

BI-WEEKLY ECONOMIC UPDATE

1 – 14 May 2017

Activity on the Polish financial market in the first week of May will be traditionally subdued. We expect that strong macro data from abroad and the Fed statement leaving the door open for rate hike in June will trigger an upward trend in bond yields in the core euro zone markets, and the Polish bonds may follow this trend. The zloty correction after the long weekend is also quite likely, which in our view, apart from the Fed's rhetoric, will be triggered by a seasonal effect.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (1 May)							
	PL	Market holiday					
14:30	US	Personal income/consumer spending	Mar	% m/m	0.3/0.2	-	0.4/0.1
16:00	US	ISM – manufacturing	Apr	pts	56.5	-	57.2
TUESDAY (2 May)							
9:00	PL	PMI – manufacturing	Apr	pts	53.9	53.1	53.5
9:55/10:00	DE/ EZ	PMI – manufacturing	Apr	pts	58.2/56.8	-	58.2/56.8
WEDNESDAY (3 May)							
	PL	Market holiday					
11:00	EZ	Advance GDP	Q1	% y/y	1.7	-	1.7
14:15	US	ADP report	Apr	k	183	-	263
16:00	US	ISM – services	Apr	pts	56.0	-	55.2
20:00	US	FOMC decision		%	1.00	-	1.00
THURSDAY (4 May)							
9:55/10:00	DE/EZ	PMI – services	Apr	pts	56.2/54.7	-	56.2/54.7
13:00	CZ	Central bank decision		%	0.05	-	0.05
16:00	US	Industrial orders	Mar	% m/m	0.5	-	1.0
FRIDAY (5 May)							
14:30	US	Non-farm payrolls	Apr	k	193	-	98
14:30	US	Unemployment rate	Apr	% y/y	4.6	-	4.5
MONDAY (8 May)							
8:00	DE	Industrial orders	Mar	% m/m	-	-	3.4
TUESDAY (9 May)							
8:00	DE	Industrial output/exports	Mar	% m/m	-	-	2.2/0.8
WEDNESDAY (10 May)							
9:00	CZ	Industrial output/CPI	Mar	% y/y	2.9/2.3	-	2.7/2.6
9:00	HU	CPI	Apr	% y/y	2.3	-	2.7
FRIDAY (12 May)							
	PL	Moody's rating review					
8:00	DE	Flash GDP	Q1	% y/y	-	-	1.2
14:00	PL	CPI	Apr	% y/y	2.0	2.0	2.0
14:30	US	CPI/retail sales	Apr	% y/y	-	-	2.4/-0.2
16:00	US	Flash Michigan	May	pts	-	-	97.0

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:

al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40

email: ekonomia@bzwbk.pl

Web site: <http://www.bzwbk.pl>

Piotr Bielski +48 22 534 18 87

Marcin Luziński +48 22 534 18 85

Marcin Sulewski +48 22 534 18 84

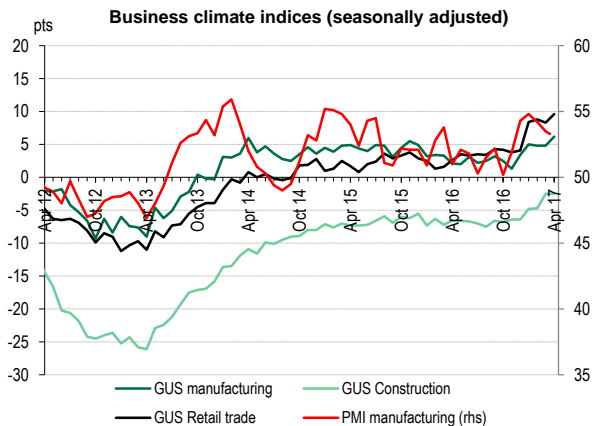
TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

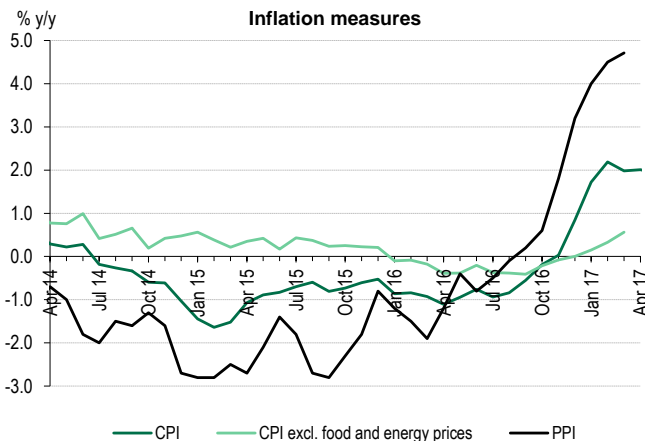
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What's hot in next two weeks – Polish PMI, election in France, rating review by Moody's

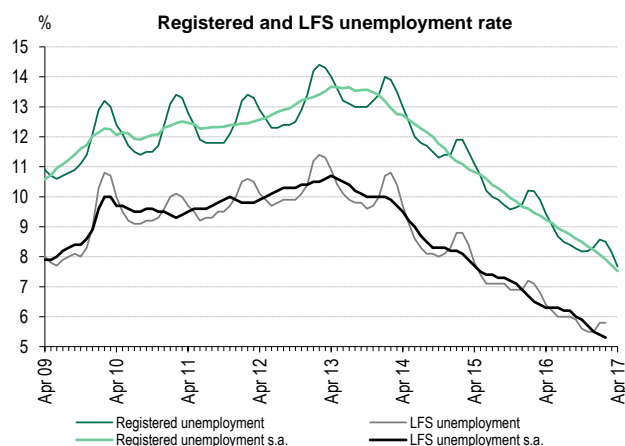


- We expect PMI index for Polish manufacturing to go slightly down in April. In our view, earlier rise of this gauge was a bit excessive, so a correction is justified, but it does not imply a deterioration of economic activity. The index will remain at a level suggesting economic expansion.
- On May 12 the Moody's rating agency is expected to review its credit rating for Poland (currently A2, negative). In our view, all major rating parameters will remain unchanged, yet we cannot rule out that rating outlook will be improved to neutral.
- Emmanuel Macron and Marine Le Pen will meet in the second round of French presidential election on 7th May. Polls show that 60% of respondents want to vote for Macron and bookmakers give him about 90% chance of winning. However, recently support for Le Pen has been on the rise.

Last week in economy – CPI stable, unemployment rate still going down



- According to the flash estimate, CPI in Poland in April reached 2.0% y/y, in line with the consensus and vs 2.0% y/y in March. Price growth was most probably contained by a relatively weak increase in food. We expect the headline figure to stay in the horizontal trend slightly below 2.0% in the coming months, with the core CPI climbing slowly towards 1.5% y/y at the year-end. For the central bank, the data justify its wait-and-see approach. No rate hikes are likely this year.
- The registered unemployment rate fell to 8.1% in March. The number of job offers is still rising very fast and in our view the unemployment rate could fall to 7% at the year-end.
- Statistics Office business climate indices recorded a further improvement in manufacturing and trade. Sentiment in other sectors stabilised at high levels. Sentiment in manufacturing, trade and construction has been improving since October 2016 and indicators reached their highest levels since 2008, confirming continuation of an economic revival and boding well for the coming months.



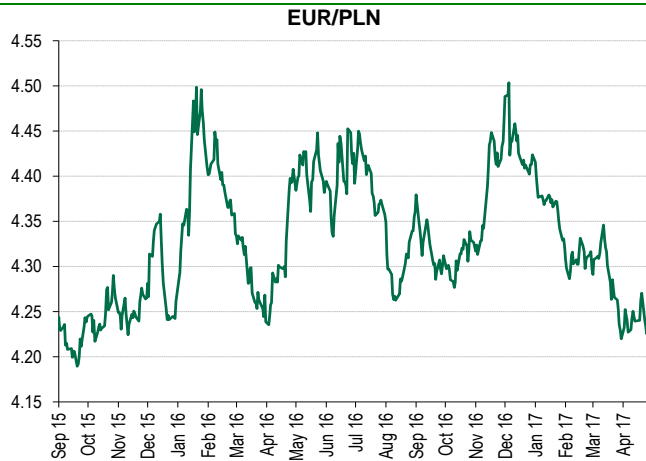
- The NBP on business climate in companies showed that at the start of the year the companies' situation improved and the positive trend should continue in 2Q and throughout 2017. Firms expect a further rise of output and demand, both on the domestic market and abroad. They also keep planning to raise employment, which may potentially trigger a higher wage pressure. Forecasts for 2Q17 suggest only cautious plans of expansion in private firms, despite a significant revival of investment activity in public companies. The NBP report noted also that the 500+ child benefit programme fuelled employment resignation and wage rises in consumer service sector, especially in retail trade. However, the scale of this phenomenon was not big, as 14% of companies pointed to new benefits as a reason behind resignations and 6% a reason behind wage rises.

Quote of the week – Poland violated all EU rules

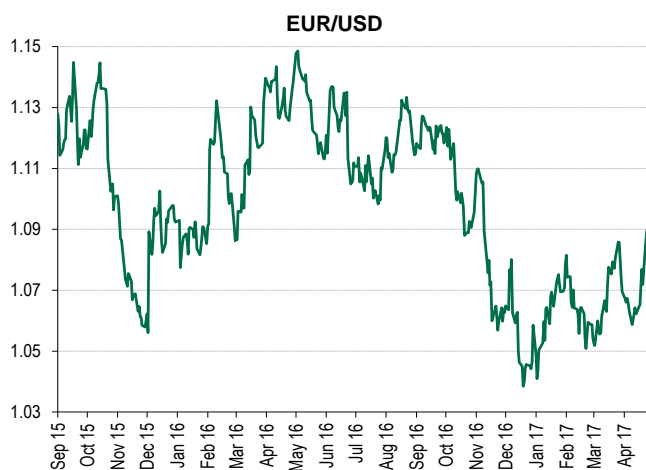
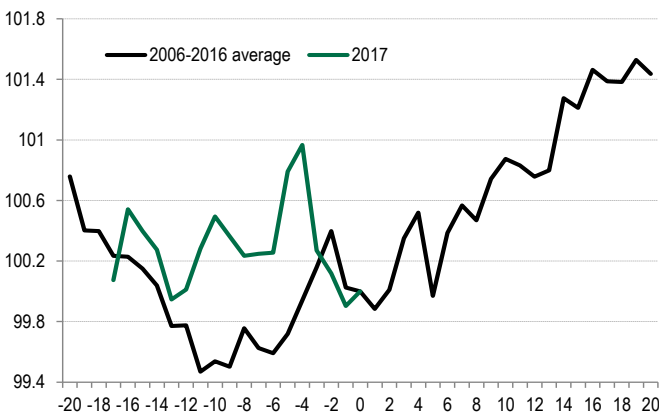
Emmanuel Macron, French presidential candidate, 27 April, Reuters
Poland violated all the European Union's rules. When the rights and values of the European Union are not respected, I want sanctions to be taken. In the three months after I'm elected, there will be a decision on Poland. You cannot have a European Union which argues over every single decimal place on the issue of budgets with each country, and which, when you have an EU member which acts like Poland or Hungary on issues linked to universities and learning, or refugees, or fundamental values, decides to do nothing.

Emmanuel Macron revealed himself as a strong proponent of sanctions against Poland. He is also known as an advocate of the two-speed Europe, which would be a bad news for Poland. While his victory in the second round of the presidential elections in France is likely to trigger a further rise of global risk appetite, we think the reaction of Polish assets may be a bit more muted than elsewhere around.

Foreign exchange market – Time for seasonal zloty's weakening?



EUR/PLN two weeks before and after the beginning of May



EUR/PLN down thanks to France and ECB

▪ Last week the zloty gained vs main currencies benefiting from the positive market reaction to the result of the first round of the French presidential elections and dovish signals from the ECB. As a consequence, EUR/PLN fell temporarily to nearly 4.21, reaching its fresh April low. USD/PLN fell below 3.86, its lowest since mid-November. CHF/PLN declined below 3.87 to its lowest level since January.

▪ In our opinion, in the coming days the zloty could be under pressure. Firstly, there is a pretty strong seasonal pattern; in the last 11 years EUR/PLN fell in May only twice. Secondly, in the first week of May, when liquidity on the Polish market is likely to be very thin, investors will focus on the FOMC decision. We do not expect any change in rates, but the tone of the statement is likely to leave open doors for a June hike. According to Bloomberg, the market sees c70% probability of a June 25bp rate hike and this still leaves room for reaction. Any signals suggesting that rates could go up at the next meeting may weigh on the EM currencies.

▪ We expect Polish manufacturing to have declined in April which may weigh on the zloty after its recent gains recorded also thanks to the robust figures on the domestic economic activity.

Euro gains on news from France and HICP data

▪ EUR/USD started the week with a gap jumping to 1.095 (its highest since November) in reaction to the result of the first round of French presidential elections and managed to stay near the weekly high thanks to the higher-than-expected flash HICP in the euro zone and despite some dovish signals from the ECB.

▪ In the first half of May, the market attention could switch to the US where the FOMC will decide on the interest rates. We think the US central bank's rhetoric could strengthen the market expectations for a June rate hike which may be dollar-positive.

Central banks (in)action

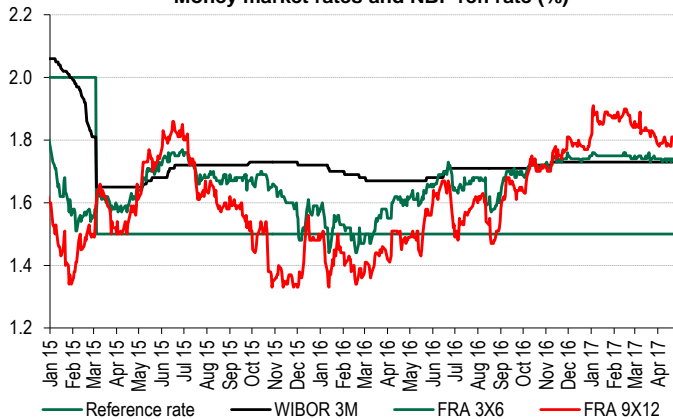
▪ Last week, EUR/HUF stayed in a 311-313 horizontal trend. The Hungarian central bank (MNB) kept the main interest rate unchanged at 0.9%, in line with expectations. The MNB repeated the declaration to maintain accommodative monetary policy and to support the economy if needed. Inflation rate in Hungary rose to 2.7% y/y in March, which was below the level predicted in the central bank's March Inflation Report. The MNB expects that the CPI should decrease later in the year and the bank sees no risk of exceeding the target (3%) neither this year nor in the first half of 2018. However, if inflation rate remains below the target, the bank is ready for further policy easing, using the non-conventional tools. The dovish rhetoric of the central bank could keep weighing on the forint, in our view.

▪ Unexpectedly, on Friday the Russian central bank cut interest rates by 50bp to 9.25% while the market expected a 25bp reduction. This decision did not have any significant negative impact on the ruble that was already under negative pressure vs the dollar earlier in the week. USD/RUB rose to 57.3 (its highest since the first half of April) amid falling oil prices.

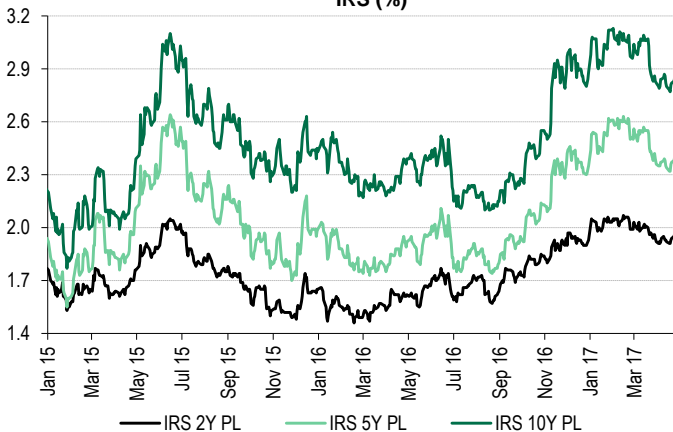
It took three weeks for EUR/CZK to reverse the sharp plunge triggered by the central bank's decision to abandon the floor; last week the exchange rate rose temporarily above 27.

Interest rate market – Fed decision in illiquid week

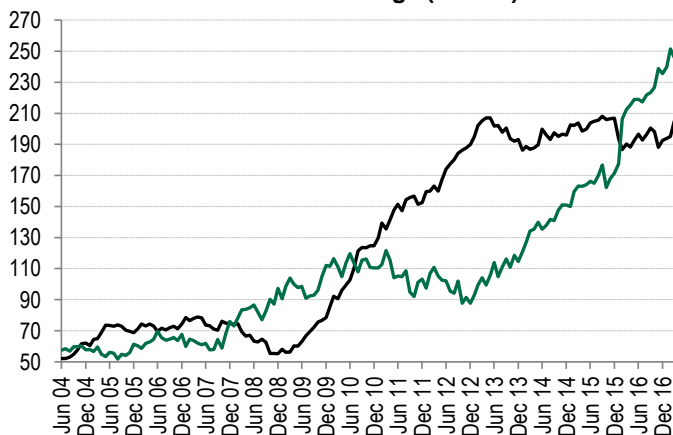
Money market rates and NBP refi rate (%)



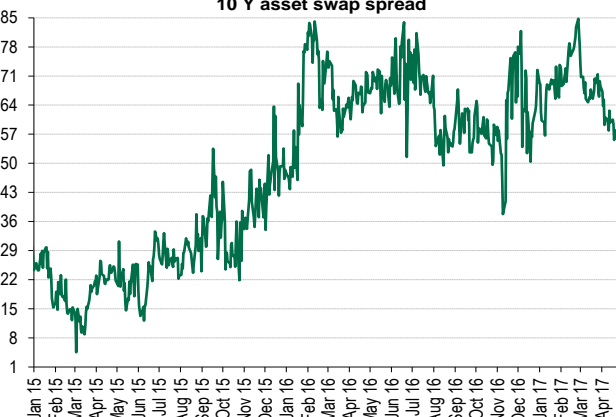
IRS (%)



Polish bond holdings (PLNbn)



10 Y asset swap spread



Rates up on internal and external factors

▪ The past week was pretty volatile on the global interest rate market. First, IRS and yields were falling after the results of the French presidential elections were released and the ECB sounded dovish. However, at the end of the week the above-forecasts flash euro zone inflation figures were released which pushed market rates up. The Polish market did not benefit from the positive sentiment persisting at the beginning of the week and was pressured by the bond auction results (see details below) and euro zone inflation data. As a result, the IRS curve remained fairly flat, while bond yields rose 2-4bp on weekly basis, mainly on the long end.

▪ -12 WIBOR rates stayed unchanged, similarly to the most liquid FRAs.

Non-residents bond holdings above PLN200bn again

▪ According to the data released by the Ministry of Finance, in March the non-residents purchased Polish PLN-denominated marketable bonds for nearly PLN10bn. After the biggest monthly buying since June 2014, nominal value of foreign investors portfolio rose to cPLN205bn, the highest since December 2015. Foreign central banks purchased debt for PLN4.4bn. This was their first buying after three months of selling and the nominal value of their portfolio reached the highest level (PLN31.7bn) since the data was made available (April 2004)) while the mutual funds added up some PLN1.9bn. Under the geographical criteria, non-residents from Asia (excluding Middle East) purchased bonds for PLN4.9bn and the ones from euro zone for PLN1.9bn.

▪ The Ministry of Finance sold bonds for PLN8.97bn amid demand nearing PLN11bn. The Ministry raised PLN2.34bn from the sale of PS0422 (issued at 2.862% yield) and PLN2.1bn from DS0727 (issued at 3.425% yield). The Ministry said that after the auction, this year's gross borrowing needs have been covered in c61%. For the market, however, the fact that demand was only slightly above the supply proved more important and this was the key reason for a negative reaction.

▪ The Ministry announced that on May 18 it will offer bonds for PLN3-5bn. On May 25, the switch auction will be held and OK0717 and DS1017 will be repurchased. As regards Polish banks, their portfolio shrunk by PLN5.5bn.

Fed decision in illiquid week

▪ On Wednesday, May 3, when the Polish market is closed, the FOMC will decide on the interest rates. We expect the parameters of the monetary policy to remain unchanged and the statement should leave the door for the June 25bp hike open. According to Bloomberg, the market sees a c70% chance for such a move and this is our base case scenario for the time being. As a result, we think there is still scope for global (and Polish) rates to rise in reaction to the FOMC statement. This could actually be the case when the market seems to start to play the "inflation trade" again amid data showing rising prices.

▪ On Friday, May 12, Moody's may review its assessment of the Polish sovereign rating. As it was the case last week with the S&P, we expect no change in the Moody's view and this even should be at least neutral for the Polish bonds.

▪ The 10Y asset swap spread rose 5bp to 63bp and we think there is still some room to the upside.

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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