Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

10 – 16 September 2018

Market mood remained adverse for EM currencies this week and we could see them depreciate until Thursday. Only on Friday the losses were trimmed. The upward pressure on domestic bond yields occurred in response to continued global uncertainty as well as a sell-off of bond portfolios by some local financial institutions. PMIs in Europe and Poland surprised negatively, as did data on economic activity in German industry, signaling that a slowdown might appear in 2H18. Polish MPC still wants to keep rates on hold this year and next.

In the coming week we predict that EURPLN could remain slightly above 4.30 as a result of sustained risk aversion. Later in the week, further weak data from Europe and a potentially slightly softer tone of the ECB press conference may bring back positive mood to the debt market.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (10 September)					
09:00	CZ	CPI	Aug	% y/y	2.4		2.3
		TUESDAY (11 September)					
09:00	HU	CPI	Aug	% y/y	3.3		3.4
11:00	DE	ZEW Survey Current Situation	Sep	pts	71.6		72.6
		WEDNESDAY (12 September)					
11:00	EZ	Industrial Production SA	Jul	% m/m	-0.3		-0.7
		THURSDAY (13 September)					
08:00	DE	HICP	Aug	% m/m	0.1	-	0.0
10:00	**PL**	**CPI**	**Aug**	**% y/y**	**2.0**	**2.0**	**2.0**
13:45	EZ	ECB Main Refinancing Rate	Sep-18	%			
14:00	**PL**	**Current Account Balance**	**Jul**	**€mn**	**-722**	**-418**	**-240**
14:00	**PL**	**Trade Balance**	**Jul**	**€mn**	**-460**	**-255**	**-413**
14:00	**PL**	**Exports**	**Jul**	**€mn**	**17191**	**17160**	**18071**
14:00	**PL**	**Imports**	**Jul**	**€mn**	**17750**	**17415**	**18484**
14:30	US	CPI	Aug	% m/m	0.3	-	0.2
14:30	US	Initial Jobless Claims		k	212.5	-	213.0
		FRIDAY (14 September)					
14:00	**PL**	**CPI Core**	**Aug**	**% y/y**	**0.8**	**0.8**	**0.6**
14:30	US	Retail Sales Advance	Aug	% m/m	0.6	-	0.5
15:15	US	Industrial Production	Aug	% m/m	0.4	-	0.1
16:00	US	Michigan index	Sep	pts	96.2	-	96.2
	PL	**Rating Review by Moody's**					

Source: BZ WBK, Reuters, Bloomberg

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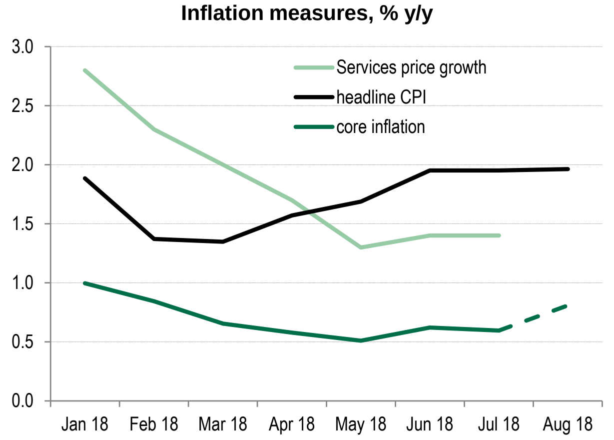
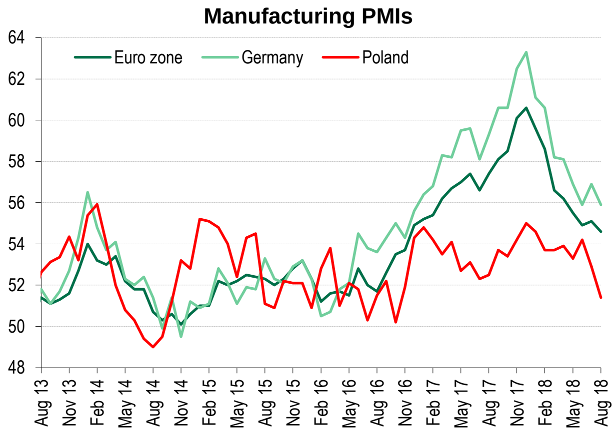
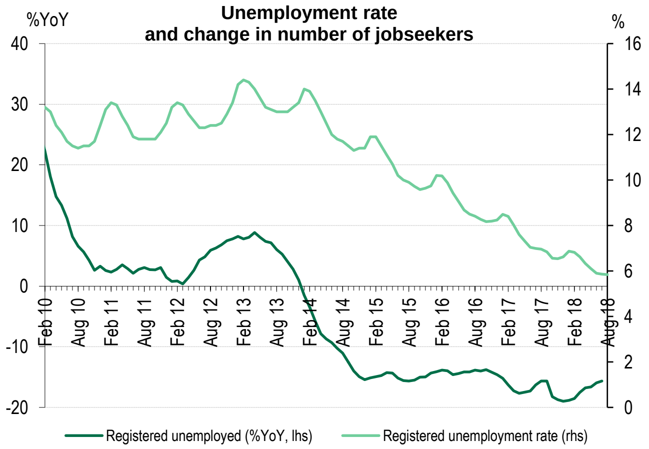
What's hot next week – Stronger core of inflation



- The fact that flash CPI reading for August showed it clinging to 2% y/y vs. our 1.8% call made us push up our estimate of core inflation. It seems underlying inflation may have made a significant step higher for the first time this year, to 0.8-0.9%, so it is important to look at the CPI details and core inflation measures to be released this week. We might finally see some increase in services inflation, which was depressed in 1H18 from 2.8% y/y to 1.4%, and failed to rebound despite all the pressure coming from the labour market. While we expect the headline CPI decline gradually for the rest of the year, core inflation may actually follow an upward trend.
- Balance of payment data should look quite OK, with export and import growth still near 10-11% y/y in July. With the deterioration of business sentiment and German factory orders we worry more about what comes in the next months.
- Moody's is to review Poland's rating (A2/stable) on September 15. Any changes seem unlikely to us at this stage.

Last week in economy – Sliding business sentiment





- Polish manufacturing PMI went down from 52.9 pts to 51.4 in August, its two-year low, while 53 was expected. The report mentions many areas of weaker activity – current output, new orders (lowest in 2 years, export orders component lowest in 4 years), employment, easing pressure on supply chains. In just two months PMI lost 2.8 pts – this is a sharp turn, which seems to confirm that 2H18 may be about (gradual) economic slowdown. We expect real data for August to confirm the weakening of business activity that the recent sentiment indicators suggested.
- Another below-consensus reading of German factory orders (July) does not bode well for prospects of Polish industry. All the 2018 readings but May have been worse than expected, which undermines the story that 1Q weakness of the euro zone economy was only a temporary soft patch. The index has been falling now in y/y terms for the second month in a row, while it started the year at +8% y/y. Readings close to zero were also observed between 2H14 and 1H16 – during the period when the euro zone economy could not break above 2% y/y growth. In Europe, the retail sales and PMI readings (for both industry and services) were also mostly below-consensus. Chinese services PMI also surprised to the downside.
- According to Labour Ministry's flash estimate, the registered unemployment rate in August fell from 5.9% to 5.8%, while almost all market analysts assumed that it stayed unchanged. The number of unemployed decreased by 2.3k m/m, less than a year ago (-3.9k m/m), but enough to bring unemployment rate lower.

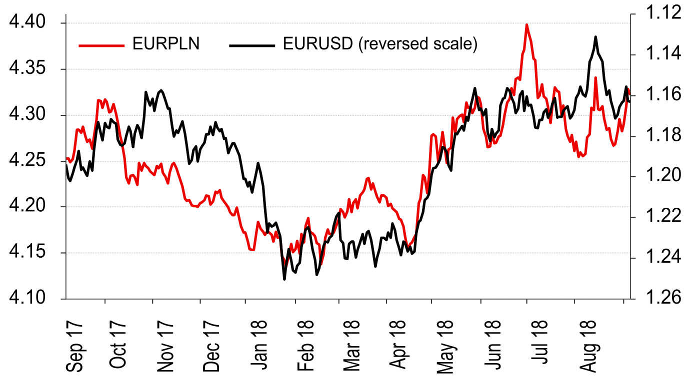
Quote of the week – We are an oasis of stability

Adam Glapiński, NBP governor, MPC press conference, September 5
We are an oasis of stability (…) Interest rates could stay on hold until the end of 2019 or even in the first quarters of 2020, maybe until its end. Everyone is waiting for hikes, but it may well be that ECB loosen policy further at that stage. We have only two MPC members [out of 10], and with opposite views, who challenge the internal consensus about the future path of interest rates.
Kamil Zubelewicz, MPC member, MPC press conf., September 5
The current monetary policy is not stable if seen through (negative) real interest rates and in case risk of inflation overshooting the target grows, I expect there will be motions to hike rates.
Jerzy Żyżyński, MPC member, MPC press conf., September 5
It is hard to find reasons to interfere in the economy.

The Monetary Policy Council kept interest rates unchanged, as expected, with the main rate at 1.50%. The concluding remarks in the statement still point to the Council's conviction that inflation will remain close to the target for long. The MPC sees economic outlook as positive despite some slowdown expected in the coming years. Thus the Council still thinks keeping rates stable is the optimal solution. Adam Glapiński mentioned that there are no significant changes in approved 2019 monetary policy guidelines (yet unpublished). We think the period of interest rate stability will last until at least November 2019. In our view, decision to hike rates will require solid macro conditions (with CPI getting above the 2.5% y/y target) and economic outlook as well as ECB making the move first.

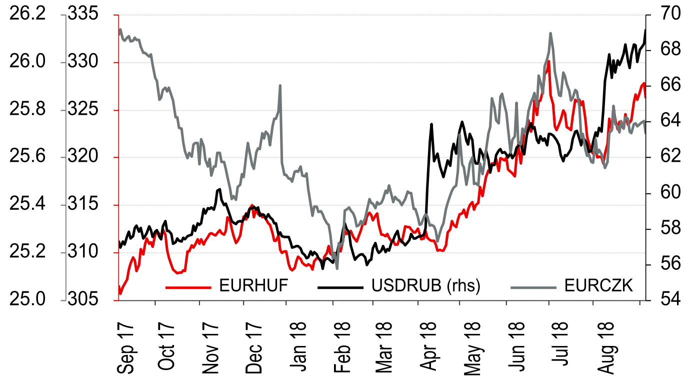
FX and FI market – Sailing the rough sea

EURPLN and EURUSD



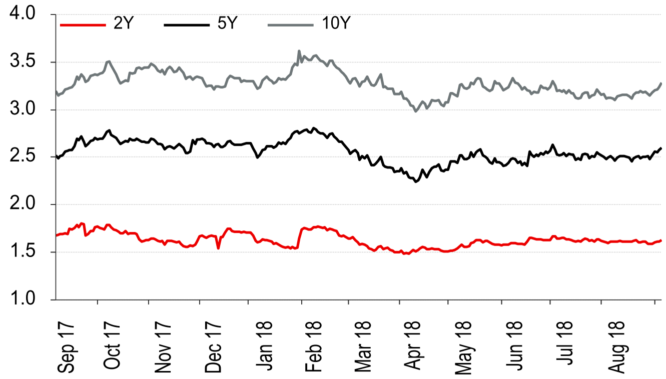
Source: Thomson Reuters Datastream, Bank Zachodni WBK

EURHUF, USDRUB, EURCZK



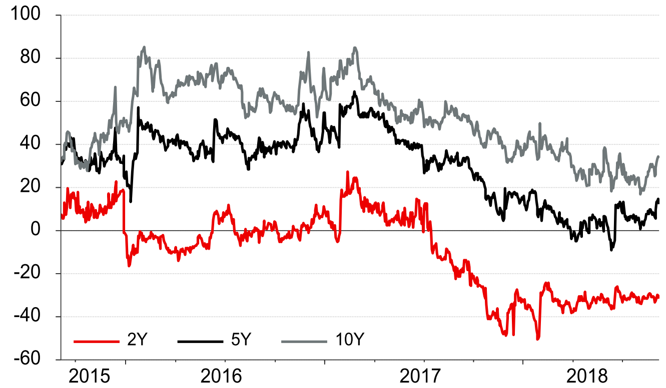
Source: Thomson Reuters Datastream, Bank Zachodni WBK

Poland bond yields (%)



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Bank Zachodni WBK

Last week on the market

- **FX** EURPLN has been rising throughout most of last week, pushed upwards by concerns about new waves of crisis in Argentina and Turkey. It was also affected by uncertainty about the future of world trade, given the lack of progress in US-Canada and US-EU negotiations, and looming extension of US tariffs on China. As a result, EURPLN shifted from 4.297 at the beginning of the week to above 4.33 on Wednesday-Thursday and only at the end of the week managed to trim some losses, returning to slightly above 4.30, supported by a broader rebound in EM currencies and euro appreciation versus dollar.
- **FI** Yields of domestic bonds rose during the week by c5bp in all segments. The upward pressure on domestic bond yields occurred in response to continued global uncertainty which had weakened developing countries' currencies and stock markets. Furthermore, debt was negatively affected by the sell-off of bond portfolios by some local financial institutions.

What to watch for next week

- This week's key events include the publication of data by ZEW in Germany and the ECB press conference. The ZEW indicator may drop, following falling stock markets in Europe and expectations of worse results for European companies. The ECB conference ought to bring about a softening of the bank's language in response to a series of poor data from Europe (retail sales, inflation, money supply). However, we still predict the conference will result in a confirmation of the previously declared path of QE tapering.
- Data concerning Polish and European inflation will not be so keenly watched by investors owing to earlier flash CPI publications. Similarly, we do not foresee a large interest in the current account results for July. In the case of Moody's rating revision planned for the end of the week, we expect that the previous evaluation of Polish debt and its perspectives will be maintained.

Market implications

- **FX** In the coming week we predict that the EURPLN will remain slightly above 4.30 as a result of sustained risk aversion. In our opinion, the potential negative influence of trade wars on developing economies in conjunction with the prospect of rising interest rates in USD will continue to negatively affect the currencies of developing markets.
- **FI** In the debt market, we expect a continuation of the sell-off that was occurring at the beginning of the week (the increase in yields in the 5-10Y segment should not exceed 2-4bp). Towards the end of the week, the expected weaker ZEW data and the tone of the ECB conference should improve the mood on the debt market and in turn decrease the domestic yield curve. The behaviour of the US Treasury market, however, remains a risk factor. The planned increase in US Treasury bond supply may push the curve upwards. Nevertheless, any negative effect of this factor on domestic bonds ought only to be temporary.

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