Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

13 – 19 June 2016

The Fed meeting will be this week's key event. Weak US data and comments of FOMC members have slashed the probability of the priced-in June rate hike to 0%. For investors, it will be the tone of the statement that will be key, as well as new economic forecasts and the "dot chart" presenting the central bankers' expected interest rate path – all in the context of the most likely timing of the next hike. There will also be numerous important data releases, mostly from Poland. Since we already know the flash inflation reading, economic activity data, such as production, sales, employment, will likely be in focus. If they are solid (and we assume they will be), chances for better GDP in the coming quarters should grow. Market sentiment will this week depend mainly on the tone of the FOMC statement – if it is dovish, some strengthening of the zloty and bonds is still possible. However, we think these zloty gains would be neither significant nor persistent. Room for its appreciation will be limited by worries about the outcome of the looming EU membership referendum in the UK.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		SUNDAY (12 June)					
18:00	**PL**	**EURO2016: Poland – Northern Ireland**			**1-0**	**1-1**	**-**
		MONDAY (13 June)					
14:00	**PL**	**Current account**	**Apr**	**€m**	**342**	**397**	**103**
14:00	**PL**	**Exports**	**Apr**	**€m**	**15159**	**14992**	**15417**
14:00	**PL**	**Imports**	**Apr**	**€m**	**14845**	**14750**	**15213**
14:00	**PL**	**CPI inflation**	**May**	**% y/y**	**-1.0**	**-1.0**	**-1.1**
		TUESDAY (14 June)					
11:00	EZ	Industrial output	Apr	% m/m	0.6	-	-0.8
14:00	**PL**	**Money supply M3**	**May**	**% y/y**	**11.3**	**11.0**	**11.5**
14:00	**PL**	**Core inflation**	**May**	**% y/y**	**-0.4**	**-0.5**	**-0.4**
14:30	US	Retail sales	May	% m/m	0.3	-	1.3
		WEDNESDAY (15 June)					
15:15	US	Industrial output	May	% m/m	-0.2	-	0.7
20:00	US	FOMC decision		%	0.25-0.50	0.25-0.50	0.25-0.50
		THURSDAY (16 June)					
11:00	EZ	HICP inflation	May	% y/y	-0.1	-	-0.1
14:00	**PL**	**Wages in corporate sector**	**May**	**% y/y**	**4.6**	**4.8**	**4.6**
14:00	**PL**	**Employment in corporate sector**	**May**	**% y/y**	**2.8**	**2.8**	**2.8**
14:30	US	Initial jobless claims	week	k	270	-	264
14:30	US	Philadelphia Fed index	Jun	pts.	1.0	-	-1.8
14:30	US	CPI inflation	May	% y/y	1.1	-	1.1
21:00	**PL**	**EURO2016: Germany - Poland**			**-**	**0-2**	**-**
		FRIDAY (17 June)					
14:00	**PL**	**Industrial output**	**May**	**% y/y**	**4.6**	**5.0**	**6.0**
14:00	**PL**	**Construction and assembly output**	**May**	**% y/y**	**-9.2**	**-11.3**	**-14.8**
14:00	**PL**	**Retail sales (constant prices)**	**May**	**% y/y**	**5.6**	**5.6**	**5.5**
14:00	**PL**	**PPI**	**May**	**% y/y**	**-1.0**	**-0.7**	**-1.2**
14:30	US	House starts	May	k	1150	-	1172
14:30	US	Building permits	May	k	1145	-	1116

Source: BZ WBK, Reuters, Bloomberg

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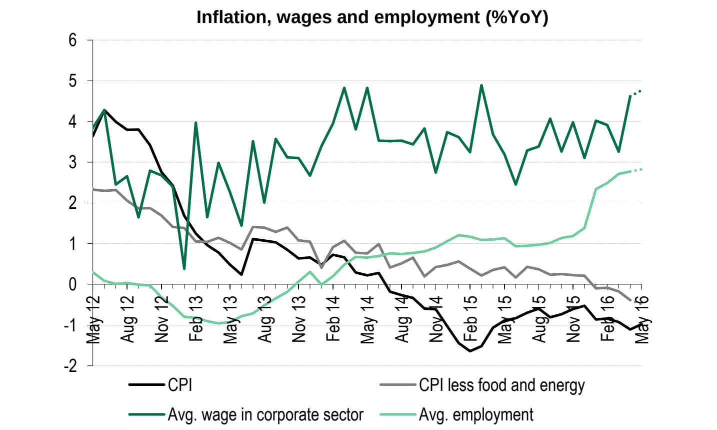
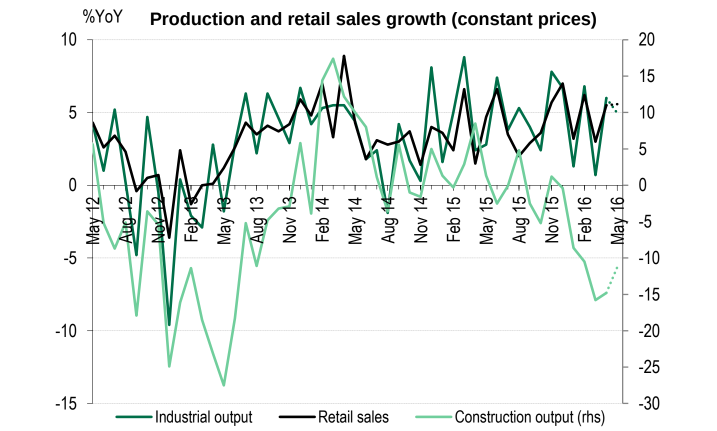
What's hot this week – Key Polish data in bulk





▪ We expect a rebound in exports in April on the back of stronger industrial output in that month. The current account balance is likely to improve thanks to improved readings of all the subaccounts. Exports proved to be disappointing in Q1 (up 1.5% y/y in euro) and their performance in the following months will likely be crucial for assessing whether this was only a temporary slowdown or a longer-lasting phenomenon connected to weaker trade dynamics worldwide.

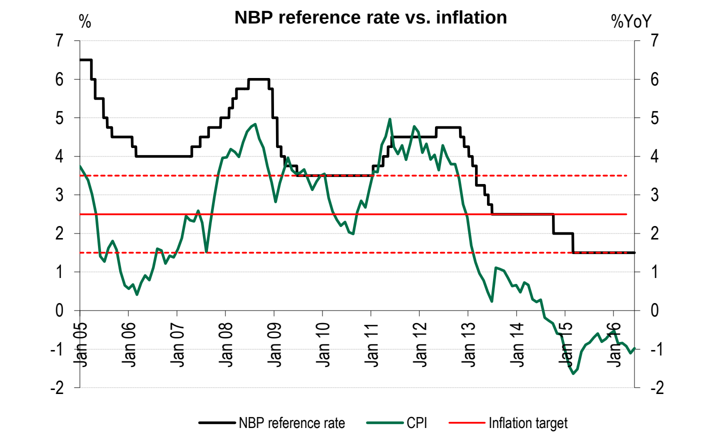
▪ We are curious to see the detailed CPI breakdown after the quite surprising flash estimate at -1.0% y/y (below expectations). In our view, core CPI may have fallen to an all-time low of -0.5% y/y, showing that deflation is not eager to leave Poland. At the same time, we expect a rebound in PPI on the back on higher commodity prices.

▪ The labour market is likely to show positive results. We expect wage growth to stay close to 5.0% y/y thanks to wage hikes in big retail trade companies. Employment growth will stay at a healthy 2.8% y/y, in our view.

▪ Industrial output growth will decelerate a bit in May after a surprisingly strong April, in our view. However, the underlying trend should remain robust thanks to accelerating growth in the euro zone. Construction output growth is likely to stay deep in the sub-zero territory. However, this statistic should be eyed closely in the months to come, as it can be a sign that EU funds disbursement is warming up. We expect retail sales to perform well, confirming that private consumption remained strong at the start of Q2.

▪ Some PLN strengthening at the end of May is likely to drive the M3 money supply growth lower. The loan statistics will be key, in our view, given the factors that could possibly weaken loan growth (bank tax, new land act).

Last week in the economy – Interest rates on hold at Governor Marek Belka's last meeting



▪ The Monetary Policy Council (MPC) kept interest rates on hold (the main reference rate still at 1.50%), in line with expectations. The tone of the official statement did not change versus the previous month either – the key fragments at the statement's end remained exactly the same. The main message remained unchanged as well – deflation has had no negative impact, GDP growth slowdown in 1Q16 (and in particular the drop in investments) was temporary and the current level of interest rates allows to keep the economy on a balanced growth path. NBP president Marek Belka said the Council members discussed different economic scenarios, but were not concerned too much about the economic outlook. He also admitted that a deterioration of corporate financial results would be something that could make the MPC reconsider monetary easing, but it is not taking place.

Quote of the week – President has the final say

Witold Modzelewski, member of President's FX loan team, June 7, PAP

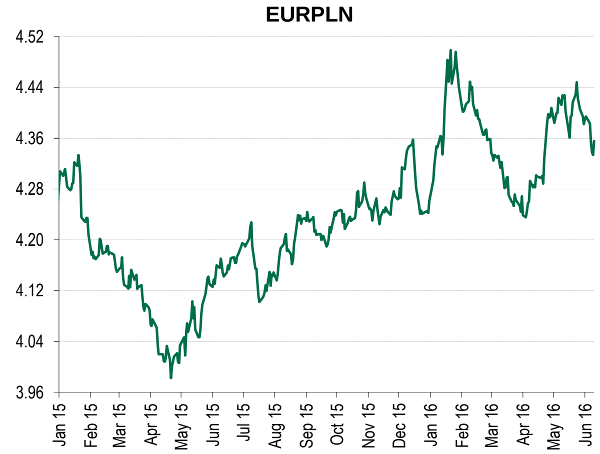
The most important thing is that [the solution] ensures security for both the borrower and the lender. (…) We certainly agreed as far as one thing is concerned - the draft bill will spread in time the economic and financial effects in a way, which does not threaten the stability of the public finance sector. (…) The method for spreading out the impact over time lies in the securitisation of the restructured loans. (…) We haven't considered the option of NBP participation. In our opinion, there is no such need. Nor from the state budget, nor from BGK or public means at all.

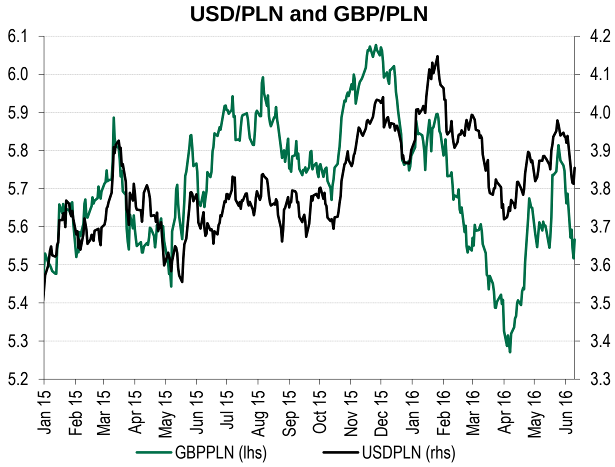
Przemysław Bryksa, member of President's FX loan team, June 7, PAP

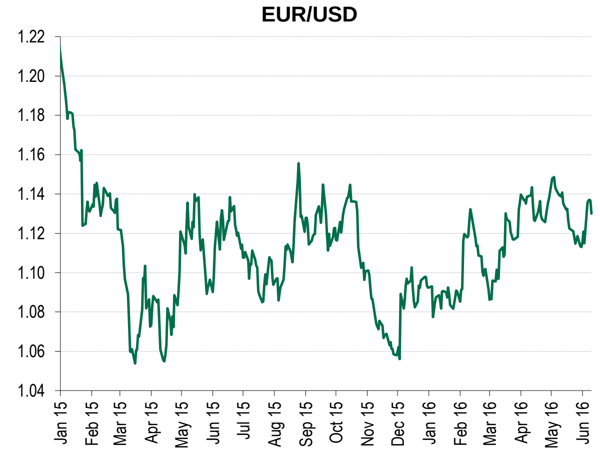
The result of team's work is not a draft bill, the final decision will be up to the President's Office.

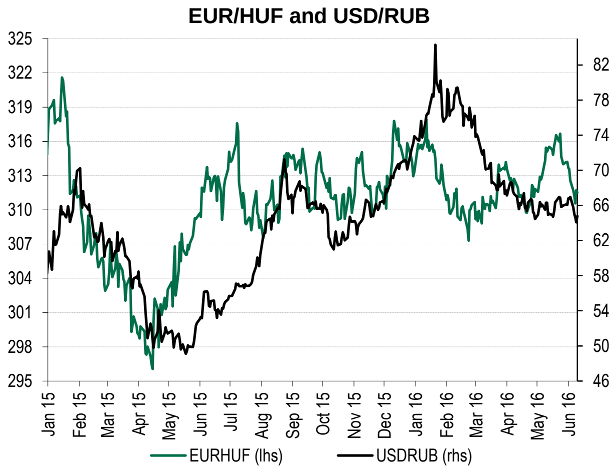
Advisors to President Duda held a press conference to sum up their recommendations on the FX loan issue. Unfortunately, information presented during the conference lacked clarity and details. It failed to clear doubts regarding the final shape of the solution and its possible impact on the economy and the financial sector. The advisors suggested that costs reaching PLN30-40bn would be spread over at least 30 years, though they failed to present the details. They also said that neither the central bank nor any other public institution will have to be involved in the conversion. But there was no explanation on how the FX loan conversion would not lead to zloty depreciation without the involvement of the central bank. The President's Office is now to take over the work and will prepare the final draft that is to be submitted to Parliament in the early summer. We think that uncertainty about the final solution will continue weighing on the financial markets in the weeks to come.

Foreign exchange market – Room for stronger zloty limited even with dovish Fed









Higher zloty volatility

▪ The past week saw somewhat higher volatility on the Polish FX market with both internal and external factors driving the zloty. First, the domestic currency continued to benefit from the weak US nonfarm payrolls that diminished chances for a fast Fed rate hike in the near future. The zloty firmed to 4.31 per euro and 3.78 per dollar, also thanks to hopes that the second version of the draft bill on how to solve the FX mortgage loan issue will remove uncertainty over its impact on the Polish economy and the financial system. However, some general ideas were presented only and they lacked detail. This did not trigger any noticeable market reaction, however. Nevertheless, later in the week, the global market sentiment deteriorated and investors decided to take profit from the zloty's earlier appreciation and EURPLN rebounded to 4.36 and USDPLN to 3.86.

▪ We think both internal and external factors may drive the zloty this week again. The market does not expect the FOMC to hike rates, but the post-meeting statement will likely be a key guide for investors regarding the likely timing of the next step towards monetary policy normalisation. The market's reaction is likely to be straightforward – a dovish tone should be positive for the risky assets, while a hawkish message could lead to a noticeable deterioration of the global market sentiment. At the same time, we think that if the Fed boosts optimism, the room for zloty appreciation will be limited due to the uncertainty about the outcome of the UK referendum next week.

▪ Important levels to watch for EURPLN are: support at 4.31 (next one at 4.26) and resistance at 4.40 (next one at 4.46).

Fed key for the dollar

▪ The dollar recovered marginally vs the euro after the severe losses it had suffered last Friday on the disappointing US nonfarm payrolls. EURUSD corrected to 1.13 after rising first above 1.14.

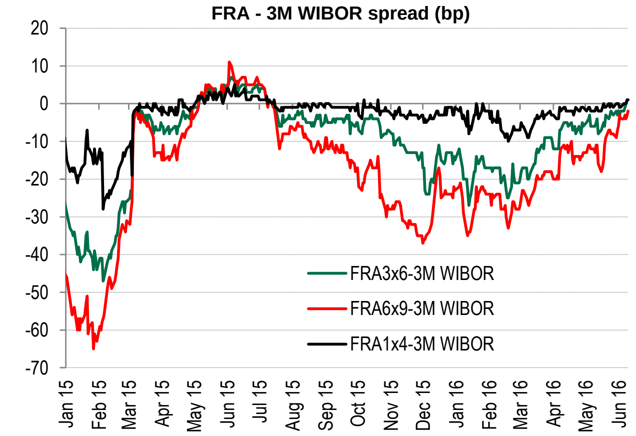
▪ The outcome of the FOMC meeting will obviously be crucial for the exchange rate this week. Falling chances for Fed rate hikes in June and July have pushed EURUSD to its highest since mid-May and the tone of Wednesday's evening statement is very likely to determine whether the dollar will continue to depreciate or regain some ground. We think that the recently very disappointing nonfarm payrolls might have been to some extent caused by seasonal and one-off factors and so the FOMC may put less focus on the recent number than the market. This could mean that the statement could sound rather more hawkish. If this is the case, the dollar may gain this week. Nevertheless, the room for a stronger euro looks limited with the nearing UK referendum.

Global factors crucial for CEE currencies

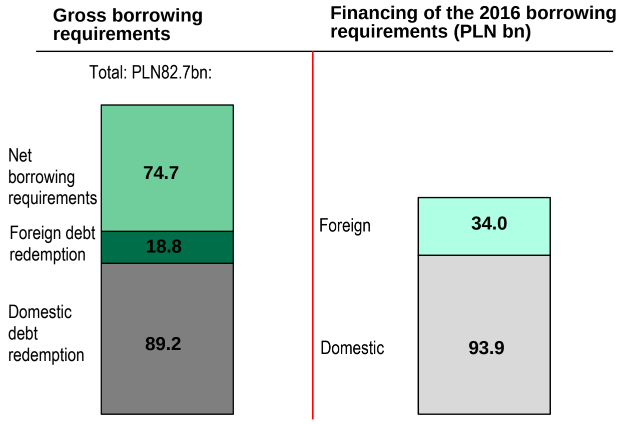
▪ Just like EURPLN, EURHUF was also pretty volatile last week. It first fell below 310, but soon rebounded to 312. At the same time, USDRUB established its fresh YTD low at 63.375, though ended the week above 64.0.

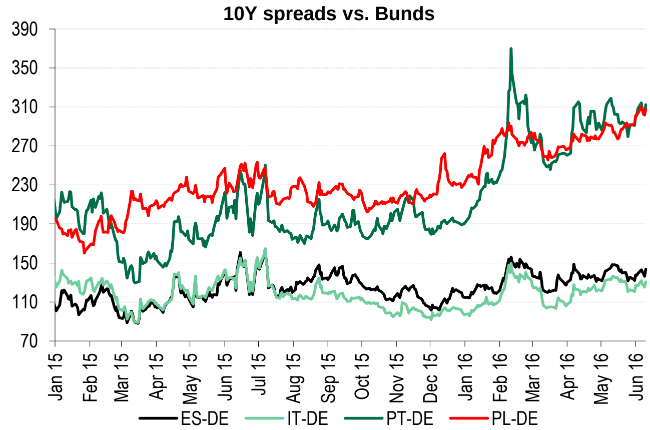
▪ In line with expectations, Russia's central bank cut its main interest rate by 50bp to 10.50% for the first time since almost a year. It believes that inflation risks are diminishing. The bank also underlined that more easing may take place.

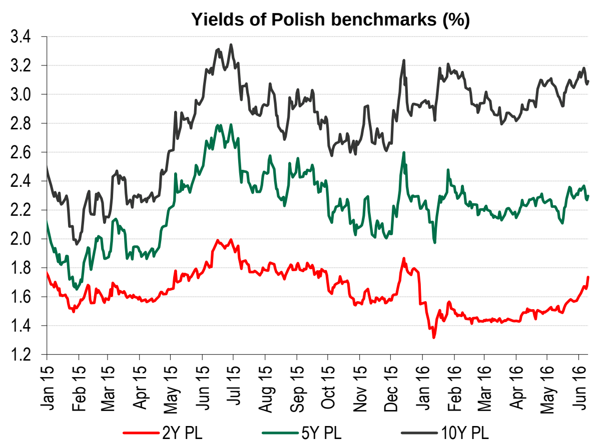
Interest rate market – Upward pressure and high volatility may persist



The 2016 gross borrowing needs and financing







The long end of the curves benefiting from global mood

- On the money market, WIBORs inched slightly up (by 1-2bp across the curve), with the exception of the 3M rate (which was stable at 1.68%). At the same time, FRAs continued their upward trend, rising 2-3bp on weekly terms. Still, the quite hawkish MPC rhetoric scaled back market expectations on monetary easing later this year. In our view, the market is now pricing-in more or less stable rates over the next 12 months.
- Poland's interest rate market strengthened over the past week, mainly on the belly and long end of the curves. At the beginning of the week, the 10Y benchmark yield rose to nearly 3.20% to fall to almost 3.05% in the following days. This was mainly due to strengthening on the core market (yield of 10Y Bund fell below 0.03%) after the very weak US jobs report for May and favourable auction results (details below). The belly of the curves also benefited from the improved sentiment, while the front end inched slightly higher.
- On a weekly basis, the yield curve flattened visibly, with the 2-10Y spread below 140bp for the T-bonds (for the first time since the end of 2015). As we had expected, the risk premium stayed elevated last week, remaining above 300bp over the Bunds in the 10Y sector.
- Poland's Ministry of Finance successfully launched OK1018 and DS0726 bonds at the only regular auction in June. As we had expected, the offered range was narrowed to PLN3-4bn from PLN3-6bn indicated earlier. The recorded demand was strong. As a result, the ministry would not have any problems with placing all the securities on the market. It sold the 2Y benchmark worth cPLN1.05bn with the yield at 1.708% and the 10Y benchmark worth PLN3.36bn with the yield at 3.05%. We estimate that after the auction c70% of the government's 2016 borrowing needs have been covered. Commenting on the auction results, deputy finance minister Piotr Nowak also said that the ministry was on track to issue Panda bonds and that the ministry's liquidity cushion allowed the ministry to cancel one or two auctions after a potential turmoil due to the outcome of the EU referendum in the UK.

FOMC and domestic macro data in the spotlight

- This week investors will focus again on Poland's fundamentals as the calendar is bursting with domestic macro publications. While the final CPI should be in line with the flash figure of -1.0% y/y, we expect further improvement on the labour market (with strong wage growth acceleration) and quite decent growth of industrial output and retail sales. This may result in some upward pressure on FRA, in particular on the longer tenors (over 12M) and on the front end of the curves.
- Global factors are still the key for the belly and long-end of the curves. June's FOMC meeting will, therefore, be in the spotlight. Given the disappointing GDP growth and May's weak labour market report in USA, the Fed is likely to postpone its interest rate hike to at least July. This could support Poland's assets in the short run. However, risk factors, both internal (news about the presidential proposal of FX-loan conversion) and external (the outcome of the EU referendum in the UK) remain in place for Poland's interest rate market. We expect these add to the market volatility, creating upward pressure until their solution later this month. As a consequence, the spread vs the bunds could remain quite wide with the political and fiscal risks still elevated in Poland.

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