

# WEEKLY ECONOMIC UPDATE

26 June – 2 July 2017

Last economic data releases from Poland were not very bad, but they confirmed that the pace of economic growth may decelerate slightly in the second quarter of the year, and that investment recovery is still not very strong. Still, we expect investments to recover in the second half of the year, which will help the economy to grow by nearly 4% in 2017. The Finance Ministry's data showed that the state budget is in excellent shape, with tax revenues boosted by strong private consumption and unusually low deficit after five months of the year. It seems increasingly likely that the budget deficit at the end of the year may be close to PLN30bn (instead of planned PLN59bn).

The coming week should be relatively calm, as there are not many important events in the agenda. The most important domestic release will be the flash CPI estimate on Friday. We expect inflation to drop to 1.7% y/y from 1.9% y/y recorded in May. In our view the upward tendency in food prices, especially in meat and fruit will be offset by a fall in fuel prices and lower roaming fees. Flash inflation estimates will be also released in the euro zone and some of its member countries, which may be important for market expectations regarding the ECB's policy outlook.

## Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (26 June)</b>							
10:00	PL	Unemployment rate	MAY	% y/y	7.4	7.4	7.7
10:00	DE	Ifo index	JUN	pts	-	-	114.6
14:30	US	Durable goods orders	MAY	% m/m	-0.9	-	-0.8
<b>TUESDAY (27 June)</b>							
16:00	US	Consumer confidence index	JUN	pts	115.4	-	117.9
<b>WEDNESDAY (28 June)</b>							
16:00	US	Pending home sales	MAY	% m/m	-	-	-1.3
<b>THURSDAY (29 June)</b>							
14:30	US	Third GDP estimate	Q1	% y/y	1.2	-	1.2
<b>FRIDAY (30 June)</b>							
9:00	CZ	GDP	Q1	% y/y	2.9	-	2.9
9:00	HU	PPI	MAY	% y/y	-	-	4.4
11:00	EZ	Flash CPI	JUN	% y/y	1.3	-	1.4
14:00	PL	Flash CPI	JUN	% y/y	1.9	1.7	1.9
14:30	US	Personal income	MAY	% m/m	0.3	-	0.4
14:30	US	Consumer spending	MAY	% m/m	0.1	-	0.4
16:00	US	Michigan index	JUN	pts	95.0	-	94.5

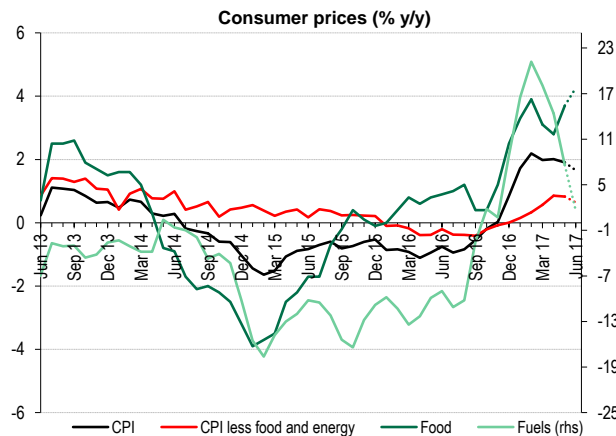
Source: BZ WBK, Reuters, Bloomberg

### 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 next week – Flash CPI and unemployment rate**

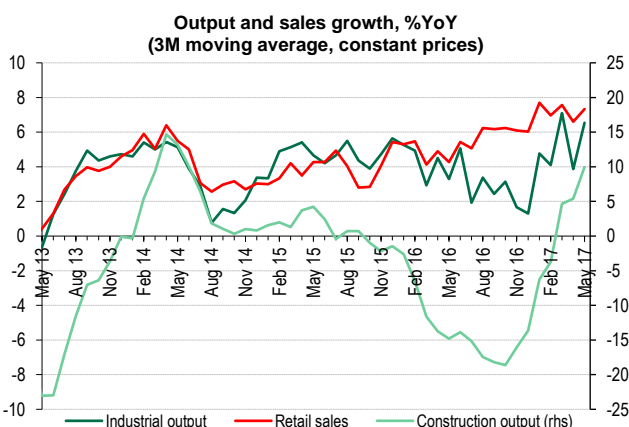
■ We think flash June CPI will go down to 1.7% y/y from 1.9% y/y recorded in May. In our view the upward tendency in food prices, especially in meat and fruit will be offset by a fall in fuel prices and lower roaming charges. We expect CPI to stay around 2.0% in the months to come and to decline to about 1.5% in December. At the same time, core inflation will be slowly going up to almost 1.5% y/y at the year-end.

■ According to our estimates, registered unemployment rate fell to 7.4% in May from 7.7% in April. We see some upward risk after the Labour Ministry released its estimate at 7.5%. May's data showed some deceleration in downward march of unemployment and we are curious to see whether this was only a one-off or a beginning of a shift in unemployment tendencies. Unemployment is already so low that its slide has to halt at some point in time.

**Last two weeks in economy – May data suggest Q2 GDP growth may be a bit weaker than Q1**

■ Polish C/A deficit amounted to €275m in April and was in line with expectations. However, the breakdown proved rather surprising, as both export and import were weak. The market consensus on exports was clearly overshoot, despite the fact that weak industrial output suggested a paltry growth of that measure (+0.6% y/y). It is possible that the same effect dragged imports down (+3.4% y/y), but this low reading came as a surprise to us, given strong private consumption.

■ Labour market data from the Polish enterprise sector for May showed an acceleration of wage growth from 4.1% y/y to 5.4% and a slightly reduced pace of employment growth – from 4.6% y/y to 4.5%. Wage bill in the corporate sector increased by 8.1% y/y in real terms, the strongest since August 2016. Strong rise in households' incomes will be supportive for the private consumption in 2Q17 and in the following quarters.



■ After a decline by 0.6% in April, in May the manufacturing output rose by 9.1% y/y with working days effect playing an important role in both readings. Seasonally adjusted output growth reached 6.5% y/y in May, whereas in April it was 4%. Growth of construction output by 8.4% y/y was disappointing. After removing the working days effect there was a decline by 3.2% m/m in May (the biggest since June 2016). Weak construction output is yet another signal from the economy that the revival in investment can be delayed. Retail sales grew by 7.4% y/y in real terms, which was a bit below market expectations, but in our view it confirms a continually good state of consumer demand.

■ In sum, May data suggest in our view that the pace of economic growth in 2Q17 might be slightly slower than in 1Q17, but we still assume that growth at nearly 4% is possible within the whole year.

**Quote of the week – New arguments to maintain the dovish bias****Jerzy Kropiwnicki, MPC member, 20 June, PAP**

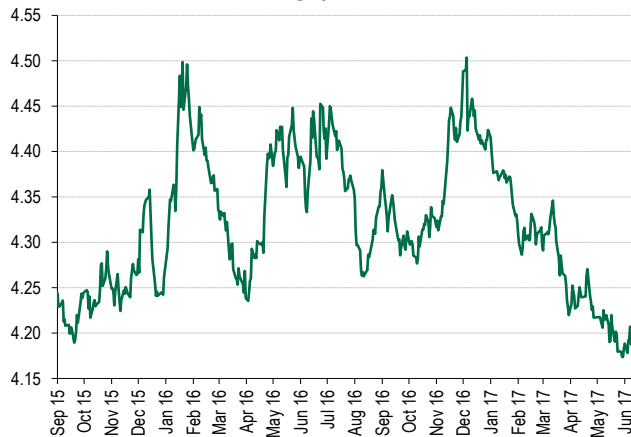
We do not see reasons to push for a rate hike, because we are aware of the negative consequences of a rise in interest rates (...) The most important rule is 'do no harm', do not cause a deterioration of the current state of the economy.

Every monetary policy council inherits the trauma, when during the AWS rule [late 90s/early 00s] the MPC effectively cooled down the economy, caused a double-digit unemployment rate and knocked the economy out of its growth path.

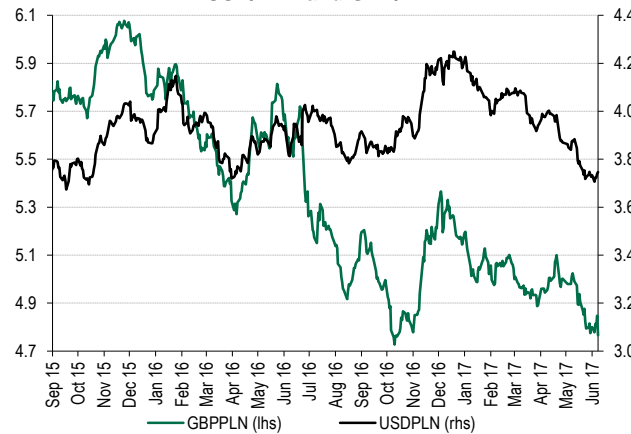
The market expectations for tighter monetary policy in Poland are moving further into the future. This is understandable given the rhetoric of the MPC. The reluctance of the Council to consider a less dovish policy has recently been expressed in a new way by Jerzy Kropiwnicki. In his speech he referred to an episode in Polish monetary policy history and to a principal rule of non-maleficence used in medicine. In fact the economy does not require any treatment now. Absence of macroeconomic imbalances is one of the main arguments that allows the MPC to stick to the 'wait-and-see' approach.

## Foreign exchange market – Prepare for volatility in the summer

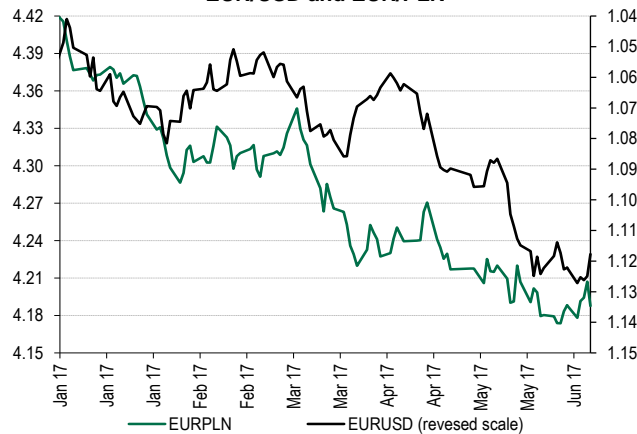
### EUR/PLN



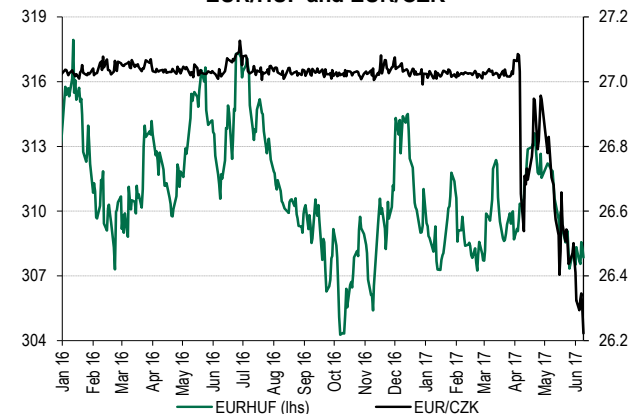
### USD/PLN and GBP/PLN



### EUR/USD and EUR/PLN



### EUR/HUF and EUR/CZK



### PLN correction losing steam

▪ Important events abroad (ECB meeting and Fed rate hike) contributed to increase in the Polish zloty volatility. After May's appreciation of domestic currency, the zloty weakened against euro and almost touched 4.26, the highest level since first round of French presidential election.

▪ In the summer, the Polish currency is usually under the influence of strong seasonal pattern. The correction that took place in June already seems to be losing steam as the month is nearing its end. In July the zloty usually tends to be stronger against euro (in the last seven years the EURPLN fell on average by 1.8% in this month), which is very often followed by a correction in August. We expect this pattern to be repeated this year.

### Dollar's rally after Fed was just a drop in the ocean

▪ The dollar gained against the euro after the June Fed interest rate hike and EURUSD is now slightly below 1.12. However, the scale of the gain was relatively small if compared to its earlier loss this year. USD has performed poorly in 2017 so far with the biggest loss against the euro among G10 currencies.

▪ Although one more interest rate hike in 2017 is expected plus Fed announced to shrink its balance sheet we think US political turmoil regarding fiscal stimulus and medicare bill can play bigger role and as a result, negatively affect the dollar.

▪ Reduced Eurozone risks after market-friendly election outcomes across the Europe together with improving economic outlook should boost the euro. However, retaining the ultra-loose monetary policy by ECB for longer period and downward revision of inflation path in the Eurozone may limit the euro advance.

### CE3 under pressure

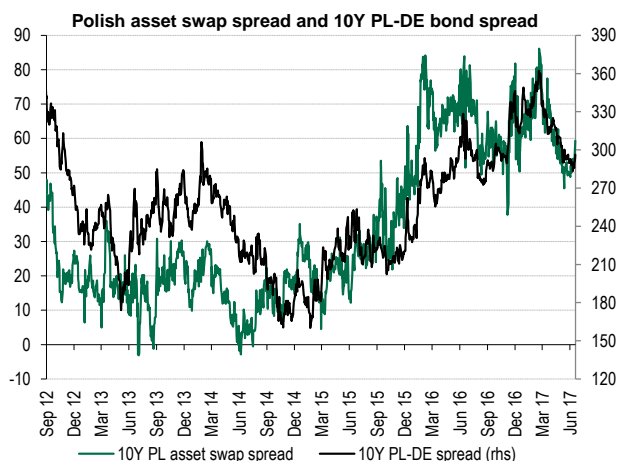
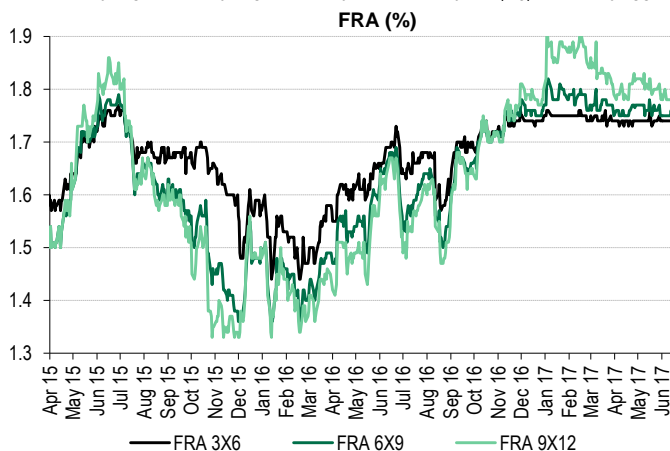
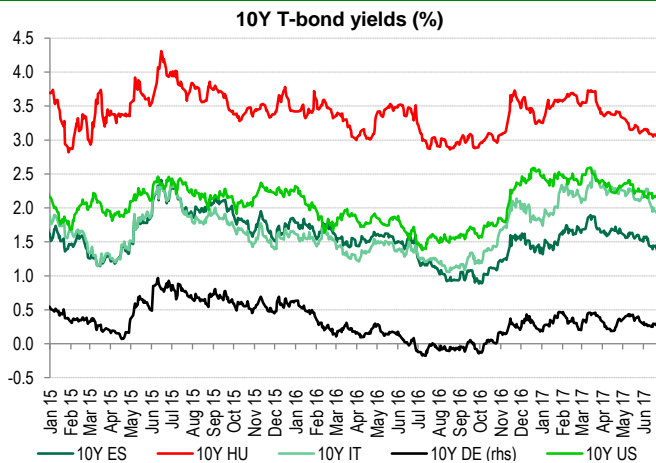
▪ CE3 currencies were at the disadvantage after FOMC decision and they lost against the main currencies.

▪ Despite good macro releases and hawkish rhetoric from the Czech central bank (CNB), the koruna lost in the last two weeks due to external factors and negative global sentiment. We still think, however, that domestic situation in the Czechia will boost the koruna and EURCZK should move to 26.0.

▪ On the other hand, dovish statement from the Hungarian central bank (MNB) and lower inflation path with reaching the target rate of 3% in 2019 may weigh on the forint. We believe that expansion in Hungarian economy is favourable for the forint in the medium-to-long run because all major internal risks are now balanced.

▪ Continuing sharp drop in oil prices due to oil oversupply in the US resulted in rising USDRUB which broke 60, the highest level since January. Additionally, the interest rate cut by Russian central bank and further loose monetary policy could be harmful for the ruble by the end of the year.

## Interest rate market – Lower supply to support Polish debt?



### Asset swaps widened again

▪ Last week, there was a clear discrepancy between Polish yield and IRS curves. While Polish yields rose with the strongest increase at the short end (+6bp), the IRS curve flattened and the long end dropped by 3bp. As a result, 10Y asset swap spread increased to 59pts, the highest level since French elections.

▪ FRAs remained fairly stable, but we saw some upward move (by 2bp) at 15x18 and 18x21 rates. FRAs at the moment imply the first 25bp rate hike in Poland to take place in next 18-21 months. We still think the first rate hike will come in 4Q18

▪ Good macro data from Polish economy led last week to decrease in Polish risk and as a result 5Y CDS rate on Polish assets dropped below 69pts, the lowest level since August 2015.

### MinFin started pre-financing of 2018 borrowing needs

▪ On Thursday switch auction the Ministry of Finance sold bonds worth PLN4.16bn and bought back short-term bonds (OK0717, DS1017, WZ0118) of PLN4.03bn. The bid/cover ratio amounted to 1.24. The outstanding debt to be repaid in 2017 amounts to PLN22.8bn after the tender.

▪ The MinFin started to pre-finance 2018 gross borrowing needs with buyback of WZ0118 (PLN620mn). Deputy finance minister said that PS0422 will no longer be offered and at the next auction new 5Y benchmark bond will be issued.

▪ In the FT deputy minister Piotr Nowak stated that 3Q bond supply will be reduced and only four auctions instead of previously planned six will take place in July-September. The debt supply amount will be limited to PLN10bn due to the better than planned result of the state budget after May.

### Rate hike by Fed strengthened Treasuries

▪ On June meeting FOMC decided to hike federal funds rate by 25bp to 1-1.25%. The Federal Reserve indicated one more interest rate hike this year. The market expects currently the rate hike in December with probability of c44%.

▪ This week flash CPI data in the Eurozone could support bonds in the core markets. ECB has recently revised down its CPI estimates to 1.5% from 1.7%, for 2017, still far from the target of 2%.

▪ At the end of the week we will also find out the June flash CPI reading in Poland. With our estimate of inflation down to 1.7% Polish bond curve should gain in the weeks to come.

▪ For the past 11 years Polish 10Y bond has gained in July with average yield decrease of 3.28%. This pattern did not work only in 2011 when 10Y benchmark lost 0.17%. The similar pattern we can observe in both Czech and Romanian 10Y bonds. This backdrop may no longer be sufficient to spur Polish bonds buying, but at least it should provide some protection against a significant sell-off in July.

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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](mailto:ekonomia@bzwbk.pl)