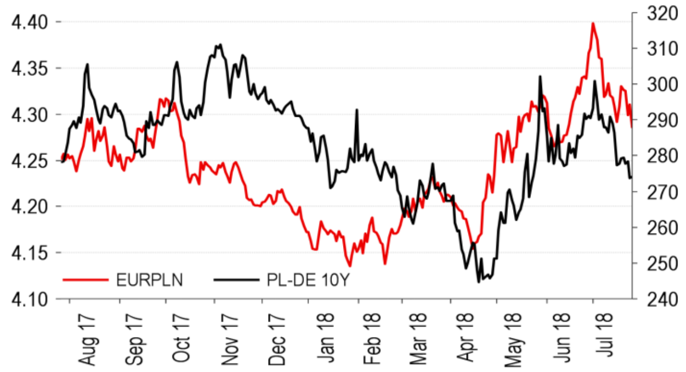
Quote of the week – NBP still critical about PPK

National Bank of Poland, comment of PPK bill, 11 July 2018
In relation to the bill on Employees' Capital Plans (PPK) of 4 July 2018 (…), the National Bank of Poland maintains its earlier comments. (…) In relation to new regulations proposed in the bill of 4 July 2018, the National Bank of Poland reports its comments on the regulation regarding breakdown of target date funds allocation, which may lead to occurrence of price bubbles on the Warsaw Stock Exchange, and on the regulation regarding the reference rate, serving as a benchmark for calculation of remuneration for investment funds.

After the release of a new draft bill on PPK (Employees' Capital Plans), we wrote more the initial proposal here), the National Bank of Poland maintained its criticism about the bill, especially pointing out that the envisaged 10-year payout scheme will fail to support retirees after they reach 70 years of age, when they are unlikely to work and their healthcare costs soar. The NBP was also negative about PPK's ability to facilitate saving of low earners, as a lot of them work in small firms, which have a possibility to opt out from the scheme. In its newest letter, the NBP has additionally criticised the regulation stating that at least 50% of AuM stock portfolio should be allocated in WIG20 companies, as this will undermine the policy diversification of different managing institutions and may fuel price bubble.

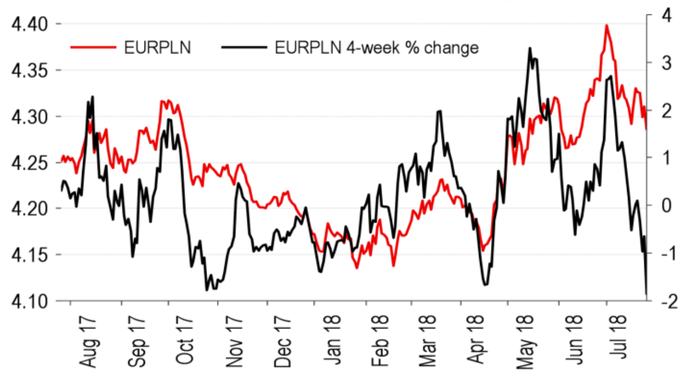
FX and FI market – EURPLN lowest this month, bonds stable

EURPLN and PL-DE 10L bond yield spread



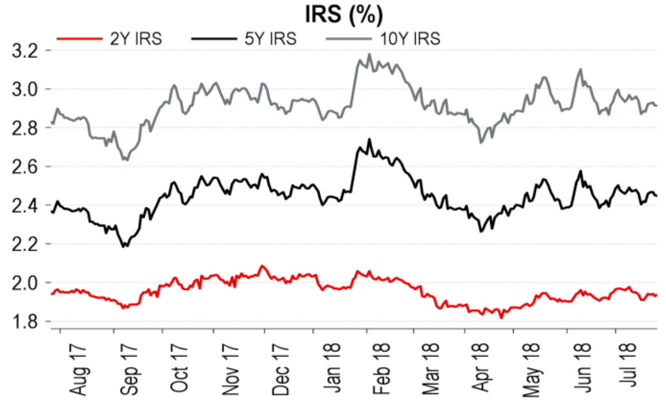
Source: Thomson Reuters Datastream, Bank Zachodni WBK

EURPLN and its 4-week % change



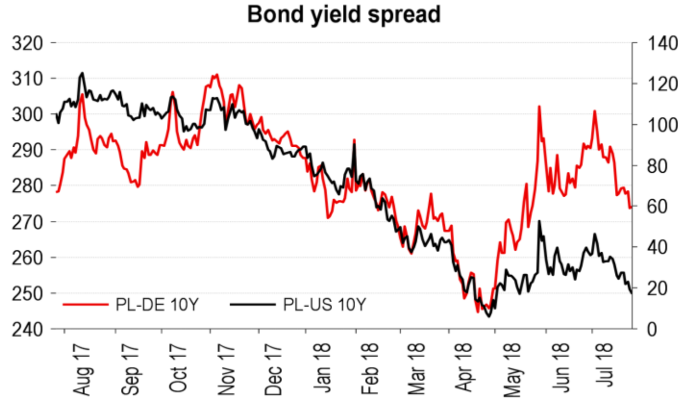
Source: Thomson Reuters Datastream, Bank Zachodni WBK

IRS (%)



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Bond yield spread



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Last week on the market

- **FX** The zloty benefited from strong European data and easing of foreign trade tensions. EURPLN fell to 4.28 (fresh July bottom), USDPLN held around 3.86, CHFPLN stayed near 3.70 while GBPPLN fell to 4.81 from 4.86.
- **FI** Polish bond yields rose marginally, giving up part of gains recorded in the previous week. Domestic debt outperformed its German and US peers again and the 10Y spreads fell to c270bp and 20bp, respectively. IRS curve remained fairly flat.

What to watch for next week

- Numerous US data will be released, with manufacturing ISM and monthly nonfarm payrolls being of particular importance.
- FOMC should keep the rates unchanged for now, waiting for the September meeting when updated forecasts will be released.
- On Tuesday, we will see Poland flash July CPI. Our forecast (1.9% y/y) is below the consensus (2.1% y/y). We assume the July PMI has not risen much and should be market-neutral.
- On Thursday, the Czech central bank will decide on interest rates. In June, investors were surprised with a 25bp rate hike.

Market implications

- **FX** Any positive surprises in the US numbers might weigh on the zloty. However, note that the market is already pricing in, to a large extent, the scenario of two more 25bp Fed rate hikes this year, so the zloty negative response to solid data may be limited.
- Polish data could be market-neutral: flash CPI may fall vs June while any rebound in PMI might have already been priced when the zloty gained after euro zone PMI release.
- The pace of EURPLN drop is gradually becoming too fast when compared to historical patterns (chart with 4-week % change) and we see little room for a stronger zloty in the short term.
- August is statistically negative month for the zloty. In the last 13 years, EURPLN fell in August only three times and the average rise of the exchange rate was 1.4% (vs. 1% of average rise for monthly data since 2000). However, we think this time round August should not be that negative for the zloty. Note that in 2Q18, EURPLN rose by c3.8%, the biggest rise in this quarter since 2010 and well above the average change in this quarter of 0.98% in the last 13 years. In our view, the zloty depreciation in 2Q was more than enough and we expect the August seasonal pattern to be weaker than in the past years.
- Rhetoric of the CNB after the June rate hike sounded rather neutral, but last week two members said that rates may rise already in August. We do not expect this to happen as so EURCZK could rise this week if our scenario materializes.
- **FI** In the recent days, Polish bonds were outperforming their foreign peers (thanks to positive liquidity conditions) but we think that global factors could again start to play the main role on the domestic market in the days to come. Numerous US data would be a good occasion for the correlation with cores to rise.
- Outlook for the net bond supply to rise in the coming months is likely to encourage investors to take profit from recent yield drop.
- Poland below-consensus CPI could be positive for bonds but the recent Bund and UST spread narrowing together with looming higher debt supply should prevent yields from falling in the nearest future, in our view.

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