Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

13 – 19 November 2017

This week will be interesting. It will start with a publication of Inflation Report, including the details of the new NBP projections, with – as we already know – a bit higher CPI and GDP paths. New comments made by MPC members may be expected and they may not be as dovish as those by NBP governor Glapiński. Shortly afterwards we will see data about balance of payments and inflation, and on Wednesday flash GDP data for 3Q17. CPI growth slowed slightly in October, but it may rebound already in November due to significant rise in fuel prices. The balance of payments data could be a positive surprise (better trade balance, higher exports), which was suggested by the GUS data on foreign trade. It also implies an upward risk for 3Q GDP growth forecasts. The end of the week will see the release of data on wages and employment, which should confirm building wage pressure. There will also be lots of data releases abroad: inflation, flash GDP, several other indicators in Europe and USA – plus numerous public speeches made by central bankers.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (13 November)					
14:00	**PL**	**CPI**	**Oct**	**% y/y**	**2.1**	**2.1**	**2.2**
14:00	**PL**	**Current account**	**Sep**	**€m**	**-350**	**-667**	**-100**
14:00	**PL**	**Exports**	**Sep**	**€m**	**17 050**	**16 892**	**15 682**
14:00	**PL**	**Imports**	**Sep**	**€m**	**16 686**	**16 939**	**15 384**
		TUESDAY (14 November)					
8:00	GE	Flash GDP	Q3	% y/y	2.3	-	2.1
9:00	CZ	Flash GDP	Q3	% y/y	4.8	-	4.7
9:00	HU	Flash GDP	Q3	% y/y	3.7	-	3.2
10:00	**PL**	**Flash GDP**	**Q3**	**% y/y**	**4.5**	**4.3**	**3.9**
11:00	EZ	Flash GDP	Q3	% y/y	2.5	-	2.5
11:00	EZ	Industrial output	Sep	% y/y	3.3	-	3.8
11:00	GE	ZEW index	Nov	pts	88.0	-	87.0
14:00	**PL**	**Core inflation**	**Oct**	**% y/y**	**0.9**	**0.8**	**1.0**
		WEDNESDAY (15 November)					
14:30	US	CPI	Oct	% m/m	0.1	-	0.5
14:30	US	Retail sales	Oct	% m/m	0.1	-	1.6
		THURSDAY (16 November)					
11:00	EZ	CPI	Oct	% y/y	1.4	-	1.5
14:30	US	Initial jobless claims	week	k	-	-	239
14:30	US	Philly Fed index	Nov	pts	24.0	-	27.9
15:15	US	Industrial output	Oct	% m/m	0.4	-	0.3
		FRIDAY (17 November)					
14:00	**PL**	**Wages in corporate sector**	**Oct**	**% y/y**	**6.5**	**6.4**	**6.0**
14:00	**PL**	**Employment in corporate sector**	**Oct**	**% y/y**	**4.5**	**4.5**	**4.5**
14:30	US	House starts	Nov	% m/m	5.4	-	-4.7
14:30	US	Building permits	Nov	% m/m	1.4	-	-3.7

Source: BZ WBK, Reuters, Bloomberg

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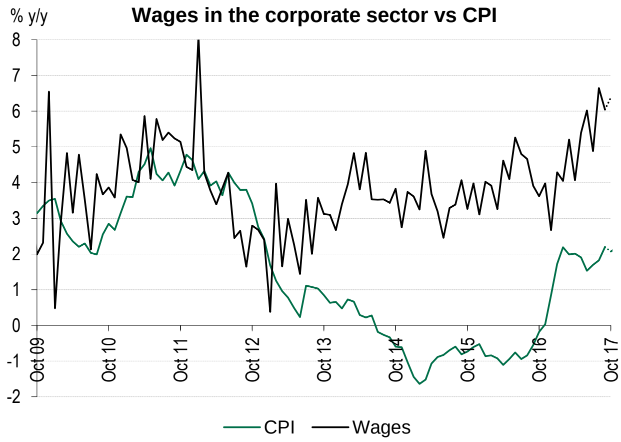
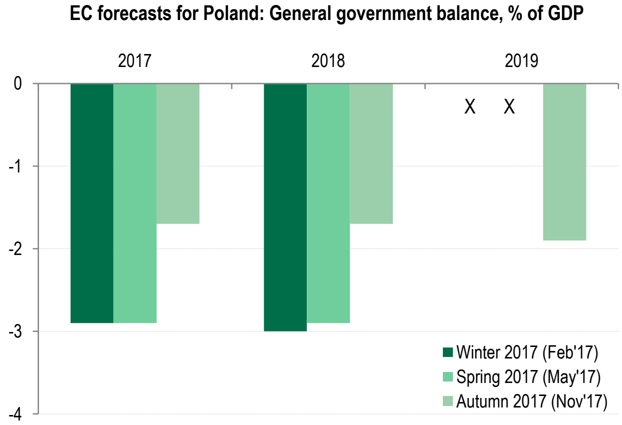
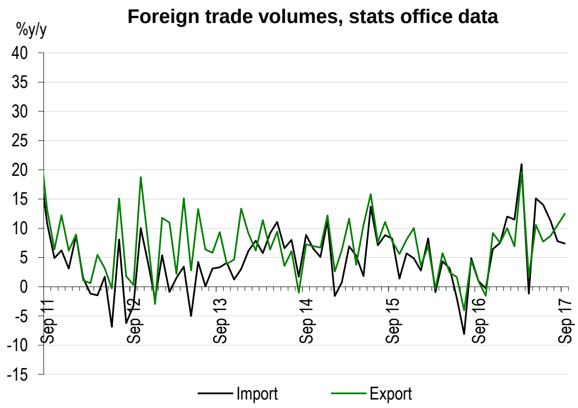
What's hot next week – 3Q GDP and NBP projection details



- The dovish press conference offset the fact that the tone of the statement was a bit more hawkish and that NBP revised its projections higher. The week starts with details of the inflation and GDP projection. We have not heard from the hawkish MPC wing yet and these members may be tempted to deliver their comments on projections to the market.
- Pricing of tighter policy may return thanks to hard data coming this and next months. Wages may accelerate to 6.4% y/y in Oct and 8% y/y in Dec. CPI could go above current expectations by rising oil prices, possibly blocking a base effect-linked return below 2% y/y in December, while October should be confirmed this week at 2.1% y/y.
- Flash GDP for 3Q should be clearly above 4% y/y (our call 4.3%, consensus is 4.4-4.5%). The risk of forecast error is high due to revisions of past values (the stat office did not publish past quarterly GDP, only the revised annual figures).

Last week in economy – Upgrade of fiscal outlook by the European Commission





- The European Commission significantly reduced general government (GG) deficit forecast for Poland. The revision of 2017 and 2018 deficit went from 2.9% GDP to just 1.7% and the forecast for 2019 is at 1.9% GDP. It is the largest positive change recorded among all the 33 countries for which the Commission showed forecasts, for both 2017 and 2018 fiscal balance. The structural balance is expected at 2.1% GDP this year, 2.3% in 2018 and 2.5% in 2019 (the previous round showed 2017 deficit at 3.2% and 2018 at 3.1%). It means that on average it remains at a similar level to the level reported in the three previous years. This seems a really positive result, given the scale of additional expenditures introduced by the current government (e.g. 500+ child benefit programme, lower retirement age). Possibly, the EC has become convinced that government efforts to improve tax compliance were successful. Despite the large positive correction in GG forecasts, Poland still looks poor compared to the rest of EU (seventh highest deficit vs fifth highest in the previous round).
- GUS foreign trade data for September have shown a surprisingly strong rebound in exports (+12.5% y/y) amid moderate import growth (7.4% y/y). The trade surplus in Jan-Sep was €1.86bn, which implies that in September alone the balance reported a record-high surplus of almost €1bn. This implies, in our view, high probability that the NBP's balance of payments data on Monday will show a positive surprise (consensus for trade balance is +€340mn, for C/A balance -€350mn). It also generates upward risk for 3Q GDP forecasts.
- The Labour Ministry said that the registered unemployment rate amounted to 6.6% in October, in line with our forecast. Unemployed count fell by 46k m/m, which is the highest drop in October since 2007 and, in our view, it results from the reduction of retirement age.

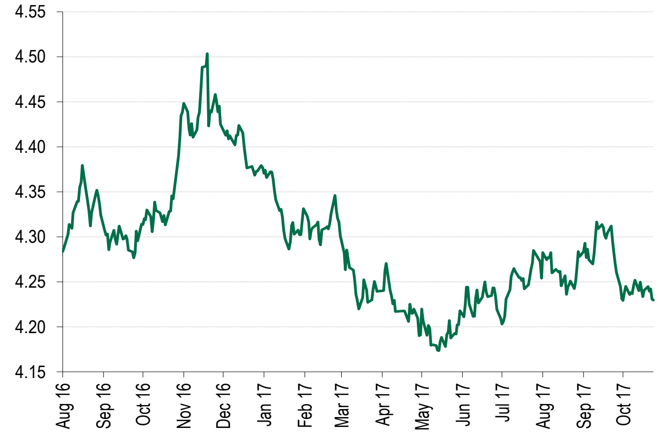
Quote of the week – Inflation will run close to the inflation target

MPC statement, NBP, 8 November
All core inflation measures have risen, though still remain moderate. Taking into account the present information, including the results of the November projection, the Council judges that in the coming years inflation will run close to the inflation target. As a result, the current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic stability
Adam Glapiński, NBP governor, Bloomberg, 8 November
There are slight changes to data and to projections, but they are too small to change my views. The policy mix is rather conservative with 2018 budget deficit reduced, higher taxation and strengthening zloty adding to restrictiveness of the monetary policy.

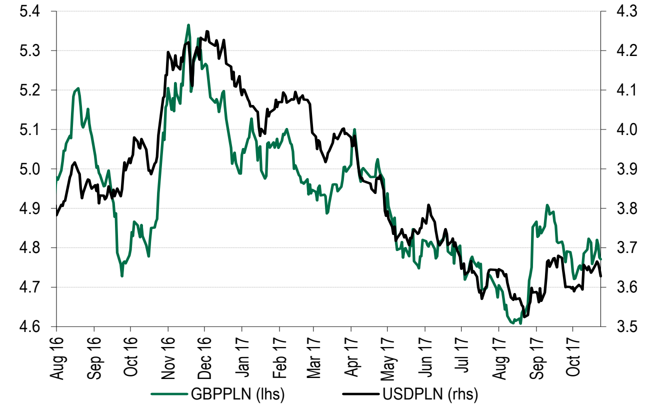
We learned from the NBP press conference that governor Adam Glapiński did not worry about higher projections, even challenging the growth outlook by naming several risks. However the MPC statement was slightly tweaked to sound more hawkish. The risk of inflation running persistently above the target in the medium term is no longer seen as limited and core inflation has not been called "low" anymore. It signals that views more hawkish than Glapiński's (who wants to keep rates unchanged also in 2018) are gaining strength inside the Council. Soon interviews with MPC members may appear, which would remind investors about how many members have already put into question the governor's views and envisage a rate hike in 2018, under some conditions.

Foreign exchange market – Still quiet

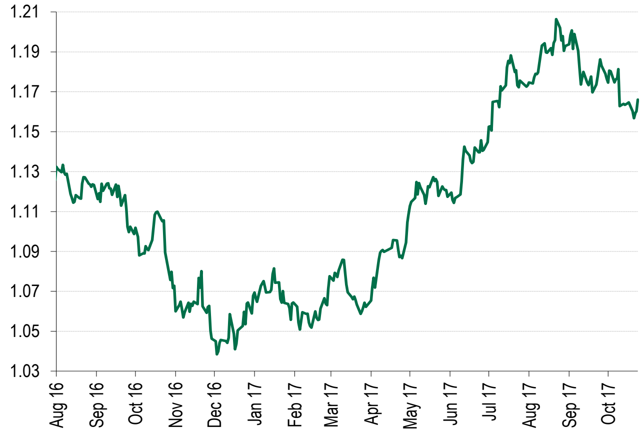
EURPLN



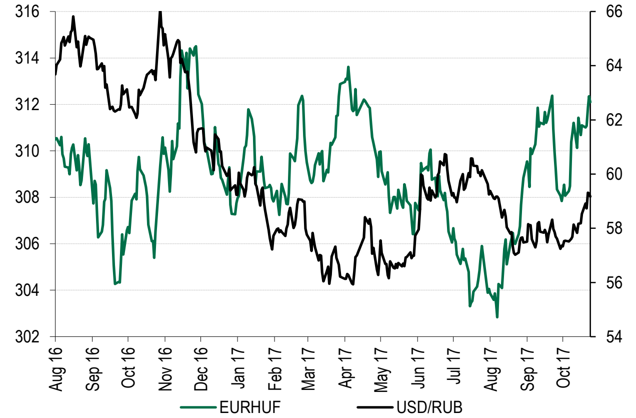
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Polish FX market still stable

- In our previous report, we pointed to the low (and falling) volatility on the Polish FX market and nothing has changed on this front in the last few days. EURPLN has remained near 4.23 and reaction to the positive European Commission forecasts and dovish tone after the MPC meeting was limited. USDPLN held close to 3.65, CHFPLN was stable 3.66 and GBPPLN did not move much from 4.78.
- This week many data are on the agenda, including Polish flash 3Q GDP estimate and numerous US data. Our forecast for Polish economic growth in 3Q is slightly below the market consensus but after the Friday's stat office foreign trade data we see a big upside risk to our estimate. Since early October, the zloty has been gaining amid decent Polish macro data that prompted foreign institutions (rating agencies, IMF, WB) to revise their GDP forecasts up. However, EURPLN stabilization observed for four weeks suggests that a lot of that supportive information has already been priced in and the scope for zloty's appreciation after the release may be limited.
- As regards the US figures, the market is currently nearly fully pricing the December Fed rate hike and the Janet Yellen's successor has been perceived by the markets as a continuator of a moderately hawkish approach to the pace of the monetary policy normalization. As a result, we think that US releases may have a positive impact on the zloty (and other emerging market currencies) if they prove disappointing, rather than significantly negative if they look hawkish.
- Furthermore, many speeches of global central bankers (like Draghi, Kuroda, Carney, Yellen and other FOMC members) are scheduled for the coming days. This adds to the list of factors that could finally trigger higher volatility. We still think that EURPLN could go up in the remainder of the year.

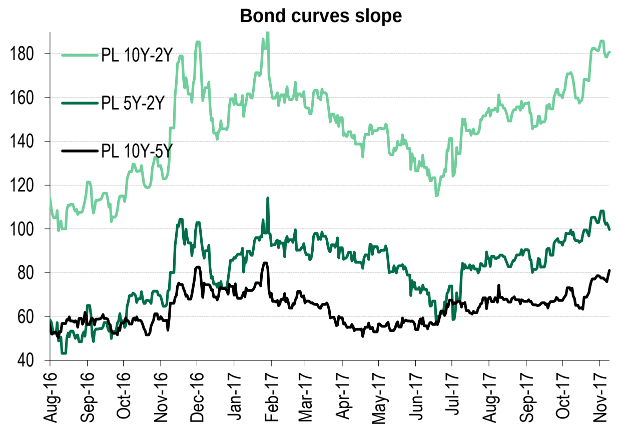
EURUSD still waiting for trigger

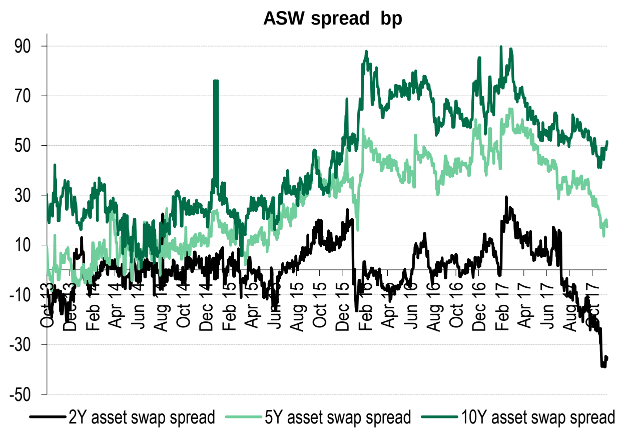
- EURUSD has held around 1.16 in the last few days as there were no important data releases that could spur volatility.
- Numerous US economic activity data are on the agenda this week. The market is pretty confident that FOMC will deliver its next 25bp rate hike in December and so strong macro data may not trigger any sustainable dollar appreciation. We think volatility could actually rise if US numbers disappoint boosting the euro. Also, the market will follow comments of global central bankers very closely. Important levels to watch for EURUSD are at 1.152 (local low) and 1.17 (support broken in October).

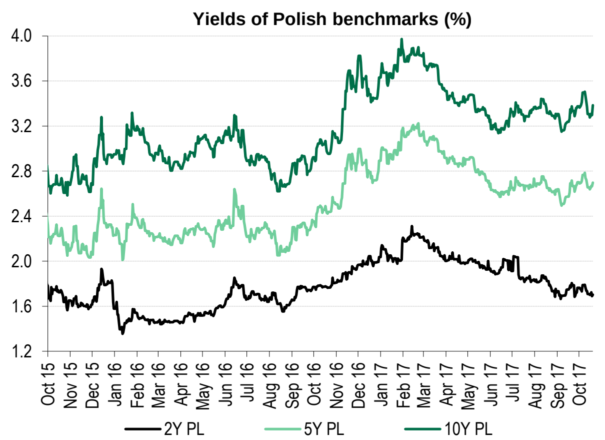
Koruna gains, ruble and forint depreciate

- Czech koruna resumed the appreciation trend with EURCZK falling temporarily to 25.50 after higher-than-expected inflation reading for October (2.9% y/y, highest for five years).
- Ruble was the worst performing CEE currency last week. The Russian currency did not benefit from rising oil prices and was hit by the emerging market currencies sell-off. As a result, USDRUB jumped to 59.58, its highest since August 2017.
- EURHUF stayed in a gradual upside trend and neared the local peak at c312.5 reached in early October.

Interest rate market – Expected steepening of the yield curve







Following the bunds

▪ In the first part of the week, we saw the yields starting from elevated levels, after a sell-off of domestic bonds in early November. Consequently, by Tuesday domestic bonds were trying to follow the rising prices of German bonds. The latter were driven by information on the debt maturity structure of the ECB portfolio, implying that in 2018 the ECB will have to roll over €180 million of euro area countries' debt. Information on the improved fiscal situation in Portugal was another driver for the lowering of yields.

MPC conference pushed the yield curve down

▪ Domestic factors prevailed in the second half of the week. The mild tone of the MPC conference contributed to a downward shift of the domestic curve by 1-3 bp (stronger at the short end). This is how investors responded to the clearly dovish comments of the chair and other members of the MPC at the conference where a new, higher inflation projection was presented. The downward shift after the conference was revised following the Thursday auction, at which the Ministry yet again increased the share of floating-coupon securities and the 5Y-10Y fixed-coupon bonds. As a result, at the end of the week the yields in the 5Y-10y segment of the yield curve were 5-7 bp lower, while the short end rose by 1 bp. This was accompanied by small unspecific changes in the credit risk curve.

Switch auction

▪ Bonds worth PLN 8.1 bn were exchanged at the auction, of which PLN 3.26 bn were floating-coupon WZ0528 and PLN 2.42 bn were WZ1122, followed by PS0723 (PLN 1.01 bn) and DS0727 (PLN 1.01 bn). Traditionally the least traded were OK0720 (PLN 0.378 bn). This constellation indicates that the Ministry of Finance continues to prefer extending the maturity of its PLN liabilities.

5Y-10Y is likely to be widen

▪ This week we expect a return of the steepening of the yield curve. We believe that this effect will be more visible in an increase in the 5Y-10Y spread than in the 2Y-5Y spread returning to the level from late October. This process will be driven by market expectations that the policy of extending debt maturity will be maintained. So far this policy has mainly been implemented by increasing the sale of floating-coupon papers and a moderate supply of fixed-coupon papers in the 5Y-10Y segment (with a minimum supply of fixed-coupon 2Y debt). In our opinion, such a scenario implies a growing interest in 5Y papers, as a substitute for low-yield 2Y bonds, and a gradual increase in long-end yields. In effect, this should lead to a reduction in the 2Y-5Y spread and an increase in the 5Y-10Y spread. The scenario of 5Y-10Y spread widening should be supported by the expected increase in yields at the long end of the curve, in response to good GDP data for Poland and the euro area released this week.

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