Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

3 July – 9 July 2017

Last week proved to be very interesting as we got to see a lot of hawkish signals from numerous central banks. ECB's Mario Draghi was the main culprit here, as he suggested that the monetary policy in the euro zone will become tighter. Despite some signals from the ECB that Draghi was actually misinterpreted, bond and stock markets witnessed a strong sell-off.

This week looks very promising with heavy macro calendar, including PMIs, US and German factory orders, and non-farm payrolls. Markets are eyeing messages from the central banks so also the ECB and FOMC minutes may be important. As for Poland, we will get to see PMI and results of the MPC meeting. The NBP will release new inflation projection and this document may be crucial for Polish monetary policy prospects.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (3 July)					
9:00	**PL**	**PMI – manufacturing**	**Jun**	**pts**	**-**	**54.2**	**52.7**
9:00	HU	PMI – manufacturing	Jun	pts	-	-	62.1
9:30	CZ	PMI – manufacturing	Jun	pts	-	-	56.4
9:55	DE	PMI – manufacturing	Jun	pts	59.4	-	59.3
10:00	EZ	PMI – manufacturing	Jun	pts	57.0	-	57.3
16:00	US	ISM – manufacturing	Jun	pts	55.0	-	54.9
		TUESDAY (4 July)					
	US	Market holiday					
		WEDNESDAY (5 July)					
09:55	DE	PMI – services	Jun	pts	--	--	53.7
10:00	EZ	PMI – services	Jun	pts	--	--	54.7
11:00	EZ	Retail sales YoY	May	% y/y	--	--	2.50%
16:00	US	Factory orders	May	% m/m	-0.50%	--	-0.20%
16:00	US	Durable goods orders	May	% m/m	--	--	-1.10%
20:00	US	FOMC minutes	14-Jun		--	--	--
	PL	**Base Rate Announcement**			**1.50%**	**--**	**1.50%**
		THURSDAY (6 July)					
08:00	DE	Factory orders	May	% m/m	--	--	-2.10%
13:30	EC	ECB minutes					
14:15	US	ADP report	Jun	k	183k	--	253k
16:00	US	ISM – services	Jun	pts	56.5	--	56.9
		FRIDAY (7 July)					
08:00	DE	Industrial output	May	% m/m	--	--	0.80%
09:00	CZ	Industrial output	May	% y/y	--	--	-2.50%
14:30	US	Change in nonfarm payrolls	Jun	k	180k	--	138k
14:30	US	Unemployment rate	Jun	%	4.30%	--	4.30%
	HU	Rating review by Moody's					
	PL	**Rating review by Fitch**					

Source: BZ WBK, Reuters, Bloomberg

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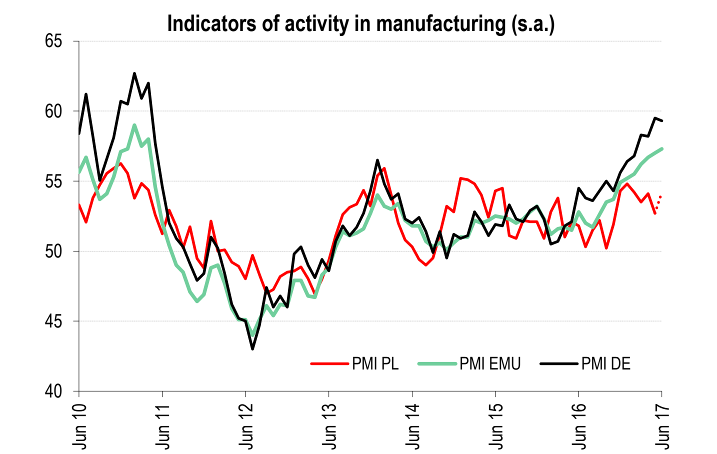
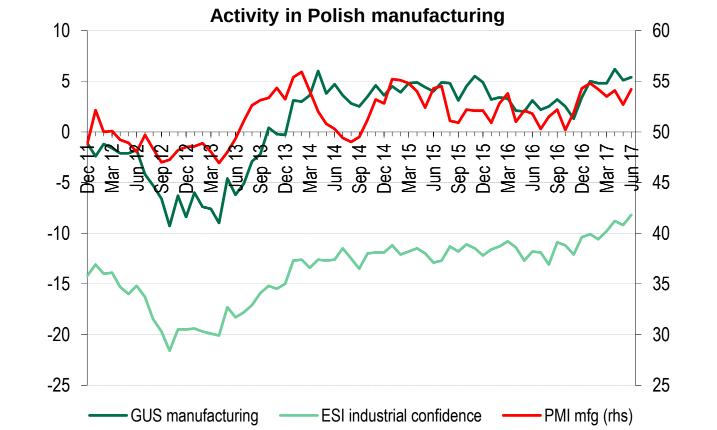
What's hot next week – PMI, MPC and rating review





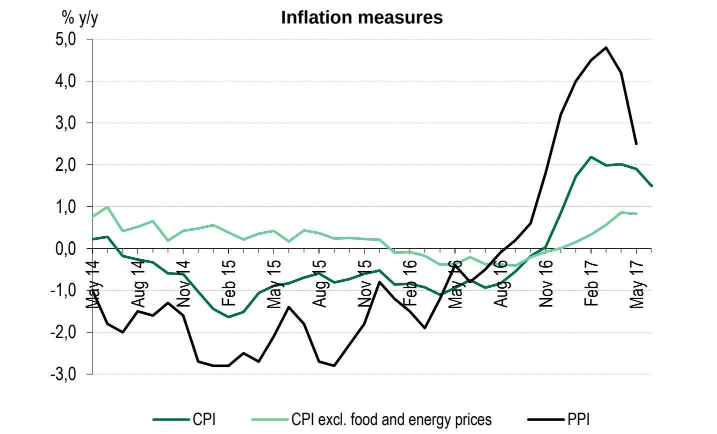
▪ PMI releases will flood the markets this week. May readings in CEE were relatively weak and the gap to the Euro zone business sentiment is wide historically. This is why we could see some catching up, especially with flash indices from Germany and the Euro zone coming stronger than expected. We will also get real data from Germany (new orders, output) to help assess chances of CEE countries maintaining good economic momentum. European Sentiment Index for Poland and the stat office measure of business sentiment both improved vs. May which bodes well for the PMI.

▪ The Monetary Policy Council, which holds a meeting this week, is unlikely to join the choir of surprisingly hawkish central bankers at the ECB forum in Sintra, even if the Czech Central Bank is going for a rate hike in 3Q17 unless the koruna gets too strong in the meantime. Bloomberg survey conducted among analysts showed that the expected time of the first rate increase in Poland moved from 3Q18 to 4Q18. The MPC will get an update of the projection, most likely with higher path of GDP, but with CPI still staying below 2.5% target by the end of 2019. The disappointing flash CPI for June can make the Council ignore the likely GDP outlook upgrade.

▪ Fitch is to release a rating review on Poland, weighing the improved economic outlook and outstanding central budget performance on one side and the re-ignited tensions with the European Commission about abiding by EU rules, which may impact the volume of EU funds Poland is going to obtain in the next EU budget. Gross external debt, which is important for the rating, fell in 1Q17 from 76% to 72.2% of GDP.

▪ The echo of the key events from recent weeks, the FOMC and ECB meetings, will come back to the markets in the form of minutes releases.

Last week in economy – Further decline of inflation



▪ Flash estimate of CPI for June, 1.5% y/y, was much below the market and our forecast of 1.7%, as it went further down from the 2.2% y/y February peak, after 1.9% y/y was recorded in May. This surprise makes the full report (due 11-Jul) a highly awaited release. Based on our calculations it seems likely that the low CPI headline could not be achieved without core inflation moving down in June. Growing food prices (of meat and fruit in particular) were probably offset by falling fuel prices and lower roaming charges. We expect CPI to stay around 1.5% in the months to come and to decline to about 1.2% in December. At the same time, core inflation might stay depressed in the summer and rise to 1% only in late 2017.

▪ The unemployment rate fell to 7.4% in May, in line with our forecasts and below the Labour Ministry's estimate of 7.5%. Full quarterly data on balance of payments data suggested that there could be an upside revision of GDP in 1Q.

Quote of the week – What does Fitch say to the improved growth outlook and fiscal position?

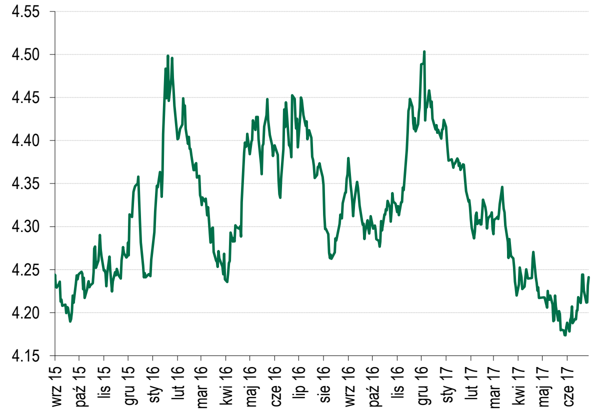
Fitch, rating agency, 13 January

Poland's 'A-' ratings are supported by its solid macro fundamentals (…) Fitch expects GDP growth will accelerate to 3.0% in 2017 and 3.2% in 2018 (…). The agency expects the government deficit will be 3.0% of GDP in 2017 (…) Uncertainties over demand from Poland's main trade partners in the EU (80% of total exports) and the potential negative impact of increased economic policy uncertainty and domestic political tensions on investment are the main risks to the outlook. (…).Continued high GDP growth that supports income convergence towards the 'A' category median could trigger positive rating action.

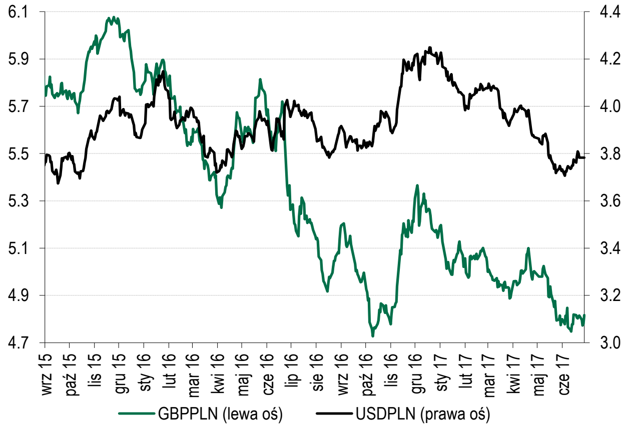
Fitch has held Poland at A-/stable since 2013. The agency did not downgrade the country in 2016 so it does not need to reverse these changes now. Fitch January macro forecasts apparently need upgrading - the market consensus for 2017 growth is 3.8%, 3.5% for 2018 and fiscal deficit is expected to come at 2.7% this year. The economic upturn in the EU mitigates one of the economic risks. Given that Fitch has generally been less active than others we think it will not change the rating.

Foreign exchange market – Zloty should be back on track

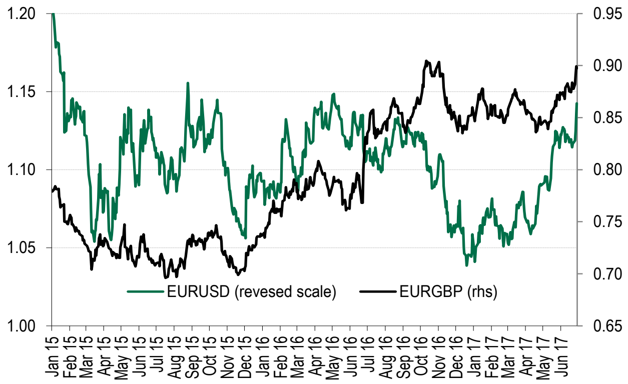
EUR/PLN



USD/PLN and GBP/PLN



EUR/USD and EUR/GBP



EUR/CZK

July is zloty appreciation's month

▪ The hawkish comments from global central bankers last week resulted in increased volatility of the zloty which moved widely in the range of 4.20-.4.25. Global risk aversion increase contributed to depreciation of CEE currencies in June.

▪ As you remember from our last Weekly that historically in July the zloty tends to be stronger against euro. We think that Wednesday's MPC decision will be neutral for the zloty as the Council managed to anchor monetary policy expectations to leave interest rates unchanged until late 2018/early 2019.

▪ In the coming week Polish PMI data will be released. We expect that better than expected data may boost Polish zloty. On Friday, Fitch will publish the credit outlook for Poland which, in our view, should be neutral for the zloty and Polish assets.

Draghi sparked the euro's rally

▪ The euro gained significantly against the dollar this year and EURUSD is now slightly above 1.14. The euro extended gains as investors now started to price in tighter monetary policy in the Euro zone, following hawkish comments made by Mario Draghi last week.

▪ The dollar slides to the lowest level since October 2016 as the market still waits for further signs of the Federal Reserve's likely rate hike trajectory through the end of the year. The pressure on dollar arises due to weakness of Trump's administration to push through his reforms package.

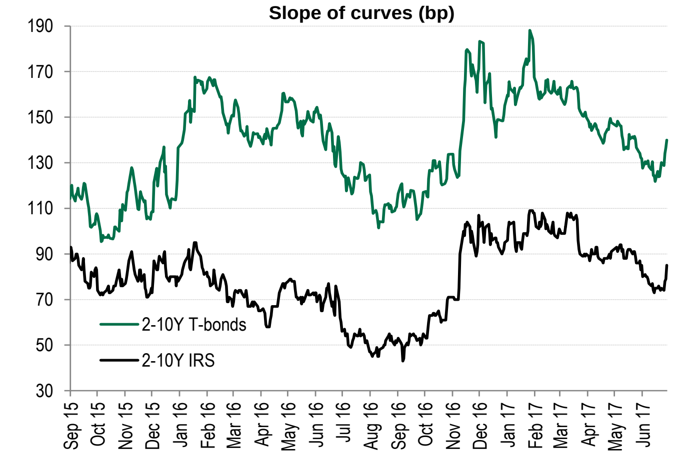
Czech central bank to rise interest rate in 3Q17

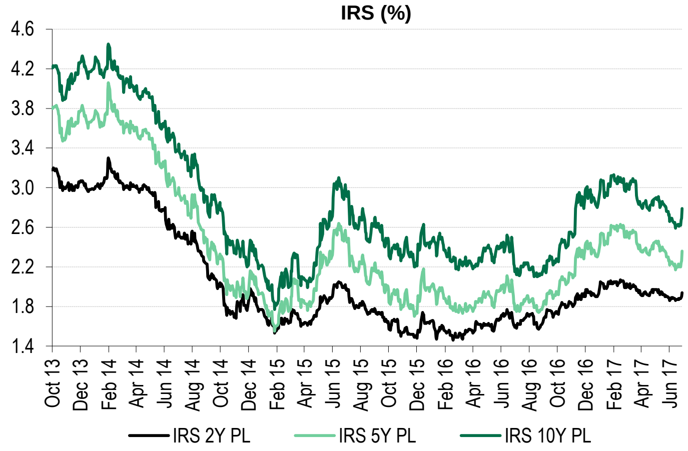
▪ Czech central bank (CNB) kept the main rate unchanged last week (0.05%), but signaled interest rate hike in Q317 and later in 2018 which would depend, however, on the macroeconomic data and the exchange rate of the koruna. According to the current forecast, inflation will stay in the upper half of the tolerance band around the target in 2017. It will decline towards the 2% target at the start of 2018 and remain very close to it during the year. The Bank Board assessed the risks to the current forecast as being slightly inflationary. Despite hawkish of the statement we expect the first 20bp hike to be delivered in 4Q17.

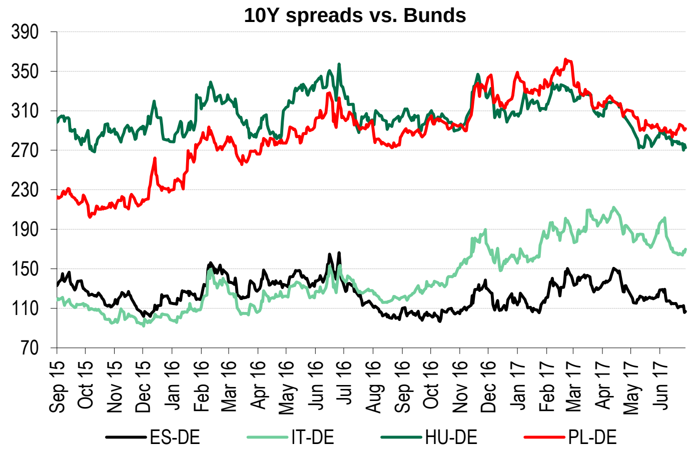
▪ In 2Q17 the koruna is the best performing currency vs the euro. We believe that expansion in Czech economy is supportive for the koruna in the medium-to-long run. The exchange rate remains a significant source of uncertainty for the monetary authorities in the Czechia who estimate that 1% appreciation of the koruna is effectively similar to 25bp interest rate hike. However, in the quarters to come, the Czech currency may be weaker than due to the closing of CZK positions by financial investors and risk hedging by domestic exporters as a result of the lack of a counterparty for these transactions. Moreover, 46.09% of Czech domestic bonds are held by non-residents.

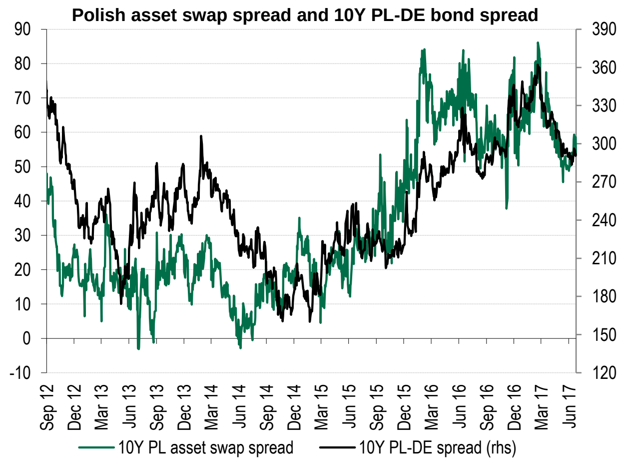
▪ The Russian rouble has remained stable recently. Despite higher oil prices, USDRUB stays close to 59 and the strengthening of the rouble is capped by both market sentiment and globally lower demand for emerging market assets.

Interest rate market – Global sell-off hit Polish debt









Hawkish bets weigh on Polish debt market

- Last week, Polish bond yield curve steepened with the strongest increase at the long end (-7bp). June was the second month of Polish 10Y bond weakening this year (after January when price dropped by c7%). Currently, 10Y yield is close to 3.30% and we think that in July it will move down to 3.10% with respective PL-DE spread between 290-300bp.
- IRS curve followed the bond yield curve last week.1-12M WIBORs did not move on a weekly basis. Asset swap spread tightened to 50bp.
- The hawkish comments from Janet Yellen and Mario Draghi surged yields of Bund and Treasuries by 19bps and 14bps respectively.
- The euro zone core inflation rise to 1.1% in June from 0.9% in May indicates the bias to the upside in the coming months.10Y-high reading of economic sentiment index in the Euro zone may suggest inflationary pressure is gaining steam, so ECB tightening may come earlier

Non-residents sold Polish bonds in May

- The Ministry of Finance informed that no bond auctions in July will be held. Bond supply in 4Q17 will be higher than PLN3-10bn announced for 3Q17.The Ministry plans to pre-finance 20-30% of 2018 borrowing needs. In order to reduce the burden of debt maturing in 2018 (PLN109.1bn), the switch auctions will be held in 4Q17. Moreover, MinFin needs to repay CHF1.03bn, EUR2.25bn and JPY50bn outstanding bonds in 2018.
- According to the Ministry of Finance data, in May foreign investors sold Polish PLN marketable bonds for nearly PLN0.5bn, taking the nominal value of their holdings to PLN209.5bn. The duration of their portfolio remained at the historic high of 4.84.
- Foreign commercial banks sold bonds for PLN1.25bn and the nominal value of their holdings fell to PLN6.1bn, the lowest level since comparable data has been made available (April 2004). The central banks and mutual funds cut their exposure by PLN718mn and PLN465mn, respectively. The major buyers in May were public institutions that increased their holdings by PLN1.35bn.
- Under the geographical criteria, non-residents from Europe but outside the EU bought bonds for PLN1.4bn and those from Asia (excluding Middle East) increased their portfolio by PLN386mn. Meanwhile, investors from the EU sold bonds worth PLN3.2bn.

Fitch in the spotlight

- In June Polish inflation eased to 1.5% from 1.9% in May. In our view, inflation is likely to hover near 1.5% in the next months as the base effects fade away. As inflation is close to lower bound of the target rate range, we do not expect any changes in Polish MPC's rhetoric. As a result, Wednesday's MPC meeting should be rather neutral for both domestic currency and the bond market.
- The Fitch's review of Polish rating will be announced on July 7, after the end of the session. We think this event should be neutral for the market.

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