WEEKLY ECONOMIC UPDATE

6 – 12 August 2018

Last week was relatively stable, mostly thanks to falling risk related to trade wars. Higher risk appetite was a positive factor for Polish assets, with PLN and T-bonds strengthening. Domestic debt outperformed Bund thanks to cancellation of August regular auction, in our view. Core yields went up and BoE and CNB delivered rate hikes. The Turkish lira was a clear underperformer in EM universe, with USDTRY rate surpassing 5.00 on US sanctions against Turkish policymakers. In Poland, CPI inflation stabilized at 2.0% in July and we expect it to decline in the months to come, while PMI fell unexpectedly.

This week is rich in German data, which may help assess the first impact of trade wars, with possible negative effect on orders and positive on exports (frontloading). In USA we will get to see CPI, but in our view this statistic will not gather much attention given that PCE is the favorite inflation measure of FOMC. There will be no major information from other countries, especially from Poland, so we are expecting Polish asset prices to follow global trends, with possible slight profit-taking on zloty and some upward correction of bond yields.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (6 August)					
08:00	DE	Factory Orders	Jun	% m/m	-0.4	-	2.6
09:00	CZ	Industrial Production	Jun	% y/y	1.9	-	1.4
10:00	**PL**	**Credit Market Survey**	**3Q**				
		TUESDAY (7 August)					
08:00	DE	Exports SA	Jun	% m/m	0.0	-	1.8
08:00	DE	Industrial Production SA	Jun	% m/m	-0.6	-	2.6
09:00	HU	Industrial Production SA	Jun	% y/y	-	-	3.8
14:00	**PL**	**Official Reserves**	**Jul**	**€bn**	-	-	**93.6**
		WEDNESDAY (8 August)					
03:00	HU	MNB minutes			-		
09:00	HU	CPI	Jul	% y/y	3.3	-	3.1
		THURSDAY (9 August)					
09:00	CZ	CPI	Jul	% y/y	2.3	-	2.6
14:30	US	Initial Jobless Claims	week	k	220	-	217
		FRIDAY (10 August)					
14:30	US	CPI	Jul	% m/m	0.2	-	0.1

Source: BZ WBK, Reuters, Bloomberg

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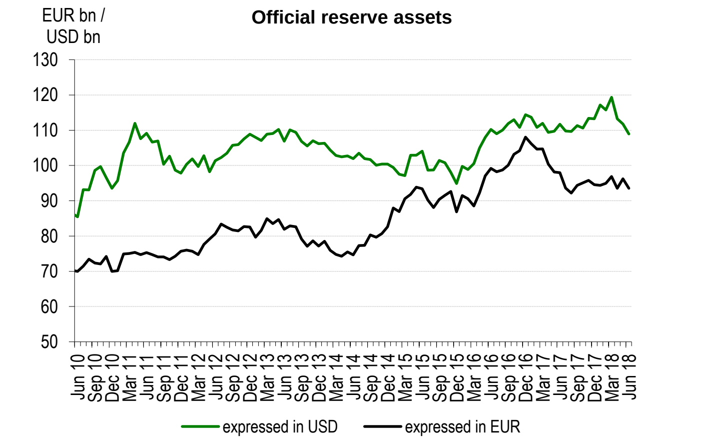
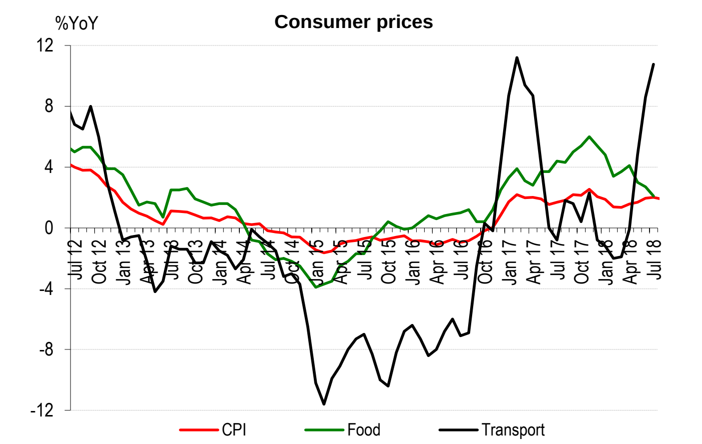
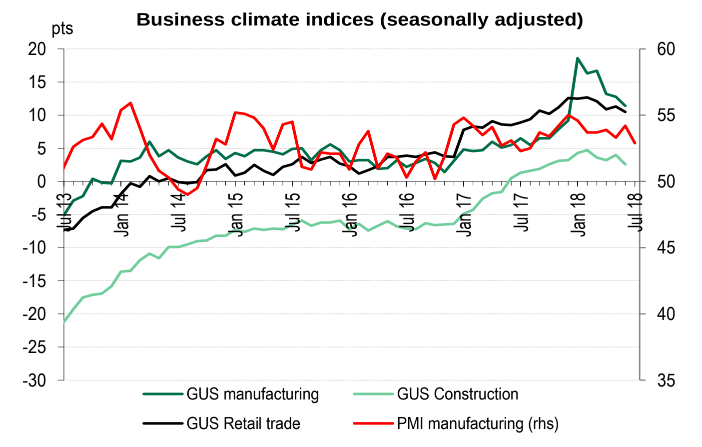
What's hot next week – No important data releases



- There are no important market-moving data releases this week in Poland. Still, we will get to see data on Polish reserve assets in July and results of credit conditions survey in 3Q18.
- Official reserve assets were at EUR93.6bn in June, equal to 4.7 months of imports (IMF recommending >3), 20.3% of GDP or 217% of short-term external debt (IMF recommending >100%). Over the last year, the reserve assets were oscillating around EUR95.0bn after falling from peak at EUR108bn in December 2016 when the NBP was artificially increasing its reserve asset holdings by massive use of repo and reverse repo operations (yet euro strengthening also played some role in decline of assets expressed in this currency). We are expecting the stabilisation of reserve assets to hold.
- The lending survey is likely to show a further rise of demand for loans amid no major changes in credit conditions.

Last week in economy – CPI at this year's top, PMI fell unexpectedly





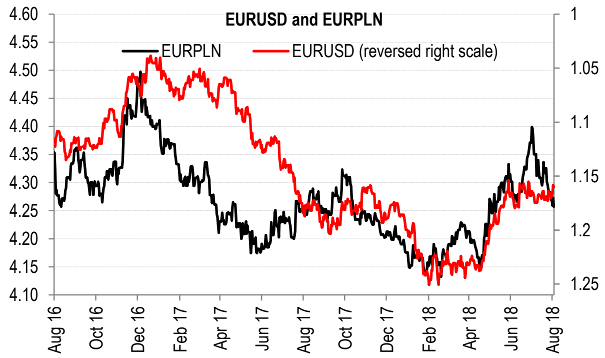
- July's flash CPI came in at 2.0% y/y, unchanged from June, versus market consensus at 2.0% y/y and our forecast at 1.9% y/y. Even though the headline gauge remained flat, some downward pressure on CPI was exerted by food prices, which fell 0.7% m/m - in our view mostly due to lower prices of fruits and vegetables, while butter and poultry prices went up. The upward tendency in poultry was due to an EU ban on chicken imports from Brazil after sanitary issues were found in some products. The impact of food prices was offset by a low statistical base effect in fuels (a year ago, fuel prices fell almost 2% m/m, whereas this year they rose 1.4% m/m). Core inflation, excluding food and energy prices, remained unchanged at 0.6% y/y, in our view. In the coming months, we expect increasing pressure from food prices due to drought effects, higher core inflation, and energy prices (recently the regulator approved higher gas tariffs, raising gas prices for households by 3.6%, adding slightly less than 0.1 p.p. to headline CPI for December 2018). Still, in our view, the 2.0% inflation reported in June and July is likely to be the peak for this year, and we forecast CPI growth to decline over the coming months to 1.6% y/y by year-end.
- The PMI index for Polish manufacturing unexpectedly fell in July to 52.9pts from 54.2pts in June, driven by weaker output, new orders, and employment sub-indices. The survey showed a further increase in cost pressures, with the sub-index for final product prices reaching the highest level since March 2011. Companies reported continuing strong pressure on capacity, with rising backlogs and longer delivery times from suppliers. The recent rebound of PMIs in the euro zone and Germany suggests that foreign demand for Polish products should remain strong, in our view. However, we expect some slight deceleration of the Polish economy in the coming quarters and believe the labour market squeeze will continue, so strong gains in Polish PMI are unlikely, in our opinion.

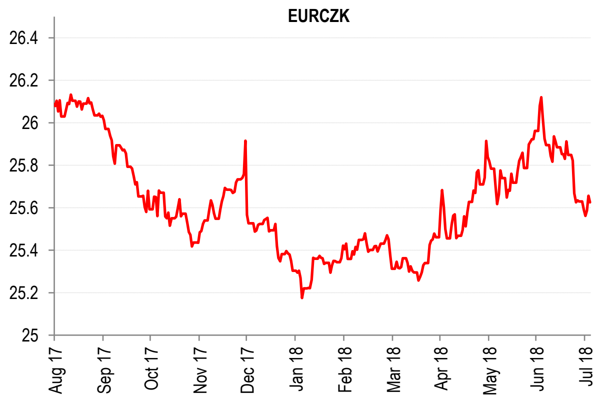
Quote of the week – Rates to stay flat in 2019, but 2020 is unsure

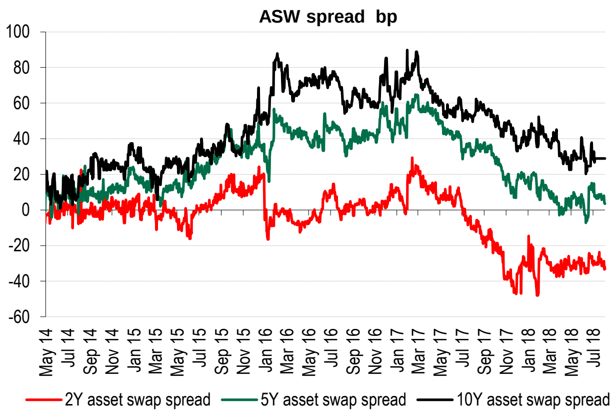
Rafał Sura, MPC member, PAP, 30 July
It is highly probable that rates will remain unchanged throughout 2019. As regards 2020, the November NBP official forecasts will be key. For now, I do not want to be precise about the future so distant. Outlook for normalization of interest rates in the euro zone is an important factor in our decision-making process, but I do not expect major changes here. Let me remind that last year the ECB suggested to abandon the loose monetary policy, but only reduced the QE programme. We should also keep in mind that rates in the euro zone are much lower than in Poland, so one rate raise by the ECB does not mean we will rush to hike rates.

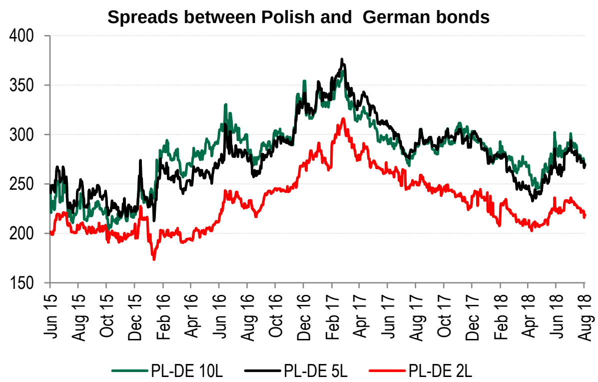
MPC's Rafał Sura supported view of NBP president Adam Glapiński, stating that he saw interest rates in Poland flat for the upcoming 12 months, but rates policy in 2020 is not sure. At the same time, Sura revealed himself a bit more hawkish than the NBP head, who expected interest rate to remain unchanged through 2020. Sura noted also that there is a risk for inflation outlook stemming from the labour market situation and upcoming elections, which are likely to fuel wage pressures in the public sector. Central banker has discarded the ECB tightening as important argument to raise rates in Poland, as the rate differential will remain high, according to Sura. We are expecting rates in Poland to stay flat in the months to come with the first hikes possible at the end of 2019 at the earliest, given tightening in the euro zone and rising core inflation..

FX and FI market – EURPLN to go back to 4.30, bonds may lose









Source: Thomson Reuters, BZWBK

Last week on the market

- **FX** EURPLN fell by PLN0.02 over the week to 4.2560 positively reacting to the trade war tension easing. GBPPLN moved down to 4.78 from 4.82 awaiting for (realized) interest rate hike by BoE. EURCZK strengthened awaiting the (delivered) CNB interest rates hike.

- **FI** The yields of domestic debt were decreasing over the last week (fueled by information about the cancelation of the regular auction in August), despite rising core markets yields. As a result, the domestic curve shifted down by 3-5bp, stronger on the long end. It translated into 3-5bp drop of the asset swap spread on the whole ASW curve and narrowed spread of Polish 10Y T-bonds over the Bunds below 270bp, while the PL10Y/US10Y spread slid to 15bp.

What to watch for next week

- This week, there are no important data in the Polish economic calendar. The core markets calendar will be dominated by the data from Germany (industrial production, exports and industrial orders). Furthermore, this week we will get to see the US CPI data.
- We believe that investors will be focused on the German industrial orders data, where we should see the first effect of trade wars (lower level of orders). However, this data will be balanced by export and industrial production data, where we expect the reading above the consensus. The US CPI data are likely to be close to the consensus. Moreover the investors and Fed monitor PCE more closely than CPI.
- We believe that among CEE currencies the most important figure will be CPI in Czechia, where the central bank is planning further interest rates hikes. In our opinion, the Hungary CPI will not be a story for the market.

Market implications

- **FX** The lack of important domestic data should lead to a slight depreciation of the zloty. In our opinion, the last rally was mainly the result of easing the fears of rapid and wide-ranging tariff increases as part of U.S. policy of recovering the trade balance. Therefore, we expect EURPLN to return to around 4.30 and stay there by the end of the month. We believe that the industrial production and retail sales data release (due for release in the second half of the month), where we expect readings above the consensus, will not affect the zloty. In our opinion, the zloty will continue to depend on global trends.
- **FI** This week we expect the yields of domestic bonds to increase by c10bp. We believe that Polish bond yields will be towed up by the core bonds market, where we expect the curve to move upwards. In our opinion, the scenario of two more interest rate hikes in the US this year will be pushing the Polish yields up on the month-end horizon. Industrial production and retail sales data, to be released in the second part of this month, should help to push the bonds prices down. Moreover, higher US sovereign debt supply will be an additional factor which should be pushing the global and domestic yields up. On the other hand, cancelling of regular bond auction in August will likely limit the room for the sell-off.

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