Bank Zachodni WBK
Grupa Santander

EYEOPENER

7 May 2018

May holiday storm over the zloty

- **US and euro zone data were not encouraging, Fed did not change interest rates and its tone**
- **Polish PMI surprised on the upside, inflation increased in April**
- **EM fx and debt sold off last week**
- **Zloty and domestic bonds recovered partially from the losses**

The positive weather conditions in Poland in early May, when many Poles were celebrating two national holidays, were not observed on the financial market. EM assets, especially these from CEE and LatAm, were hit by raised volatility. Lower liquidity on PLN and POLGB markets triggered strong moves in their pricing. Even though PLN-related risks connected to CPI and PMI data releases did not materialise, and information on the new EU budget did not draw a clear picture of new EU funds breakdown, the zloty depreciated markedly and POLGB yields climbed significantly. At the same time, US and Euro zone data supported the view that the peak of the business cycle is already behind us. Meeting of the White House representatives with Chinese deputy prime minister Liu He on new trade relations held on Thursday and Friday did not bring a breakthrough. US decision whether to withdraw from the Iran nuclear deal is still pending, and is to be made until 12 May. Uncertainty in this regard is underpinning higher oil prices. Today, the bank holiday in the United Kingdom is likely to postpone the return of the Polish markets to levels from the end of April.

The Fed did not change interest rates, in line with expectations. The central bank stuck to its willingness to tighten the monetary policy further. The statement read that inflation approached the 2% target. In our view, the Fed will hike rates by 25bp in June and then by additional 25 or 50bp in 2H18. Non-farm payrolls surprised to the downside with weak employment and wage growth, but showed a surprising drop in the unemployment rate to the lowest level since 2000.

EU financial framework for 2021-2017 is to amount to €1.279trn, (equal to 1.11% of Gross National Product) – more than in 2014-2020 framework despite Brexit. Cohesion funds are to be cut by about 7%, Common Agricultural Policy by about 5%. However, the cohesion policy aims are to be broader, e.g. by inclusion support for migrants, triggering a need to impose additional criteria for funds distribution, apart from the GDP per capita. The European Commission assessed that the most important modification is to connect EU funds disbursement with rule of law. “The new proposed rules would allow the Union to suspend, reduce or restrict access to EU funding in a manner proportionate to the nature, gravity and scope of the rule of law deficiencies.” Motion to impose such restrictions will be put forward by the Commission and voted in the European Council using reversed qualified majority. Vera Jourova, justice commissioner admitted that were these rules already enacted, Poland would qualify for EU funds limitation or freeze. The Commission also wants to launch new programmes dedicated to Euro zone members and Euro zone candidates. There are many records in the EC documents that could lead to the reduction of Poland’s share in the EU budget expenditures (due to the dispute over the rule of law, Poland’s questioning of EU migration policy and the lack of clear plans for entry to the Euro zone). These items may have set the negative market mood, as long as we do not know the by country details of the EC proposal.

Minister for investments and development, Jerzy Kwieciński, said that Poland is likely to remain the biggest beneficiary of the EU budget. Deputy minister for foreign affairs, Konrad Szymański, said that full compromise regarding the budget is distant. Details how cash will be allocated between countries is expected to be announced between May 29 and June 12.

Polish manufacturing PMI has beaten expectations with its April reading of 53.9 pts (market consensus was 53.2, previous reading 53.7). As in the case of some Euro zone PMIs, the rebound in April is small compared to the scale of the decline seen in the business sentiment indicators in 1Q (Polish PMI was at 55 pts in December). The PMI report stresses a somewhat stronger current output, the still strong employment component, plus some improvement in new export orders. On the other hand purchasing activity remained weak (lowest reading since November 2016) and yet it did not ease the pressure on supply chains (a subindex of PMI shows supplier delivery times being the longest since December 2010). Output expectations were below the readings from 2017. It seems Polish industry is caught between the moderation of demand (today we saw next German factory orders data) and capacity constraints. We think this will result in a gradually declining path of economic growth this year.

Polish flash CPI reading for April was 1.6% y/y, up from 1.3%. The rise was caused by non-core components. Food prices added c1pp vs 0.9pp in March. Statistics Poland showed

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fuel prices rising 2.8% m/m. A core CPI estimate for April based on the partial information from the flash release is 0.6-0.7% y/y, so basically unchanged vs 0.65% from March. We expect core inflation to begin systematically rising soon, possibly above 1.5% y/y this year. In our view headline inflation will recover further in the months to come, to get above 2% for a couple of months around mid-2018, and to descend to 1.8% y/y by the end of the year.

Economic Commission spring forecasts showed next downside revision of Polish general government deficit forecast to 1.4% of GDP from 1.7% in 2018 and 2019. The EC predicts the structural deficit (that is corrected for the impact of a business cycle and discretionary actions) at 2.2% of GDP for 2018 and 2019 (in autumn, EC expected 2.3% and 2.5%, respectively). Update of the Poland's Convergence Programme assumes 2.8% for this year and 2.3% in 2019. According to the Commission, new plans recently announced by the government generate an upside risk for deficit forecasts but it recons that VAT rates may stay at higher levels beyond 2018. Sources of uncertainty are the scheduled progress in increase the efficiency of tax collections and the capacity to realize public investment plans. The EC revised up its forecast for investments to 8.7% from 7.9% stressing that shortage of labour force could discourage companies from undertaking investment activity.

MPC member Eugeniusz Gatnar did not exclude interest rates hike this year if the inflation rebounded and GDP slowed down. In his opinion, the March's low CPI reading was a deviation from the trend, which gives some of the MPC members an illusive sense of comfort. In Gatnar's opinion, further rate cuts are excluded and the economy will not need stimulus using non-standard measures. If the MPC discusses such measures it was "only in the context of what other central banks are doing". **Another MPC member, Kamil Zubelewicz** mentioned about the risk of wage pressure in the budgetary sphere and potential escalation of demands that could worsen the fiscal result. In his opinion we could still expect a few quarters of high economic activity, however, but some signals of deterioration are already present.

EURUSD continued last week the downward move started in mid-April after the strong US data were released. Although the last week's US figures were not that encouraging, the dollar continued to gain as the euro zone numbers looked worrying. As a result, EURUSD fell to nearly 1.19 reaching its fresh 2018 low.

The zloty suffered much amid thin liquidity on May 1 when it lost 1.3% vs the euro and 1.7% vs the dollar – respective exchange rates jumped to 4.29 (the highest since October) and 3.57 (the highest since December). Dollar appreciation weighed also on the other CEE currencies but the zloty was underperforming, likely due to low liquidity when the local market was closed. Only on Friday the zloty managed to recover much of these losses and today in the morning EURPLN is near 4.25.

In the case of the other CEE currencies, EURHUF jumped to 315.5 (its highest since July 2016) and EURCZK to 25.8 (its highest since December 2017) on the wave of EM fx weakness. Both forint and koruna managed to recover somewhat at the end of last week. USDRUB headed towards its this year's peak at c65 (reached in reaction to new sanctions imposed by the US on Russia) but managed to fall to 63 in mid-week thanks to rising price of oil.

On Friday on the domestic debt market, the yields decreased, as a correction after the Wednesday's rise. This move was triggered by weaker European PMI services data release and downward move of yields on the global debt market. However, in total over the week the domestic curve was lifted by 12 bp, as a correction after the rally from late April. The domestic yields were rising despite rising prices on the European core debt markets. Today we expect the domestic yield to drop (but only slightly) due to the bank holiday in London. We expect some upward price correction at the end of the week.

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FX market

Today's opening

EURPLN	4.2503	CZKPLN	0.1667
USDPLN	3.5644	HUFPLN*	1.3540
EURUSD	1.1924	RUBPLN	0.0568
CHFPLN	3.5560	NOKPLN	0.4414
GBPPLN	4.8245	DKKPLN	0.5706
USDCNY	6.3621	SEKPLN	0.4031

*for 100HUF

Last session in the FX market 04/05/2018

	min	max	open	close	fixing
EURPLN	4.237	4.278	4.264	4.247	4.2771
USDPLN	3.541	3.576	3.557	3.552	3.5754
EURUSD	1.191	1.200	1.199	1.196	-

Interest rate market 04/05/2018

T-bonds on the interbank market**

Benchmark (term)	%	Change (bps)	Last auction	Paper offered	Average yield
PS0420 (2L)	1.50	0	05-Apr-18	OK0720	1.495
PS0123 (5L)	2.44	0	05-Apr-18	PS0123	2.335
WS0428 (10L)	3.15	-2	05-Apr-18	WS0428	3.123

IRS on the interbank market**

Term	PL %	PL Change (bps)	US %	US Change (bps)	EZ %	EZ Change (bps)
1L	1.73	0	2.57	1	-0.26	0
2L	1.88	-1	2.76	1	-0.15	0
3L	2.06	-1	2.85	1	0.02	1
4L	2.26	-1	2.89	1	0.20	-1
5L	2.42	-1	2.91	0	0.37	0
8L	2.75	0	2.95	0	0.77	0
10L	2.92	0	2.98	0	0.97	0

WIBOR rates

Term	%	Change (bps)
O/N	1.57	3
T/N	1.56	1
SW	1.56	0
2W	1.60	0
1M	1.64	0
3M	1.70	0
6M	1.78	0
9M	1.79	0
1Y	1.82	0

FRA rates on the interbank market**

Term	%	Change (bps)
1x4	1.70	0
3x6	1.71	0
6x9	1.73	0
9x12	1.75	0
3x9	1.79	0
6x12	1.80	-1

Measures of fiscal risk

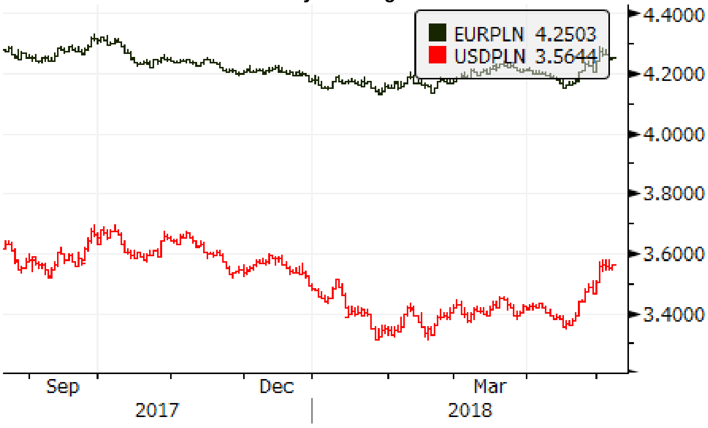
Country	CDS 5Y USD Level	CDS 5Y USD Change (bps)	10Y spread* Level	10Y spread* Change (bps)
Poland			2.62	-1
France	17	0	0.24	0
Hungary	116	1	2.06	2
Spain	39	1	0.75	0
Italy	89	0	1.25	-1
Portugal	64	0	1.15	0
Ireland	25	0	0.42	0
Germany	10	0	-	-

* 10Y treasury bonds over 10Y Bunds

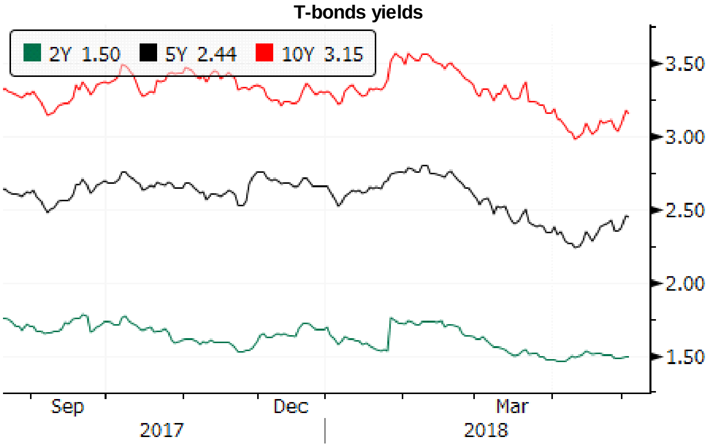
**Information shows bid levels on the interbank market at the end of the trading day

Source: Bloomberg

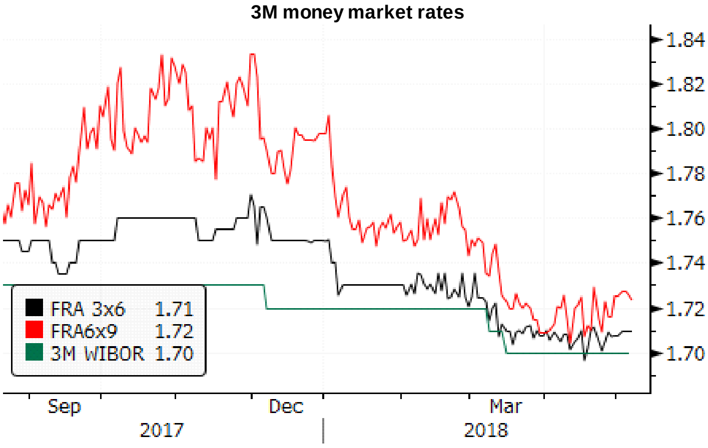
Zloty exchange rate



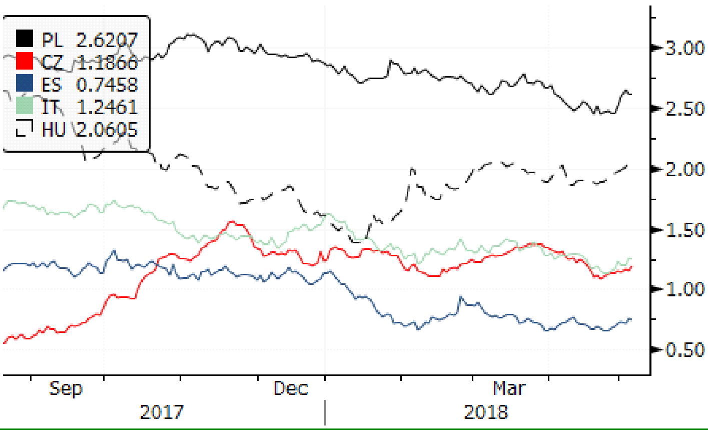
T-bonds yields



3M money market rates



10Y spread vs. Bund



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Economic calendar

TIME CET		INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	ACTUAL VALUE	LAST VALUE
			FRIDAY (May 4)					
14:30	US	Change in nonfarm payrolls	Apr	k	185	-	164	135
14:30	US	Unemployment rate	Apr	%	4.0	-	3.9	4.1
			MONDAY (May 7)					
8:00	DE	Factory orders	Mar	% m/m	0.5	-	-0.9	-0.2
9:00	CZ	Industrial output	Mar	% y/y	-0.2	-	-1.1	2.7
			TUESDAY (May 8)					
8:00	DE	Industrial output SA	Mar	% m/m	0.8	-		-1.6
8:00	DE	Exports	Mar	% m/m	1.8	-		-3.2
			WEDNESDAY (May 9)					
9:00	HU	Inflation	Apr	% y/y	2.3	-		2.0
			THURSDAY (May 10)					
9:00	CZ	Inflation	Apr	% y/y	1.8	-		1.7
11:30	**PL**	**Bond auction**						
14:30	US	Inflation	Apr	% m/m	0.3	-		-0.1
14:30	US	Initial jobless claims	Week	k	218	-		211
			FRIDAY (May 11)					
16:00	US	Flash Michigan	May	pt	98.3	-		98.8

Source: BZ WBK. Bloomberg, Parkiet

** in case of the revision the data is updated*

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