WEEKLY ECONOMIC UPDATE

24 – 30 April 2017

During the last week before the first round of the French presidential elections the euro gained, bond yields and stock indexes did not move much while the CEE currencies depreciated. Unexpectedly, British PM May called snap elections which proved positive for the pound, but negative for the UK stocks. In Poland, March economic activity data surprised well to the upside, but the positive impact on the zloty was only temporary. At the same time, the 4Q16 GDP growth was revised down. Taking all factors into consideration, we decided to revise up our 2017 GDP growth forecasts – to 3.7% in 1Q17 and 3.6% in the whole year.

The outcome of the first round of the French elections is very likely to have a key impact on the market at least at the beginning of the week. In our view, the market is not pricing-in a scenario of anti-EU candidates winning high support, so we think the market reaction to the results could be asymmetric – stronger when eurosceptic candidates perform well, triggering rise in risk aversion that may hit the zloty and Polish bonds. Although the French elections are likely to be in the spotlight, any negative impact of this event could be limited by the outcome of the ECB meeting as we expect the central bank to sound dovish. S&P's revision of the Polish rating (scheduled for April 21) should be at least neutral for the market as in our view, macro and fiscal measures now look better than during the last re-assessment.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (24 April)					
10:00	DE	Ifo index	Apr	pts	112.3	-	112.3
		TUESDAY (25 April)					
11:00	**PL**	**Bond auction**					
14:00	HU	Central bank decision		%	0.90	-	0.90
16:00	US	New home sales	Mar	% m/m	-0.7	-	6.1
16:00	US	Consumer confidence index	Apr	pts	123.7	-	125.6
		WEDNESDAY (26 April)					
10:00	**PL**	**Unemployment rate**	**Mar**	**%**	**8.2**	**8.2**	**8.5**
		THURSDAY (27 April)					
13:45	EZ	Central bank decision		%	0.0	-	0.0
14:30	US	Durable goods orders	Mar	% m/m	1.5	-	1.8
14:30	US	Initial jobless claims	week	k	-	-	244
16:00	US	Pending home sales	Mar	% m/m	-0.5	-	5.5
		FRIDAY (28 April)					
14:00	EZ	Flash CPI	Apr	% y/y	1.7	-	1.5
14:00	**PL**	**Flash CPI**	**Apr**	**% y/y**	**-**	**2.0**	**2.0**
14:30	US	Advance GDP	Q1	% y/y	1.2	-	2.1
16:00	US	Michigan index	Apr	pts	98.4	-	96.9

Source: BZ WBK, Reuters, Bloomberg

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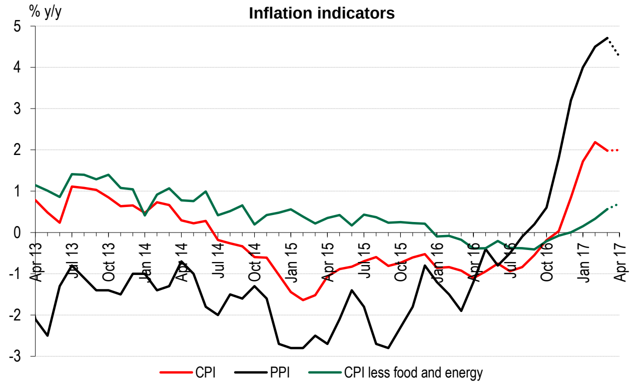
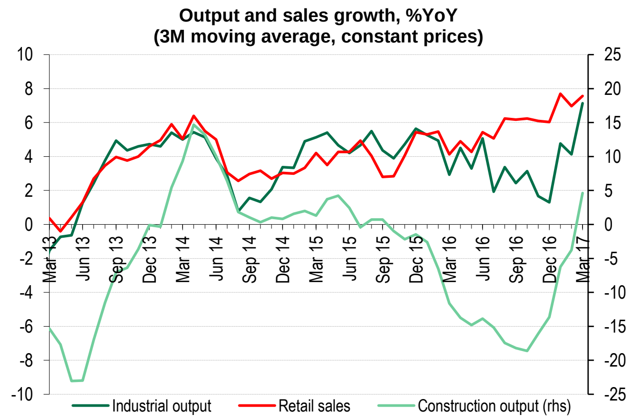
What's hot this week – CPI and unemployment rate

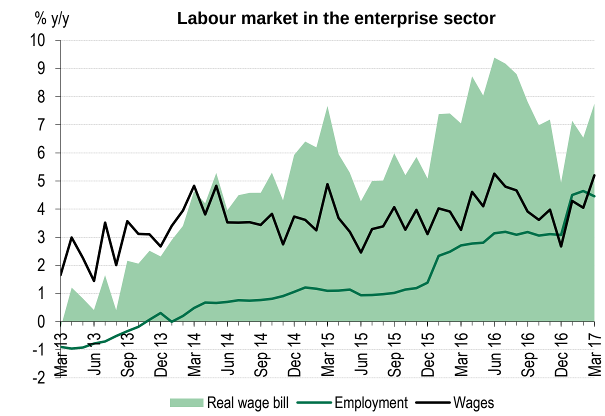


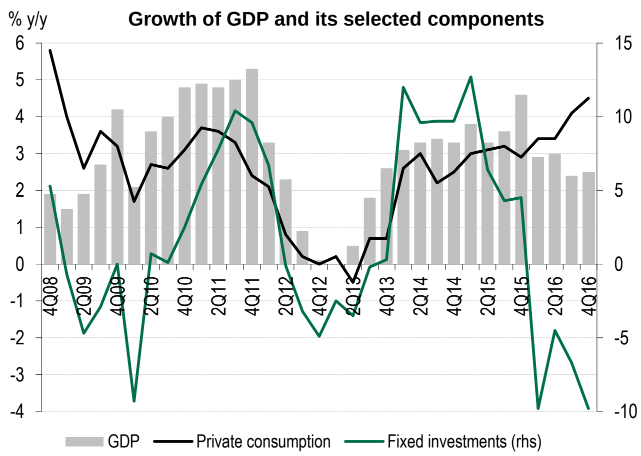
▪ We expect the April's CPI to stay at March's 2.0% y/y. Gas prices will go slightly up due to introduction of new tariffs by the regulator, but on the other hand fuel and food prices will remain stable, in our view. According to our forecasts, inflation rate will fall, hovering just below 2% for the better part of the year and may slide temporarily below 1.5% in December. Realisation of such an inflation path will support our forecasts that rates will remain unchanged in 2017.

▪ According to our estimates, registered unemployment rate fell to 8.2% in March. We have revised our forecasts upwards from 8.1% after data from the Labour Ministry were released. In our view, unemployment will fall in the months to come and reach 7.0% at the year-end.

Last week in economy – Downward revision of 2016 GDP, strong data for 1Q







▪ Industrial output increased in March by 11.1% y/y, stronger than expected. To some extent, a significant improvement in dynamics as compared to February (when growth was merely 1.2% y/y) was due to the calendar effect - in March the number of working days was 1 more than a year ago, and in February 1 less. Nevertheless, even taking into account this effect, March results seem to be impressive. Importantly, the biggest output gains were recorded in export-oriented branches. It suggests that there was a significant increase in foreign demand for Polish goods, probably under the influence of the improving business cycle in Western Europe.

▪ The construction output was even a bigger surprise and rose by 17.2% y/y, the most since April 2014. Two-digit increase in occurred in all construction sectors, which is probably a sign of revival of investment activity at the beginning of the year.

▪ In March retail sales in constant prices grew up by 7.9% y/y, slightly above expectations. The structure of growth was in line with our expectations – acceleration was mainly observed in car, clothes, furniture and household appliances, whereas sales of food went down due to the date of Easter. Good growth of retail sales supports our forecast for robust private consumption in 1Q17.

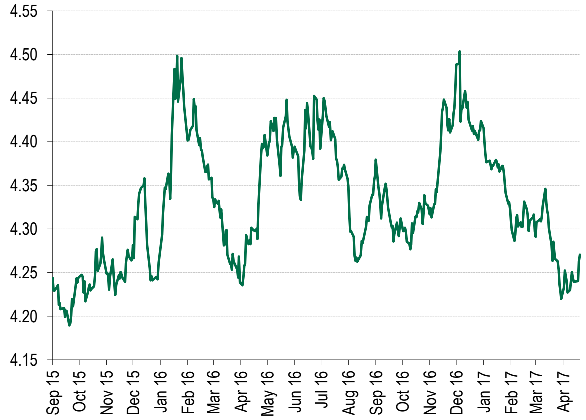
▪ Employment in the corporate sector increased by 4.5% y/y in March, slightly slower than our and market expectations. It is too early to state that the employment growth rate is losing momentum, but Polish labour market is becoming tighter and it will be more and more difficult to note significant increases in the employment in the coming months. Wages went up sharply (5.2% y/y). While we expected some acceleration because of the working day effect, but the scale of growth, in our opinion, was caused by one-off effects, such as shifts in bonus payments.

▪ GDP growth in 2016 was revised by the Statistics Office to 2.7% from 2.8%. 4Q16 data went down more considerably than other quarters, to 2.5% from 2.7%. As regards breakdown by categories, the most significant downward revision was applied to investment in 1Q and 4Q16, bringing them both down to -9.8% y/y. Private consumption was corrected slightly to the upside.

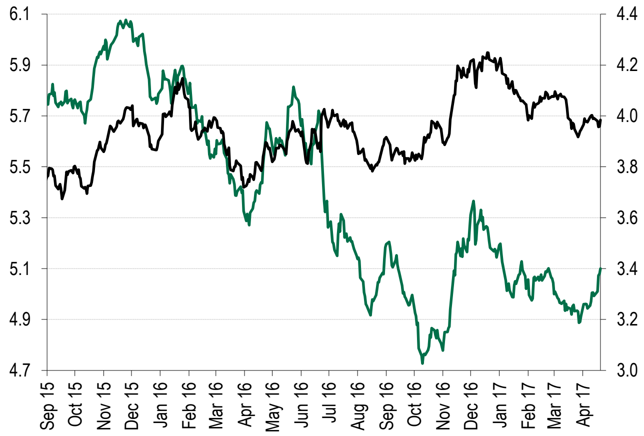
▪ After full set of monthly data and revised GDP numbers, we raise our 1Q17 GDP growth forecast to 3.7% y/y, with rebound in investment being the main culprit of the recovery. Let us note also that the lower base of investment in 1Q16 explains the relatively quick pace of rebound in this category in 1Q2017.

Foreign exchange market – French elections in the spotlight

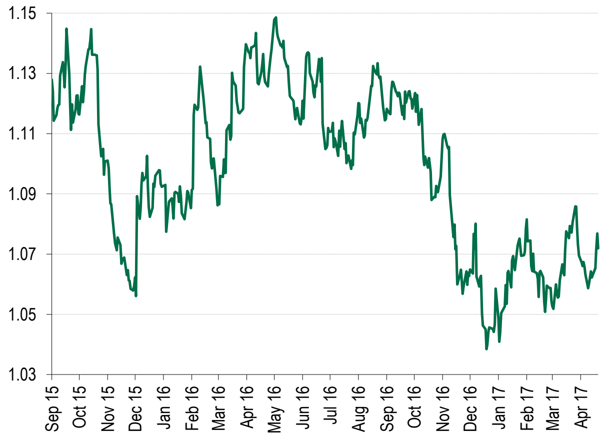
EUR/PLN



USD/PLN and GBP/PLN



EUR/USD



EUR/CZK

Zloty under pressure

- Last week EUR/PLN rose to 4.27, its highest since end-March while USD/PLN stayed stable in the 3.94-3.98 range. Impressive production and construction data in Poland had no persistent impact on the zloty and short-term appreciation was quickly neutralized.
- In previous reports we wrote that we expected correction after the zloty's recent appreciation, and the last week brought rise of EUR/PLN. The outcome of French elections will determine if this move continues.
- If the market finds the election result in France positive, the zloty may gain against euro. High support for euro-sceptics would be, on the other hand, another major political shock for Europe. In our view, markets may become nervous and the zloty and other CEE currencies could suffer as risk aversion would grow.
- This week the outcome of the ECB meeting may also be important. Last month the bank sounded hawkish but the ECB members managed to neutralize this impression and confirmed that at that time there were no plans to change the forward guidance soon. Dovish rhetoric of ECB on Thursday should support the zloty.
- On Friday evening, April 21, the S&P may review its assessment of the Polish sovereign rating. We expect no change in the S&P assessment, but if anything, a change of the rating outlook to positive cannot be excluded as domestic macro and fiscal performance has improved since the last review.

EUR/ USD up despite political uncertainty

- EUR/USD rose to 1.077 in reaction to more comments of US politicians about the dollar's strength. The euro hit 3-week high against the dollar despite high uncertainty ahead of the French presidential elections.
- After pre-Easter tranquillity and keeping high-low range for EUR/USD at the lowest since March 1986 (Reuters data), the volatility on the market started rising and we expect higher intraday changes to persist this week as well.
- In our view the market does not discount the scenario of anti-EU candidates winning high support. The investors' reaction after the weekend can be then asymmetrical – weak results of radical candidates can have a rather slight positive impact on the euro as EUR/USD has risen quite noticeably already this week. Still, investors could recall Friday's solid manufacturing and services flash April PMI in Europe which could provide some support for the euro.
- In the coming week also numerous US data will be released with consumer confidence index and advance 1Q17 GDP being most awaited. US figures could also add volatility.

Koruna gives up recent gains

- After the CNB had dropped the EUR/CZK floor at the beginning of the month, the koruna appreciated sharply. Last week, however a large part of its move reversed and the exchange rate rebounded close to 26.9 We think that EUR/CZK could stabilize near 26.8. In our view, the exchange rate may continue falling later in the year, on rising CPI and solid economic activity, although at a slow pace.

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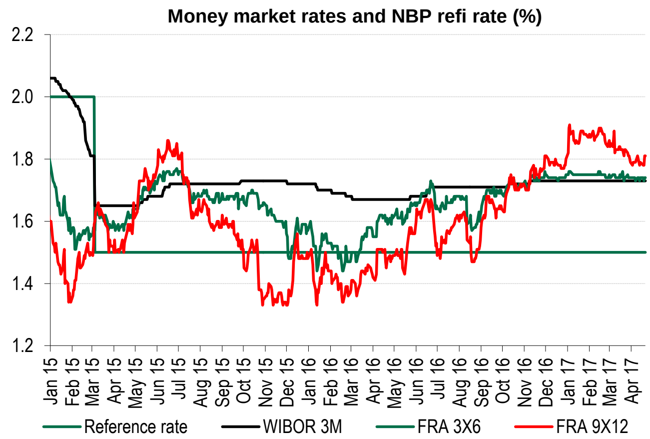
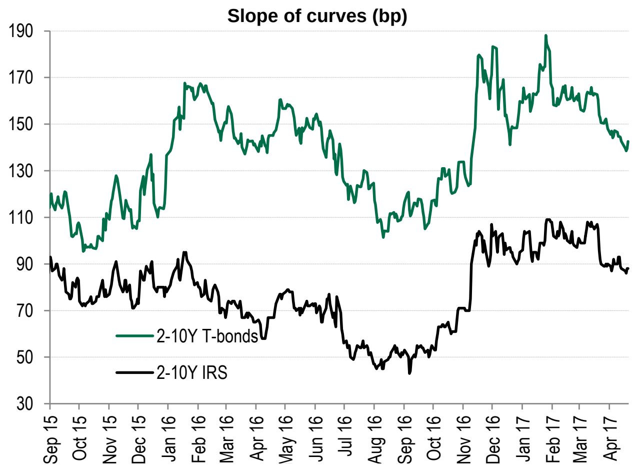
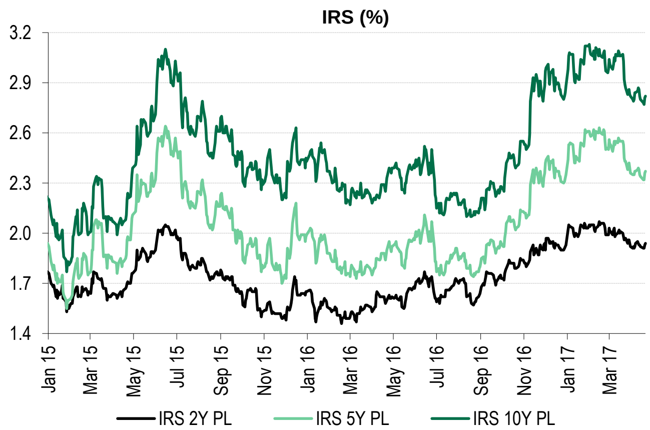
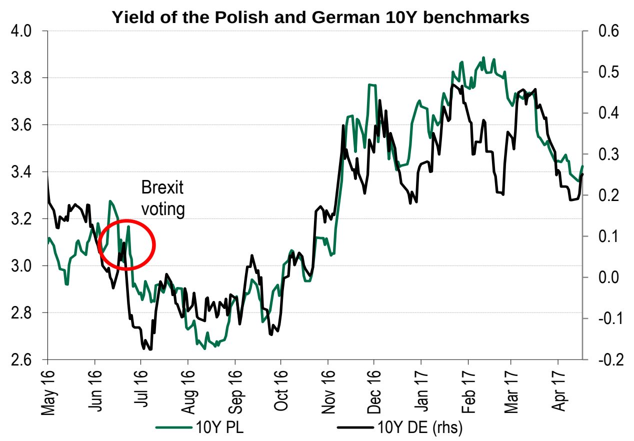
Interest rate market – French elections and ECB key









Rates stable ahead of the French elections

- Last week, Polish interest rate market remained fairly stable with only marginal decline of yields and mild increase of the IRS. Trading volume on the bond market was very thin.
- 1-12M WIBORs did not change and the FRA rates ended the week virtually flat despite the surprisingly strong Polish macro data.

French elections and ECB key

- The outcome of the first round of the French presidential elections is likely to have a key impact on the market, at least at the very beginning of the week.
- In our view, the most negative scenario for Polish debt would materialize if euro-sceptic candidates won surprisingly high support. The analogy with June 2016 Brexit voting could be premature or too extreme for the time being but recall that Polish bond yields opened with an upside gap after the results were announced while the Bund started the session stronger than on the previous day. Still, the market reaction was only temporary and it took only a few days for the Polish bonds to recover. However, we think that this time reaction to the adverse scenario could be somewhat more persistent as concerns about the EU may intensify.
- On the other hand, if the outcome of the first round does not bring high support for the euro-sceptics, we will see a rather limited room for more debt strengthening. Last week, we wrote that the market is not pricing an adverse scenario. If there is no surprise on this front, there should be no bond-supportive impulse, at least not from the elections side.
- The outcome of the ECB meeting is the second key event of the week, in our view. Last time, the market interpreted the bank's rhetoric as rather hawkish but then the ECB's officials intervened verbally trying to convince investors that the bank bias was still dovish. We think that this week the ECB's Board will try not to leave any doubts and the bank's rhetoric could be dovish, supportive for bonds in Europe.
- The S&P's review of Polish rating may be announced on April 21, probably after the end of the session. We think this event should be at least neutral for the market as in our view, macro and fiscal measures now look better than during the last re-assessment.

Second auction in April

- This week, the Ministry of Finance will try to sell OK0419/ PS0422/WZ1122/WZ0126/DS0727 for the total amount of PLN6-9bn. This year's borrowing needs are now covered in 56%. Demand on the auction should strongly depend on the market mood after the French elections. Liquidity situation is supportive as cPLN15bn will flow into the market on the last week of April from coupon payments and redemptions

Additional information is available on request. Please contact Bank Zachodni WBK S.A., Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 87, email ekonomia@bzwbk.pl