WEEKLY ECONOMIC UPDATE

27 June – 3 July 2016

Recent weeks passed in anticipation of the referendum in the UK and the following weeks will pass dominated by uncertainty about its consequences. The market's reaction to the surprising outcome was in line with a higher risk aversion scenario: lower equity prices and yields of Bunds and Treasuries; stronger US dollar and Swiss franc, weaker euro and the British pound. In this environment, Poland's assets had to suffer as well, though we have to admit that the reaction was not overly nervous. At the end of the week, EURPLN and the 10-year bond yield were at a similar level to what we saw a week ago. It has to be noted though that Friday's weakening of the zloty and bonds took place after a significant movement in the opposite direction in the days prior to the referendum (with the zloty and bonds at their strongest levels in weeks). Nevertheless, we think that the Polish assets may continue to be under pressure due to the possible negative effects of the Brexit on the Polish economy in the medium term. This is due to two transmission mechanisms: international trade (UK is Poland's third largest trading partner with the latter enjoying a big surplus), EU budget (no UK input, Poland is the biggest beneficiary). We already discussed this in detail in the March edition of our MACROscope. At this stage, it is hard to try to quantify the referendum's impact (result of negotiations between the EU and UK is a big unknown).

We also expect S&P to release its decision on Poland's rating at the end of the week, but we think the agency is unlikely to announce any changes after it had cut both the rating and outlook in January. Flash CPI and PMI releases should have just a minor impact.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		SATURDAY (25 June)					
15:00	**FR**	**EURO 2016: Switzerland – Poland**			**-**	**0-1**	**2-2**
		SUNDAY (26 June)					
		General election in Spain					
		MONDAY (27 June)					
		No important data					
		TUESDAY (28 June)					
14:30	US	GDP	Q1	% q/q	1.0	-	0.8
16:00	US	Consumer confidence index	Jun	pts.	93.1	-	92.6
		WEDNESDAY (29 June)					
14:30	US	Personal income	May	% m/m	0.3	-	0.4
14:30	US	Consumer spending	May	% m/m	0.3	-	1.0
16:00	US	Pending home sales	May	% m/m	-1.0	-	5.1
		THURSDAY (30 June)					
11:00	EZ	Flash HICP	Jun		0.0	-	-0.1
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:00	**PL**	**Inflation expectations**	**Jun**	**% y/y**	**0.2**	**0.2**	**0.2**
14:00	**PL**	**Flash CPI**	**Jun**	**% y/y**	**-0.9**	**-0.9**	**-0.9**
14:30	US	Initial jobless claims	week	k	-	-	259
		FRIDAY (1 July)					
	CN	PMI manufacturing	Jun		-	-	49.2
9:00	**PL**	**PMI manufacturing**	**Jun**	**pts.**	**-**	**52.5**	**52.1**
9:55	DE	PMI manufacturing	Jun	pts.	54.4	-	52.1
10:00	EZ	PMI manufacturing	Jun	pts.	52.6	-	51.5
15:45	US	PMI manufacturing	Jun	pts.	51.5	-	51.3
	PL	**S&P rating decision**					

Source: BZ WBK, Reuters, Bloomberg

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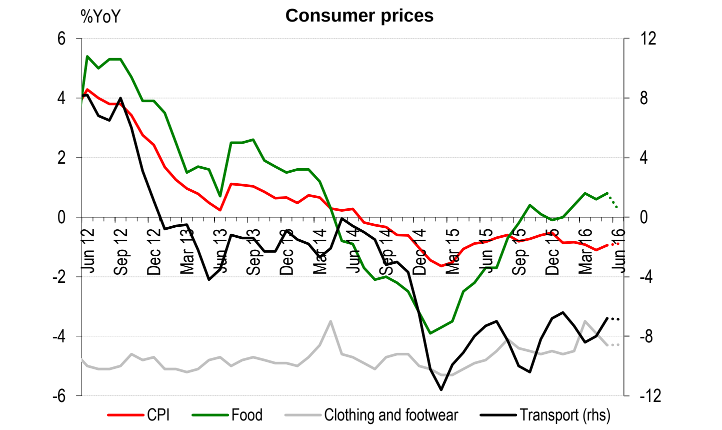
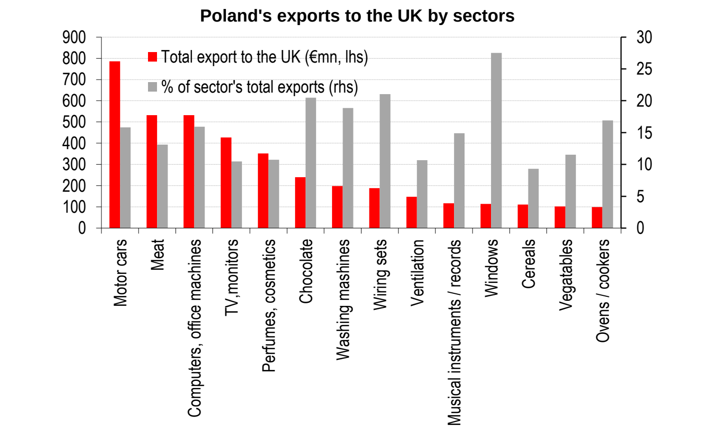
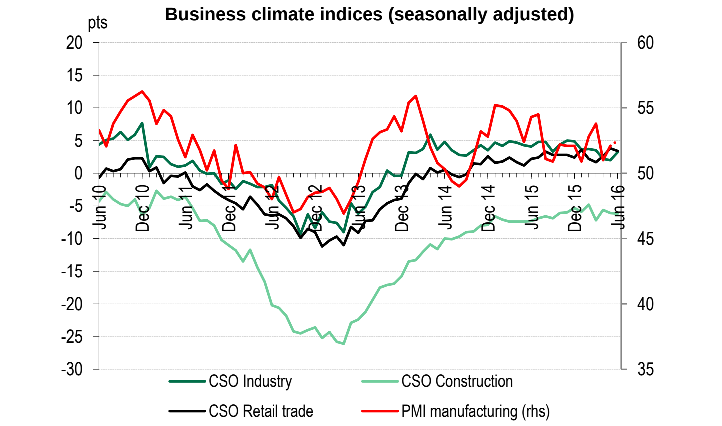
What's hot this week – PMI, flash CPI and S&P decision



- In our view, the PMI index will inch up in June given the relatively good outlook for the industry in that month. We cannot rule out, however, that the Brexit will drag the survey lower. Nevertheless, we expect the Brexit factor to have a negative impact on Polish business confidence indicators in the months to come.
- We expect the flash CPI for June to stay at -0.9% y/y, unchanged versus May. Fuel prices were likely higher in June by about 2% m/m, but this would not be enough to push the headline indicator up. We expect CPI to turn positive at the end of the year.
- Although S&P has set July 1 as the day when it could make another announcement on Poland, we do not expect the agency to make any change to Poland's ratings this time around given the strong move in January.

Last week in the economy – Brits vote to leave EU, good budget execution in Poland in May





- Brits decided to leave the EU in Thursday's referendum (51.9% in favour at an exceptionally high turnout of 72%). This poses some risks for the Polish economy due to its high exposure to trade with the UK (c7% of total Polish exports go to the UK). We also fear that if the Brexit will lead to renegotiations of the EU's budget, Poland, currently a significant beneficiary of EU funds, may lose more than other EU members. We discussed the possible consequences for Poland of the UK leaving the EU in the March MACROscope.
- The statistics office economic climate index for the Polish industry improved in June to 3.2pts from 2.0pts, while the gauges for June and retail trade were slightly down. June's results point to stabilisation of economic growth, in our view.
- The registered unemployment rate fell in June to 9.1%, in line with our expectations. The number of job offers remained high (97k vs 85k in May 2015), but the number of people removed from the unemployment rolls after taking up a non-subsidised job fell to 82k from 96k one year ago. We believe this proves that employers have growing problems with finding adequate staff.
- May's data on the central budget were quite optimistic – the deficit amounted to PLN13.5bn vs the planned PLN19.3bn. This was mostly due to lower spending, which amounted to PLN142.6bn vs PLN149.1, with the revenues (PLN129.1bn) more or less in line with the initial plan. Revenues from personal income tax PIT rose by an astonishing 33.1% y/y, but, in our view, this is simply a shift from April (this year it was possible to pay taxes in May instead of the traditional deadline on April 30). VAT revenues also recorded a strong jump of 16.6% y/y. It seems that income from the LTE auctions will be in line with plans (PLN9.2bn).

Quote of the week – Zloty to stabilise soon

Grażyna Ancyparowicz, MPC member, June 24, Reuters
The zloty will stabilise soon and everything will be fine (…) I my opinion these are only short-lived turbulences on the Polish market.

Kamil Zubelewicz, MPC member, June 24, Reuters
Zloty weakening will be short-lived. The Brexit will not have an effect on the Polish monetary policy. Our decisions are driven by local factors that consider, among others, conditions on the labour market.

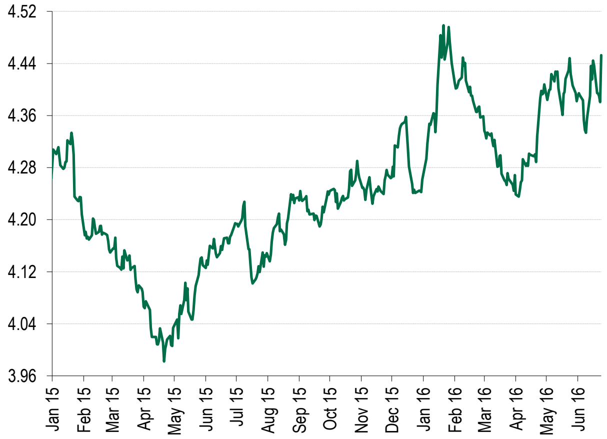
Jerzy Kropiwnicki, MPC member, June 22, Reuters
I think shocks should cease within a few months' time (…) We have a stable economy, fundamentals, which already proved good enough amid global shocks compared to which the Brexit is much ado about nothing. In my opinion deflation will last till next year.

Jerzy Żyżyński, MPC member, June 23, Bloomberg
Expansionary fiscal policy will create room for gradual monetary tightening. Arguments in favour of rate cuts are ceasing.

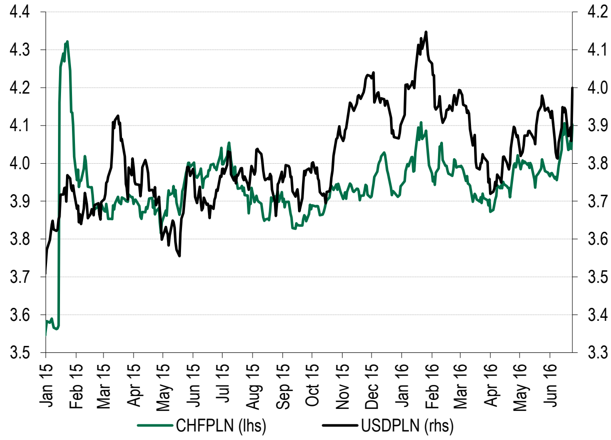
The MPC members seem to be quite optimistic about the Brexit's implications for the Polish economy – in their view, Poland's macro fundamentals are healthy, PLN weakening will be temporary and no monetary policy reaction will be needed. Actually, the MPC members' comments have been a bit more hawkish recently and even Jerzy Żyżyński, the most dovish central banker, sees less arguments in favour of policy easing and thinks that expansive fiscal policy could create room for policy tightening. We believe, however, that this is not the best moment to become more hawkish as the Brexit may weigh on the global growth outlook. We think that monetary policy prospects could change in Poland under the impact of the UK referendum because it raises the risk of an economic slowdown in Europe, which can be negative for the Polish economy.

Foreign exchange market – Muted reaction, but pressure on CEE currencies will remain

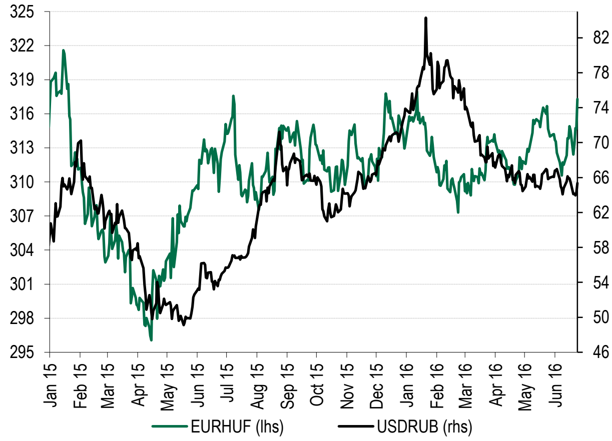
EURPLN



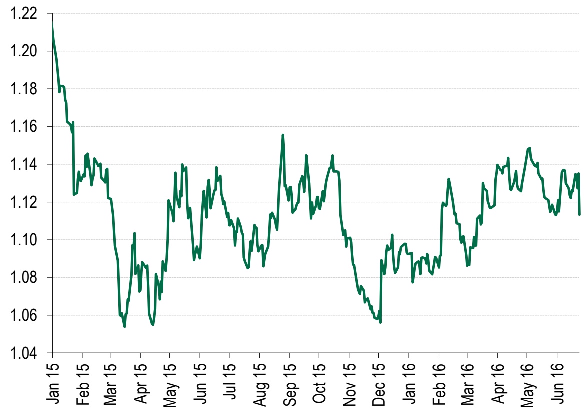
USDPLN and CHFPLN



EURHUF and USDRUB



EURUSD



The zloty suffered from Brits' decision to quit the EU …

- Last week the key event was the UK's referendum on its membership in the EU. Polish zloty strengthened quite visibly before the Thursday's voting in the UK, with EURPLN declining to 4.33 for a while (local minimum last week). This stemmed from wave of optimism that the UK will stay in the EU. However, the final results of the referendum show that the Brits voted to quit the European Union (51.9% votes in favour of leaving). The zloty sharply weakened in response to this news, with EURPLN increasing temporarily to 4.55 (the highest level since 2011), CHFPLN growing to nearly 4.25 and USDPLN reaching c4.13, but it was only short-lived. The Friday's session brought a slight rebound and as a consequence EURPLN went back below 4.45, while USDPLN below 4.00. Also, global central banks (SNB and BoE) decided to intervene on the FX market.
- In general the zloty's reaction to the Brexit was quite muted. EURPLN has returned to its fluctuation channel of 4.31-4.46 and now it is close to the upper limit of the range. In our view, the zloty will remain under pressure in upcoming weeks as a result of negative impact of the UK leaving the EU on the Polish economy in medium term. Therefore, we think that further weakening cannot be ruled out, especially as the zloty is more exposed to risk than other CEE currencies. This week, investors may also turn attention to the S&P's decision on Poland's rating. However, in our view S&P will keep rating unchanged and it could be rather neutral or slightly supportive for PLN.
- At this stage we do not change our forecasts for EURPLN (at c4.40 end-Q3 and c.4.30 end-Q4), but after Brexit we see an upside risk.

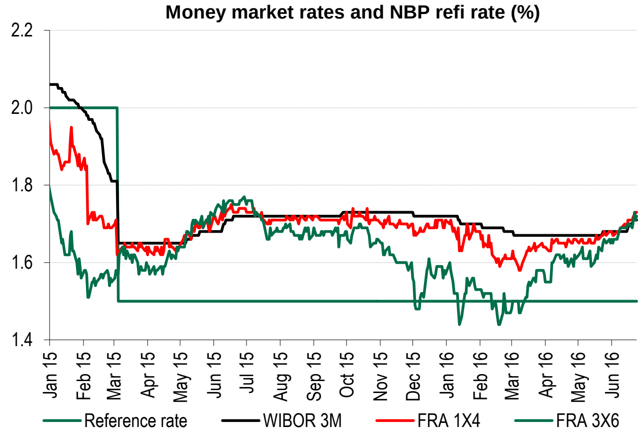
… like other CEE currencies

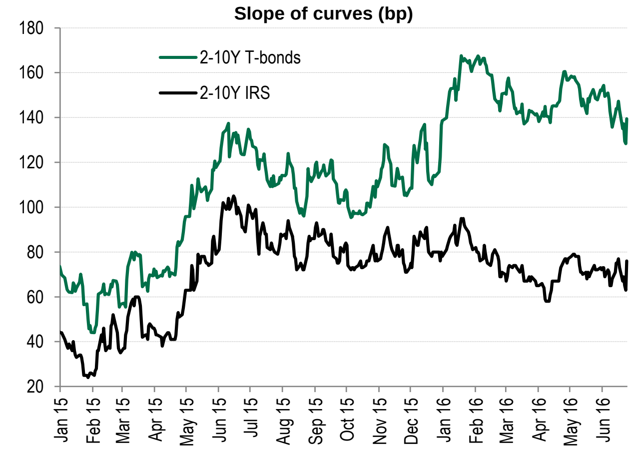
- Other CEE currencies also weakened significantly in the first reaction to the outcome of the UK referendum after quite significant strengthening ahead of voting. EURHUF increased to almost 322 for a while, while RUBUSD increased above 67 and EURCZK grew to nearly 27.2. However it proved to be only short-lived and during Friday's session CEE currencies slightly rebounded.
- Amid elevated global risk aversion, the CEE currencies will remain under pressure, while country-specific factors (including the Czech National Bank meeting or PMIs reading for CEE countries at the start of July) may be in the shadow. As a result we expect high volatility on the market in upcoming weeks.

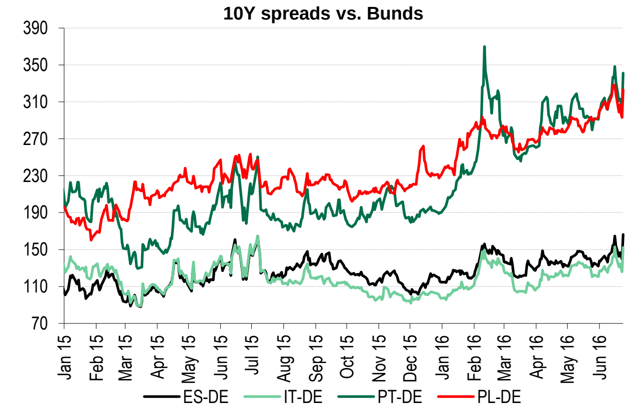
Euro weaker and pound lost the ground

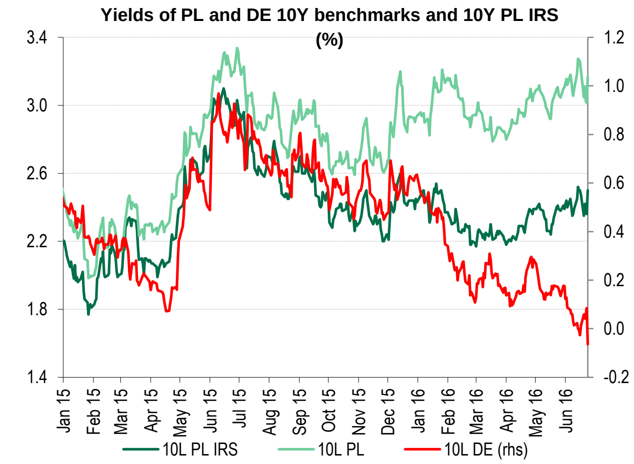
- Investors' optimism prior to the Thursday's referendum in the UK supported the euro and the British pound. As a result EURUSD increased from 1.124 (local minimum) to 1.142 before the referendum. At the same time GBP also strengthened visibly, with GBPUSD reaching its record high this year, at c1.48. However, the outcome of the UK referendum hit both EUR and GBP hard. EURUSD fell temporarily to c1.09, while GBPUSD was temporarily close to 1.32, its record low since 1985.
- EUR and GBP rebounded gradually after sharp weakening in the first market reaction to the Brits' decision. In our view nervousness will remain on the market and investors' mood will be fragile and vulnerable to news from both the UK and the EU. What is more, general election in Spain may also add to market volatility.

Interest rate market – Risk-off mode opts for wider spread over Bunds









Polish assets weaken sharply

- Poland's interest rate market gained visibly ahead of the referendum in the UK thanks to investors' expectations that the Brits will in the end vote to stay in the EU. However, the outcome of the referendum proved disappointing with the British deciding to leave. This quickly changed the risk-on into a risk-off mood. Safe-haven flows dominated Friday's trading with the German bonds as the biggest gainers. The 10Y Bund yield reached nearly -0.20% for a while, while yields of the euro zone peripheries and CEE debt increased significantly, with Poland's 10Y yield rising by c25 bp to 3.25% and yield of Hungary's 10Y up by c30 to nearly 3.50%. What is more, the spread to the German Bunds went up more than 50 bp for both Poland and Hungary. The Czech government bonds, in contrast, followed the core euro area bonds and the 10Y benchmark yield fell gradually, reaffirming the status of a CEE safe haven. During Friday's session Polish assets trimmed some of their earlier losses.
- In reaction to the UK referendum's outcome, Poland's Ministry of Finance decided to cancel Monday's switch auction. Deputy Finance Minister Piotr Nowak said that the ministry may cancel 1-2 bond auctions amid the market uncertainty following the Brexit vote. Nowak also reiterated that Poland has already covered 70% of its 2016 borrowing needs.
- On the money market, WIBOR rates rose 1-2 bp (excluding the 1M rate) over the past week. At the same time, FRAs inched up 1-4 bp across the curve in reaction to significant IRS weakening on the UK referendum. Investors expect relatively stable WIBORs as the recent comments of some MPC members and minutes from the council's June meeting clearly suggested that uncertainty was supporting stable interest rates.

Risk premium should remain high

- This week investors will still focus on the post-referendum reality worldwide. Negative market sentiment may prevail, shifting capital from risky towards safe-haven assets (mainly Bunds, US Treasuries or even Czech bonds). Therefore, market volatility (in particular on the long end of the curves) may remain elevated. What is more, the general election in Spain this weekend may also add to market volatility in the short run.
- Domestic data releases, including June's readings of flash CPI and manufacturing PMI, could be overshadowed by the global factors. They are, therefore, unlikely to have a significant impact on investors.
- Poland's Ministry of Finance will release its issue plan for 3Q 2016 this week. We expect quite a moderate supply in July as the ministry had already announced that it may cancel 1-2 auctions. However, market liquidity next month will be quite favourable for the bond market as a consequence of the OK0716 redemptions (PLN9.93bn) and coupon payments (total of PLN1.17bn).
- All in all, the domestic interest rate market will stay under pressure from the post-Brexit global market developments. Investor sentiment should remain fragile, keeping market volatility high in the coming days/weeks. As a result, we expect the risk premium level to remain elevated.

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