Bank Zachodni WBK
Grupa Santander

BI-WEEKLY ECONOMIC UPDATE

22 May – 4 June 2017

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (23 May)					
8:00	DE	GDP	Q1	% y/y	0.6	-	0.6
9:30/10:00	DE/ EZ	Flash PMI – manufacturing	May	pts	58.0/56.5	-	58.2/56.7
10:00	DE	Indeks Ifo	May	pts	113.1	-	112.9
14:00	HU	Central bank decision		%	0.90	-	0.90
16:00	US	New home sales	Apr	% m/m	-1.0	-	5.8
		WEDNESDAY (24 May)					
16:00	US	Home sales	Apr	% m/m	-0.7	-	4.4
		THURSDAY (25 May)					
10:00	**PL**	**Unemployment rate**	**Apr**	**% y/y**	**7.7**	**-**	**8.1**
		FRIDAY (26 May)					
14:30	US	Preliminary GDP	Q1	% y/y	0.9	-	0.7
16:00	US	Michigan index	May	pts	97.5	-	97.7
		TUESDAY (30 May)					
14:30	US	Personal income/ consumer spending	Apr	% m/m	0.4/0.4	-	0.2/0.0
16:00	US	Consumer confidence index	May	pts	119.0	-	120.3
		WEDNESDAY (31 May)					
10:00	**PL**	**GDP**	**Q1**	**% y/y**	**4.0**	**4.0**	**2.5**
11:00	EZ	Flash CPI	May	% y/y	-	-	1.9
14:00	**PL**	**Flash CPI**	**May**	**% y/y**	**-**	**1.9**	**2.0**
16:00	US	Pending home sales	Apr	% m/m	-	-	-0.8
20:00	US	Fed Beige Book					
		THURSDAY (1 June)					
9:00	**PL**	**PMI – manufacturing**	**May**	**pts**	**-**	**54.0**	**54.1**
9:55/10:00	DE/EZ	PMI – manufacturing	May	pts	-	-	-
14:00	**PL**	**MPC minutes**					
14:15	US	ADP report	May	k	-	-	177
16:00	US	ISM – manufacturing	May	pts	-	-	54.8
		FRIDAY (2 June)					
9:00	CZ	Preliminary GDP	Q1	% y/y	-	-	2.9
14:30	US	Non-farm payrolls	May	k	175	-	211
14:30	US	Unemployment rate	May	% y/y	-	-	4.4

Source: BZ WBK, Reuters, Bloomberg

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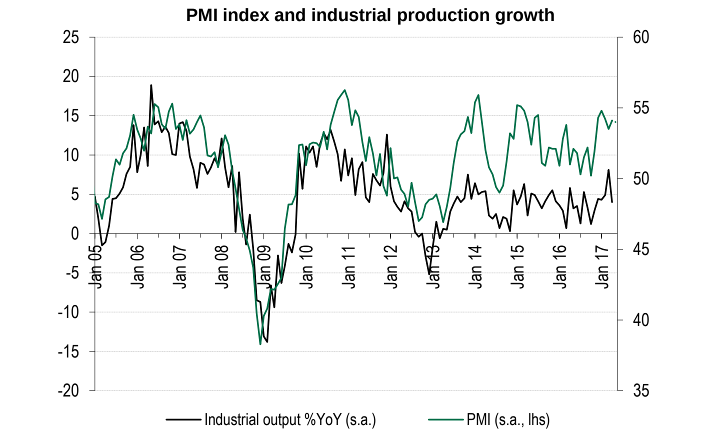
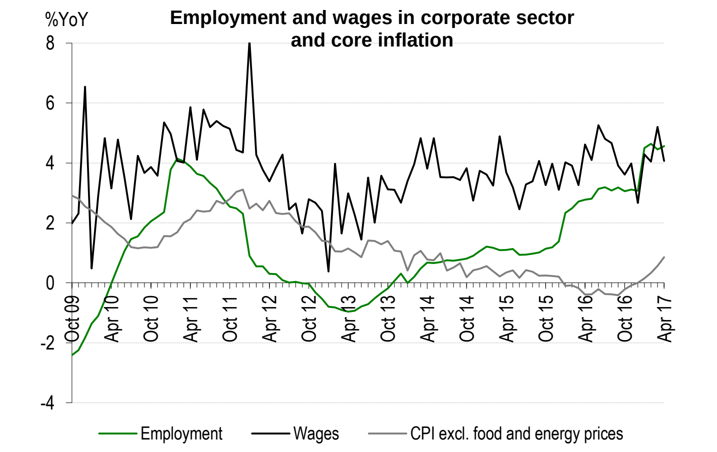
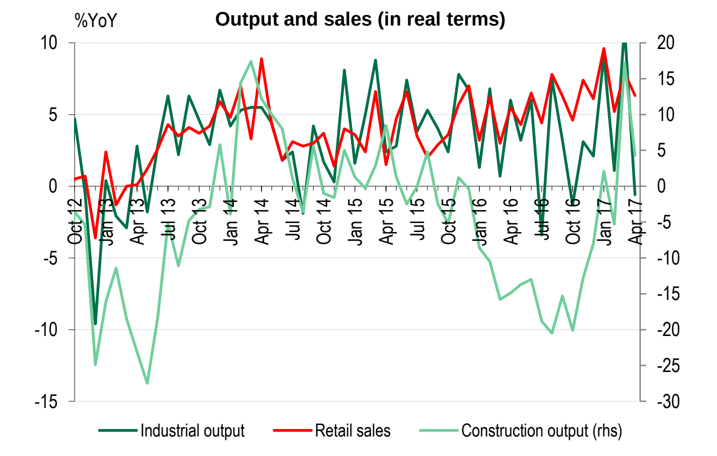
What's hot in next two weeks – A set of important data: GDP, CPI and PMI



- The upcoming two weeks will provide us with an interesting set of Polish data. Flash data on Polish GDP growth for 1Q17 confirmed that the economy is in upswing, now we will see the detailed breakdown. In our view, recovery in investments was the most important tailwind.
- CPI in May most probably inched down to 1.9% y/y from 2.0% in April, mainly thanks to lower fuel prices. However, we think that food prices went in the opposite direction, mostly in meat and fruit.
- According to our forecast, the registered unemployment fell to 7.7% in April. Estimate from the Labour Ministry confirmed our forecast, so there is not much space for a surprise. This number will confirm that demand for labour is not ebbing.
- The positive economic sentiment should help the PMI index stay close to current high levels.

Last week in economy – 1Q17 growth above forecasts, April output and retail sales disappoint





- GDP growth accelerated to 4.0% y/y from 2.5%, according to a flash release. This positive surprise suggested that the whole year could show c4% growth. Seasonally adjusted GDP rose 1% q/q (the market expected 0.8%) despite 4Q16 being the strongest quarter since the end of 2007.
- Core CPI rose 0.9% y/y in April on low base in 'recreation and culture', a seventh month of acceleration in a row.
- Imports grew sharply in March (18.9 y/y) triggering a negative surprise in c/a balance of €0.4bn (c/a moved to €738mn deficit). Exports was also rising strong, by 14.9% y/y.
- Employment growth in the corporate sector increased to 4.6% y/y from 4.5%. This was the strongest April since 2010 as far as the monthly rise of employment is concerned. The wage growth surprised to the downside, going down to 4.1% y/y from 5.2% y/y (boosted by working day effect and shifts in bonus payments) vs the 4.4% expected. Wage pressure could rise later in the year if labour shortages grow.
- April industrial output fell by 0.6% y/y with our forecast for -0.2% y/y and market consensus at +1.9% y/y. Significant slowdown with respect to 11.1% y/y recorded in March was a result of a negative working days effect (-2 y/y). Data suggested decreases of output in many export-oriented sectors, but lack of signals of worse economic climate in the euro zone makes us believe this was only a temporary weakness. Construction and assembly output was also lower than expected and grew by 4.3% y/y (we expected 6.6% y/y, market 6.8% y/y). The seasonally adjusted result was strong and similar to the one recorded in March.
- Retail sales figure disappointed as well as it rose 6.7% y/y in real terms vs 7.9% y/y seen in March, market consensus at 7.3% y/y and our forecasts at 8.8% y/y. Positive Easter effect was seen, but poor car sales brought the outcome lower.

Quote of the week – 4% GDP growth is impressive, but requires no reaction

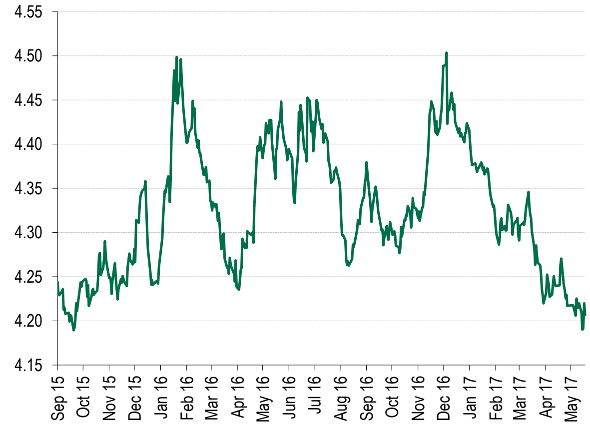
Adam Glapiński, NBP Governor, 17 May, MPC press conference
In my view there could be no need for a rate hike even until the end of 2018. I would be surprised if the economy failed to reach a 4% growth this year, but it will return to 3-4% afterwards. We have a strong rebound in investments. The economy picked up its pace without causing any imbalances. We do not need to address any imbalances. Inflation will sway around 2% y/y without hitting 2.5%. Some members assume a high probability of rate changes in the middle of 2018.

Grażyna Ancyparowicz, MPC member, 17 May, MPC press conf.
We are focusing on a time frame of 6-8 quarters ahead, not 2-3 quarters. If there is anything worrying us in the July projection we will discuss a change in our stance. For now there is no reason to make changes. A 4% growth is impressive, but will not lead to imbalances. The MPC focuses on labour market and investments.

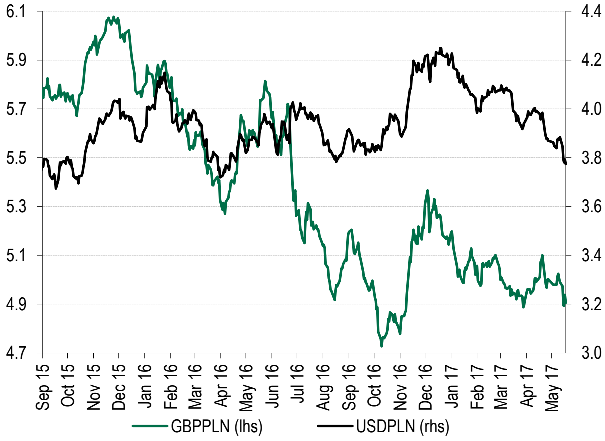
The Monetary Policy Council kept interest rates on hold in May and maintained the previous rhetoric at the post-meeting press conference despite the stronger-than-expected flash estimate for 1Q GDP and a further rise of core CPI. The MPC expects that inflation will stay at the current moderate level with limited risk of it rising above the target in the medium term. The members present at the press conference stated that a 4% growth should not generate economic imbalances in the economy and consequently should not increase the probability of rate hikes. We think a further rise of inflation would be a good argument for monetary tightening, but for now there are no signs that it is going to happen and we do not expect any rate hikes before 2H2018.

Foreign exchange market – Capital outflows from CEE

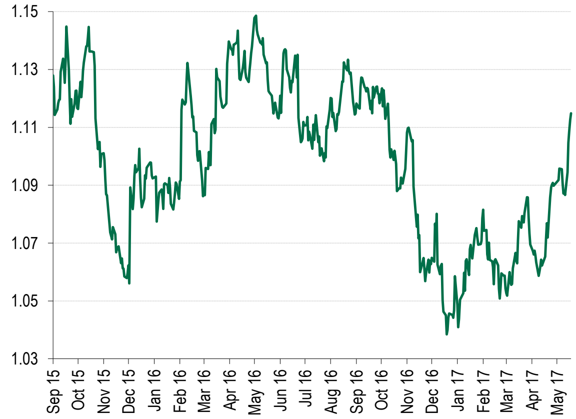
EUR/PLN



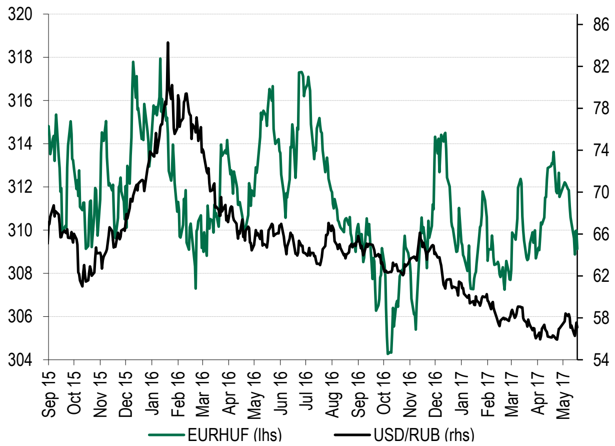
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Small potential for PLN appreciation

- Raising the Polish rating outlook to stable by Moody's and flash GDP data for 1Q17 that showed a clear acceleration of growth to 4.0% y/y boosted the zloty. On the weekly basis changes on the Polish FX market were minor, but the volatility was quite high. The zloty gained significantly against the major currencies at the beginning of the week but the turmoil in the US and Brazil caused the risk aversion on the global markets and at the end of the week the Polish zloty remained under pressure due to capital outflows from the emerging markets.
- We see a limited potential for the zloty to resume its appreciation trend in the nearest future.
- Dovish rhetoric from the Polish MPC may weigh on the zloty, especially if the next US data are sound reinforcing the FOMC's hawkish rhetoric. The Polish MPC does not see the need to increase interest rates till end-2018. At the same time the FOMC signalled at least two more hikes this year which will result in the Fed interest rate coming close to the NBP interest rate. It might be difficult for the zloty to retain its strength and capital outflows from Polish bond market can be visible.
- The zloty temporarily gained after better-than-expected 1Q17 GDP data. Friday's disappointing data on production and retail sales in April could cool down the current optimism and the Polish currency may be under pressure.

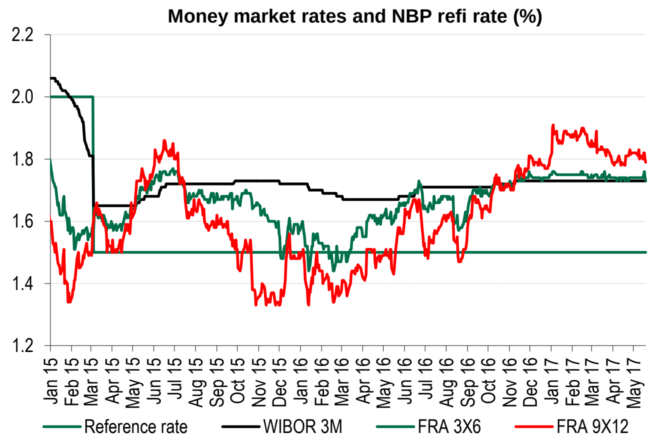
Rally on EURUSD

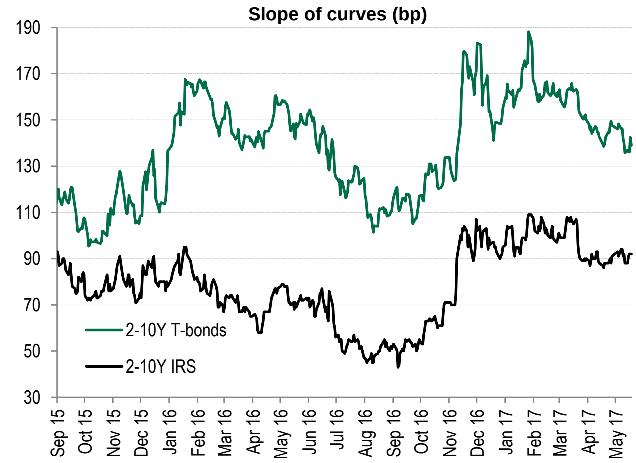
- Euro gained significantly against the dollar last week due to disappointing macro data in the US and next political tensions in the US president administration. The rise in EUR/USD was the strongest since March 2016 and the exchange rate neared 1.12, the highest level since Trump's victory in presidential elections in November last year.
- The dollar lost against all major currencies. The most downward shift was seen against the Swiss franc, the Japanese yen and the euro. Positive macro data from the US can provide additional support for the dollar because EURUSD has been rising strongly recently and is now significantly higher than before March Fed interest rate hike.

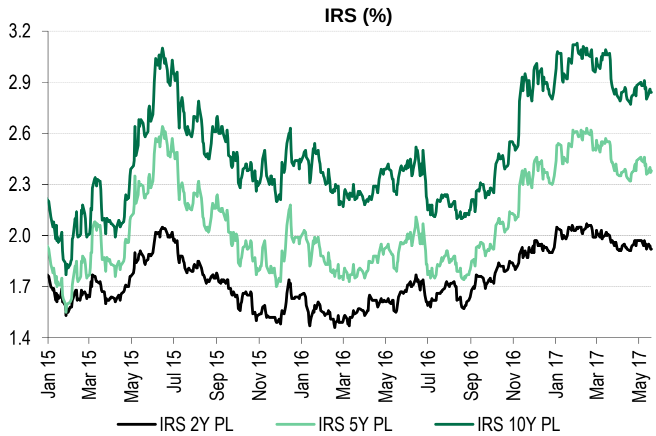
Capital outflows from CEE currencies

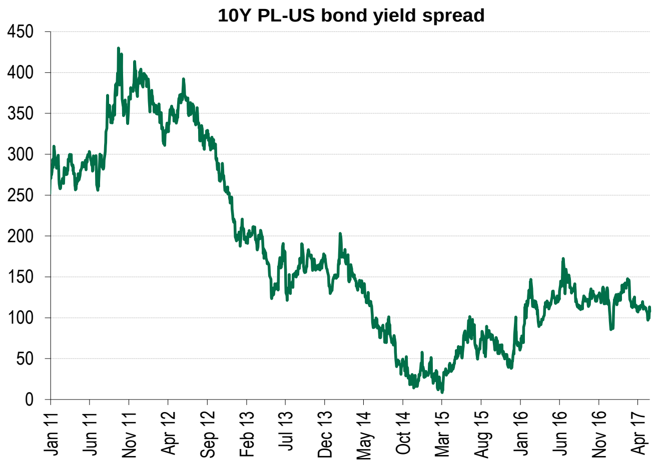
- Wednesday's publication of flash GDP data in the countries of our region contributed to the temporary appreciation of CE3 currencies against the euro The ruble gained as well, boosted by the rebound in oil price and USDRUB fell close to 56.3, the month-low.
- This week the Hungarian central bank (MNB) announces its decision. We expect the MNB to maintain its loose monetary policy conditions at the meeting. Since the MNB was dovish even when inflation was rising, evidence of a lower CPI (2.2% in April vs 2.7% in March) may put more pressure on the Hungarian currency.

Interest rate market – Rates up ahead of the FOMC?









Curves steeper

- Last week, Polish IRS and bond yield curves steepened as the dovish rhetoric of the MPC pushed the short end down and belly and long end moved slightly up. On a weekly basis, the 2Y IRS stayed roughly flat, the 5Y rate rose 1bp and the 10Y IRS added 4bp. The asset swap spreads did not change much.
- 1-12M WIBORs did not move on a weekly basis. FRAs fell 1bp vs last Friday and there was some bigger intra-week move seen after the MPC meeting when longer rates fell. Currently, FRAs are pricing in the first 25bp rate hike in Poland to be delivered in next 15-18 months, which is pretty in line with our scenario.

63% of borrowing needs now covered

- At the Thursday's auction, the Polish Finance Ministry sold bonds for PLN3bn amid demand at PLN6.86bn. Similarly to the previous auctions, the ministry raised most funds from the sale of 5Y and 10Y benchmarks (PLN972mn from PS0422 and PLN990mn from DS0727). The bid/cover ratio rose to 2.29 from 1.22 at the last auction in April. This seems to be impressive, however, this was only due to the Finance Ministry's decision to reduce the upper band of planned supply at the auction to PLN3bn from PLN5bn. Without this reduction, the bid/cover ratio would have been at 1.37, similar to April and well below the levels seen in January (2.58). The Ministry of Finance said that this year's borrowing needs are covered by 63%, in line with the pattern seen in the previous years.

Rates up ahead of the FOMC?

- May is the fourth month in a row to see the 10Y yield fall (although at a clearly slower pace than earlier this year). In the last 10 years, the longer streak was seen in 2014 (10 months in a row) and in 2012 (seven months in a row) but this was when the Polish MPC was easing the monetary policy. Obviously, now the story is somewhat different and the market is pricing rate hikes in late 2018.
- The recent US macro data were somewhat disappointing and the political tensions in the president's Trump administration provided additional support for the core markets with the 10Y Treasury yield falling by c20bp since last Friday. However, according to Bloomberg, the market still sees more than a 90% probability for a 25bp rate hike at the next FOMC meeting in mid-June. Numerous important US data are on the agenda in the next two weeks with the monthly job report being the most awaited. April saw a clear improvement vs surprisingly weak March and if the May reading is around 200k, the figure should make the market more confident ahead of the FOMC meeting particularly when the US CPI is in the upward trend.
- We still expect Polish IRS/yields to rise later in the year when the FOMC delivers more rate hikes (that the market is currently not pricing in) and the ECB signals withdrawing its monetary policy stimulus.

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