

BI-WEEKLY ECONOMIC UPDATE

12 – 25 June 2017

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (12 June)							
14:00	PL	CPI	May	% y/y	1.9	1.9	2.0
TUESDAY (13 June)							
11:00	DE	ZEW index	Jun	pts		-	83.9
14:00	PL	Current account	Apr	m	-276	-535	-738
14:00	PL	Core inflation	May	% y/y	1.0	0.9	0.9
WEDNESDAY (14 June)							
14:00	PL	Money supply	May	% y/y	6.5	5.7	6.6
14:30	US	Retail sales	May	% m/m	0.1	-	0.4
14:30	US	CPI	May	% y/y	2.0	-	2.2
20:00	US	FOMC decision		%	1.25	-	1.00
THURSDAY (15 June)							
	PL	Market holiday					
14:30	US	Philly Fed index	Jun	pts	23.5	-	38.8
15:15	US	Industrial output	May	% m/m	0.0	-	1.0
FRIDAY (16 June)							
11:00	EZ	CPI	May	% y/y		-	1.9
14:30	US	House starts/building permits	May	k	1225/1250	-	1172/1229
16:00	US	Flash Michigan	Jun	pts	97.1	-	97.1
MONDAY (19 June)							
14:00	PL	Employment/wages in corporate sector	May	% y/y	4.6/5.0	4.6/5.3	4.6/4.1
TUESDAY (20 June)							
14:00	HU	Central bank decision		%	0.90	-	0.90
14:00	PL	Industrial output	May	% y/y	7.0	9.6	-0.6
14:00	PL	Construction and assembly output	May	% y/y	13.0	16.2	4.3
14:00	PL	PPI	May	% y/y	2.9	2.8	4.3
14:00	PL	Real retail sales	May	% y/y	7.8	7.1	6.7
WEDNESDAY (21 June)							
16:00	US	Home sales	May	% m/m	0.5	-	-2.3
THURSDAY (22 June)							
14:00	PL	MPC minutes					
14:30	US	Initial jobless claims	Jun				
FRIDAY (23 June)							
9:30	DE	Flash PMI – services/manufacturing	Jun	pts		-	55.4/59.5
10:00	EZ	Flash PMI – services/ manufacturing	Jun	pts		-	56.3/57.0
16:00	US	New home sales	May	% m/m	5.5	-	11.4

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

Grzegorz Ogonek +48 22 534 19 23

Izabela Sajdak, CFA +48 22 534 18 86

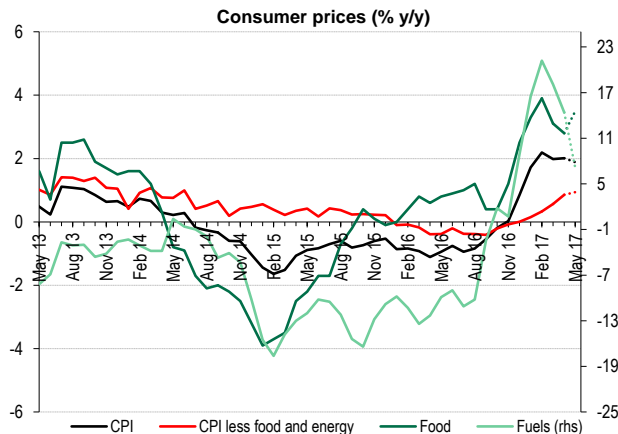
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

What's hot in next two weeks – A set of important data from Poland

- We are expecting May CPI to confirm the flash estimate at 1.9% y/y, below initial market consensus at 2.0% y/y. Even though the headline CPI fell, in our view food prices recorded the strongest rise in May since 2013, and core increased slightly (it may be visible only in the second digit). According to our forecasts, CPI will remain close to 2.0% y/y in the upcoming months, yet core inflation will be going further up.

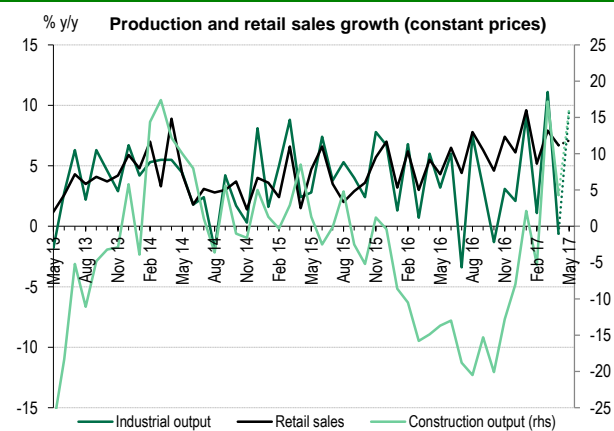
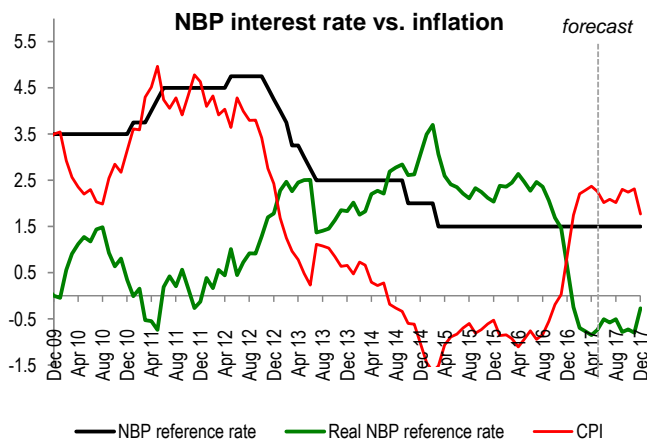
- PPI inflation slid to 2.8% y/y in May from 4.3% y/y, according to our forecasts. Low rise in producer prices stems from the stronger zloty and lower commodity prices. However, PPI is also subject to a high base effect from May 2016.

- We estimate that April's current account deficit went a bit down versus March, as the higher trade deficit was more than offset by better balances of services and incomes. We are expecting that the trade balance will show a weak reading of exports (+1.5% y/y), in line with disappointing output growth, while imports will grow by 8.8% y/y driven by high internal demand.

- May's output data will most probably show a major rebound versus the weak April, both as regards industry and construction, thanks to a positive working-day effect. Our forecasts for both statistics are above the market consensus.

- Retail sales in May should show a slight acceleration versus April, and confirm the strength of consumer demand in 2Q17.

- We are expecting strong labour market numbers, with a marked acceleration in wages (>5% y/y, but partially due to a low base effect) and a strong reading in employment growth. However, May's unemployment numbers disappointed and this may pose a risk of a weaker reading in employment numbers.

**Last week in economy** – Rates and the MPC stance unchanged

- The Monetary Policy Council kept the interest rates on hold in June. The reference rate is still at 1.5%. The tone of the statement was practically the same as in May, suggesting that there is still no need for the Council to change monetary policy parameters in the foreseeable future, read: 1-1.5 years. NBP Governor Adam Glapiński reiterated that he would be surprised if the Council raised rates before the end of 2018, despite his forecast of 4% GDP growth this year, which in his view might still be an underestimation.

- While the Council was puzzled by the high input from inventory changes in 1Q GDP (0.7pp out of the 4% growth) it remained optimistic when it comes to outlook for the real economy.

- Overall, the meeting seemed dovish and did not encourage changes to rate expectations. We still see the first rate hike coming in 2H2018.

Quote of the week – A rate hike is no closer, stronger PLN tightens monetary policy**Adam Glapiński, NBP Governor, 7 June, MPC press conference**

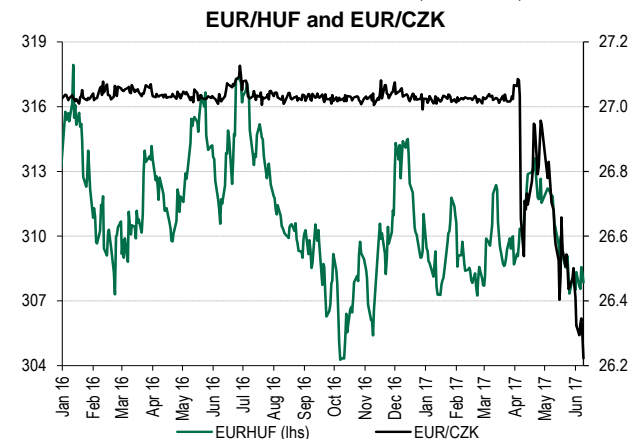
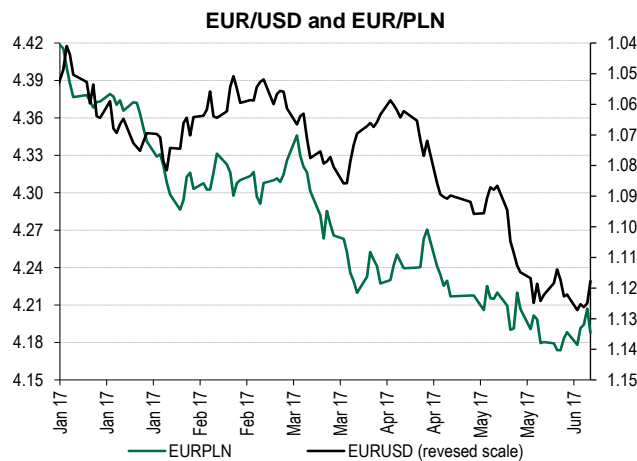
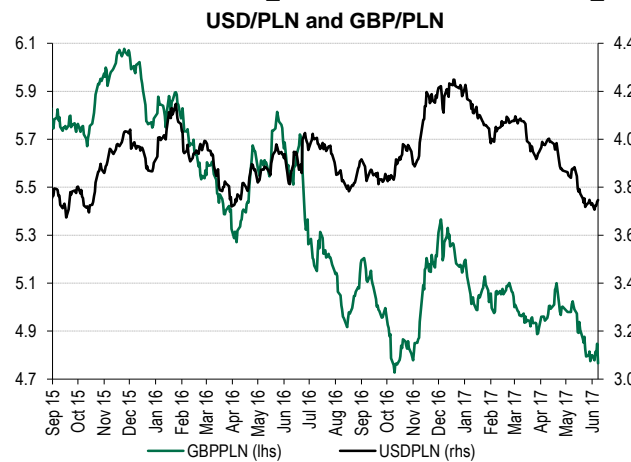
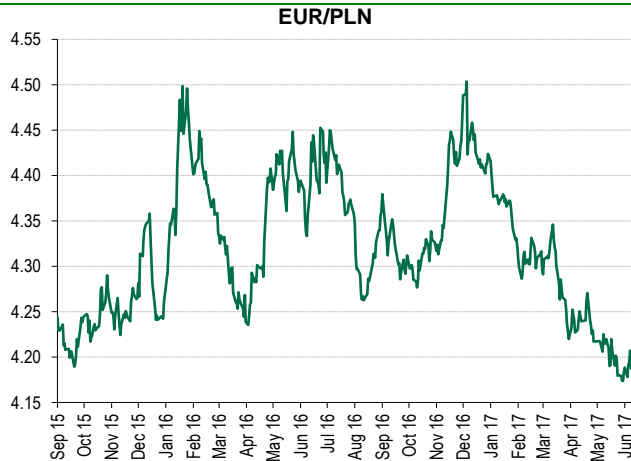
I have said many times, that I, personally, would be surprised if we were raising rates in 2018, but of course we do have a 'wait and see' position, we are watching the situation, searching for every detail. I do not foresee a rushing inflation. I still see the whole-year GDP growth at 4% and would not be surprised if it actually went higher. The exchange rate is important, the appreciation of the zloty means tightening of monetary policy. It happens independently from us, but we need to take it into account.

Łukasz Hardt, MPC member, 7 June, MPC press conference

It will be difficult for me to tolerate negative real interest rate if it extends after 2018. But it would not imply any decision on my part, just an increase of a probability [that there will be a motion to hike rates].

Listening to the MPC press conference we got an impression that the economic growth story is not a factor that could change the current monetary policy stance. Surprisingly, inflation was not covered in much detail and the discussion moved to negative real rates – again, with a conclusion that this issue is not going to change the views of the Council anytime soon. What is more, in the final sentence governor Glapiński referred to the exchange rate as an important factor doing the job for the MPC – as the substantial appreciation of PLN year-to-date is a de facto monetary policy tightening. Łukasz Hardt, whom we consider the member that could incite a debate on the need to raise rates did not really sound that hawkish.

Foreign exchange market – Macro data and Fed hike against the zloty



Macro data and Fed hike against the zloty

- Last week EUR/PLN remained fairly stable around 4.18. The exchange rate is still within the range determined by the high and low levels seen three weeks ago (c4.16-4.29) and recently volatility has been much lower than in mid-May. The last few days saw some more noticeable changes on the GBP market after the ruling Conservative Party lost majority in the UK parliament. Pound's depreciation on the global market pulled GBP/PLN down to 4.75 from 4.84. USD/PLN rose to 3.76 from 3.70 after the dollar gained vs the euro after the ECB meeting.

- We think that some of important factors for the zloty are about to change in the nearest future.

- First, zloty's rally observed since the beginning of the year has been largely fueled by improving economic outlook but in our view this may stop working as we do not expect further acceleration in economic growth. Our forecast for April's C/A deficit is below the market consensus and we think this could trigger some profit-taking after recent zloty's appreciation.

- Second, we think that narrowing positive PL-US interest rate differential is likely to finally start weighing on the zloty. In our base case scenario we assume that in mid-June FOMC will deliver second rate hike this year which we think may generate some pressure on the Polish currency.

- Third, we expect EUR/USD could move down in the short-term (see below), and with the exchange rate's correlation with EUR/PLN unchanged, this would imply also weaker zloty vs the euro.

- Finally, as it has been mentioned above, volatility of EUR/PLN dropped recently. Please bear in mind that periods of low volatility are followed by some sharper changes, which for the EM currencies usually means depreciation.

Euro weaker after the ECB

- Last week EUR/USD fell slightly below 1.12 from nearly 1.13 on only slightly less dovish stance of the ECB. This was the biggest weekly dollar appreciation vs the euro since late March.

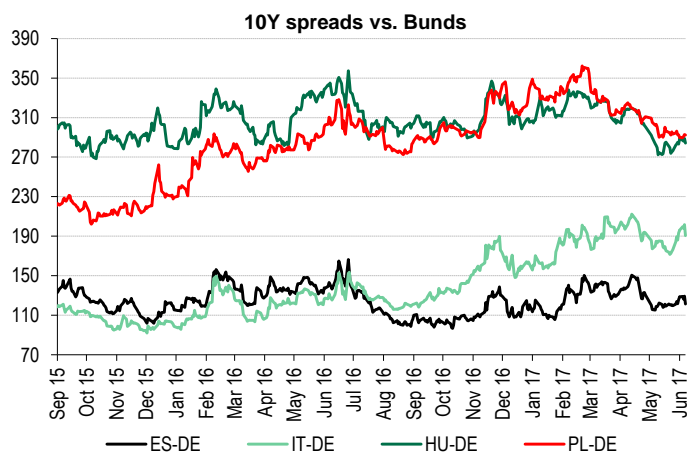
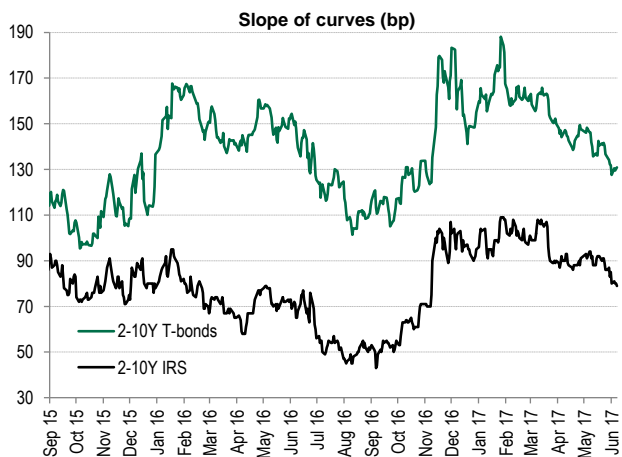
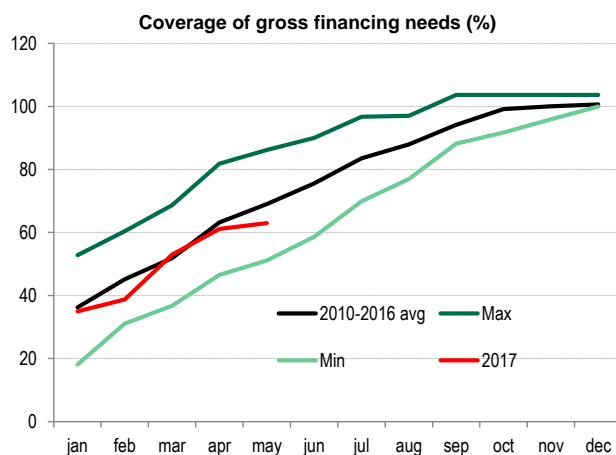
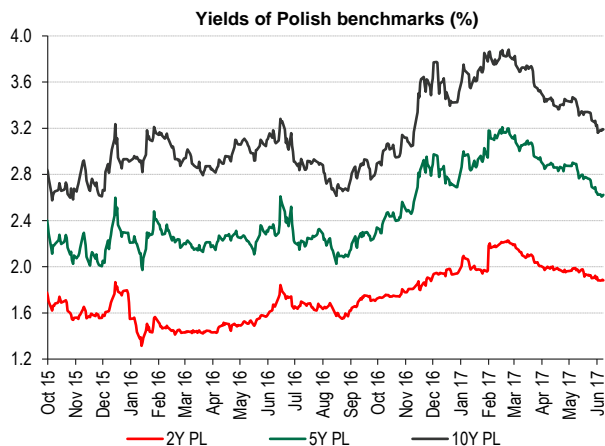
- The outcome of the UK parliamentary elections where the ruling Conservatives lost parliamentary majority weighed noticeably on the British pound – EUR/GBP jumped temporarily to c0.886 (its highest since mid-November) and GBP/PLN plummeted to nearly 1.26.

- We think the dollar should remain strong in the short-term. EUR/USD is now well higher than in March when the FOMC last hiked the interest rates and we see some room for a downside correction as next hike is very likely to be announced this week. Also, the pace of the ECB's changing its bias towards more hawkish looks to be very slow implying little support for the euro.

Koruna stronger, forint stable, ruble weaker

- Last week we learned Czech and Hungarian May inflation data. In the first case, prices rose 2.4% y/y, much faster than the market expected (2.1% y/y), while in the latter the headline CPI was just below the consensus (2.1% y/y vs 2.2%). Higher than expected Czech CPI boosted market expectations for rate hikes which temporarily pushed EUR/CZK down to below 26.2. The last week was the fourth in a row when the exchange rate fell. At the same time, EUR/HUF stayed near 308 while the ruble lost slightly vs the dollar amid falling oil prices.

Interest rate market – Strong impulse for further yield falls is needed



Steeper curves

- On a weekly basis, both Polish bond yield and IRS curve slightly steepened and rose by 3bp along the curve. Both 2-10Y and 2-5Y spreads of IRS and bond yield curves remained fairly stable last week. Asset swap spread stayed flat at 50bp.
- The dovish rhetoric of the MPC was neutral for the domestic bond market.
- On the June meeting, ECB reduced market expectations for QE tapering and cut inflation outlook in the Euro zone till 2019. In our view, ECB will remain cautious as very substantial degree of monetary accommodation is still needed. We think that ECB will still sound dovish, but impact on Polish debt will be limited in the next months.
- FRAs remained fairly stable vs last Friday but there were some bigger moves seen just before the MPC meeting when longer rates fell by c3bp. Currently, FRAs suggest interest rate hike lag with the first 25bp rate hike in Poland to be delivered in next 18-21 months. We still see the first rate hike coming in 4Q2018.

68% of borrowing needs now covered

- At the Friday's auction, the Polish Ministry of Finance sold bonds for PLN3bn amid demand at PLN6.17bn. Similarly to the previous auctions, the ministry raised most funds from the sale of 5Y and 10Y benchmarks (PLN1.085mn from PS0422 and PLN640mn from DS0727). The bid/cover ratio fell to 2.06 vs. 2.29 at the last auction in May. The Ministry of Finance said that this year's borrowing needs are covered in 68%, slightly below the pattern seen in the previous years.
- The Finance Ministry announced that debt supply in the months to come will be reduced. We think it is very likely, given that this year state budget deficit may be lower than planned even by PLN20bn. In our view, the actual coverage of gross financing needs after June auction is, in fact, higher and we expect the FinMin will start pre-financing its 2018 needs in October if market conditions are favourable. There will be only one more switch auction this month, on 22 June. The FinMin does not plan any T-bill sale auctions in June.

Fed meeting in the spotlight

- Next two weeks will be abundant in domestic macro data releases and important events abroad (rate-setting FOMC meeting in the USA on 14 June 14). In our view, economic activity in Poland in May was visibly better as compared to the previous month.
- We think that the front end of the curves should anchor close to the current levels. The belly and the long end of the curves will remain more sensitive to external factors, including macro data releases abroad and FOMC decision, which can increase market volatility. In our view, Fed decision on rates will be the key event in these busy weeks. It is broadly expected that Fed will hike rates by 25bp, so market response to such a decision might be limited. As the interest rate hike is now priced in (c98% probability of hike), investors will focus on the Fed meeting statement and dot plot. We think that a drift in Fed dot plot may evoke significant market reaction on the debt market and globally affect yields, including the Polish assets.

This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. Information presented in the publication is not an investment advice. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Forecasts or data related to the past do not guarantee future prices of financial instruments or financial results. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

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