WEEKLY ECONOMIC UPDATE

28 May – 3 June 2018

Last week was rich in swings of mood related to geopolitics, especially the US withdrawal from of the Iran deal, government talks in Italy and USA – China / North Korea talks. The events, coupled with worse macro data from the US and a bit more dovish FOMC minutes weighed on EM assets and supported the interest rate market. This has sent EURPLN to 4.32, this year's peak.

This week will be full of important data releases, including US labour market statistics, Polish CPI and GDP. In our view, May CPI will show a rebound to almost 2% y/y and this, given last signals from the MPC that the bias is becoming less dovish, however we think that it will be neutral for the Polish interest rate market. At the same time, we expect the dollar appreciation to halt, which can give the zloty a breath.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (28 May)					
		No important data releases					
		TUESDAY (29 May)					
16:00	US	Consumer Conference Board	May	pts	128.0	-	128.7
		WEDNESDAY (30 May)					
08:00	DE	Retail Sales	Apr	% m/m	0.5	-	-0.3
10:00	**PL**	**Flash CPI**	**May**	**% y/y**	**1.7**	**1.9**	**1.6**
10:00	**PL**	**GDP**	**1Q**	**% y/y**	**5.1**	**5.1**	**4.9**
11:00	EZ	ESI	May	pct.	112.0	-	112.7
14:15	US	ADP report	May	k	195	-	204
14:30	US	GDP Annualized	1Q	% q/q	2.3	-	2.3
20:00	US	Beige Book					
		THURSDAY (31 May)					
11:00	EZ	Flash HICP	May	% y/y	1.6	-	1.2
11:00	EZ	Unemployment Rate	Apr	%	8.5	-	8.5
14:30	US	Initial Jobless Claims		k	220	-	222
14:30	US	Personal Spending	Apr	% m/m	0.4	-	0.4
14:30	US	Personal Income	Apr	% m/m	0.3	-	0.3
14:30	US	PCE Deflator SA	Apr	% m/m	0.2	-	0.0
16:00	US	Pending Home Sales	Apr	% m/m	1.0	-	0.4
		FRIDAY (1 June)					
09:00	CZ	GDP SA	1Q	% y/y	4.5	-	4.5
09:00	**PL**	**Poland Manufacturing PMI**	**May**	**pts**	**53.1**	**52.9**	**53.9**
09:55	DE	Germany Manufacturing PMI	May	pts	56.8	-	56.8
10:00	EZ	Eurozone Manufacturing PMI	May	pts	55.5	-	55.5
14:00	**PL**	**MPC minutes**					
14:30	US	Change in Nonfarm Payrolls	May	k	195	-	164
14:30	US	Unemployment Rate	May	%	3.9	-	3.9
16:00	US	ISM manufacturing	May	pts	58.0	-	57.3

Source: BZ WBK, Reuters, Bloomberg

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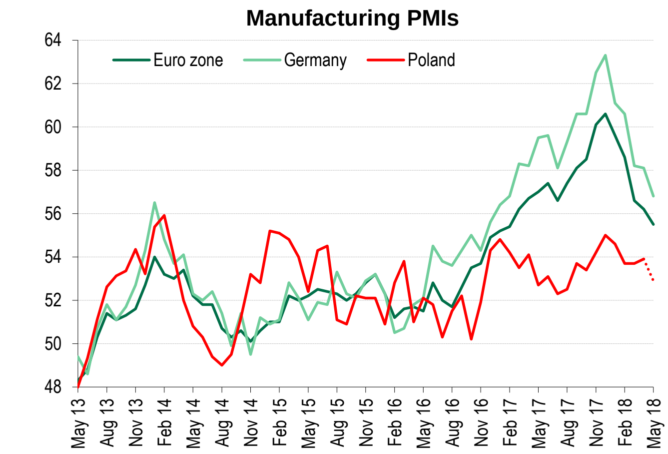
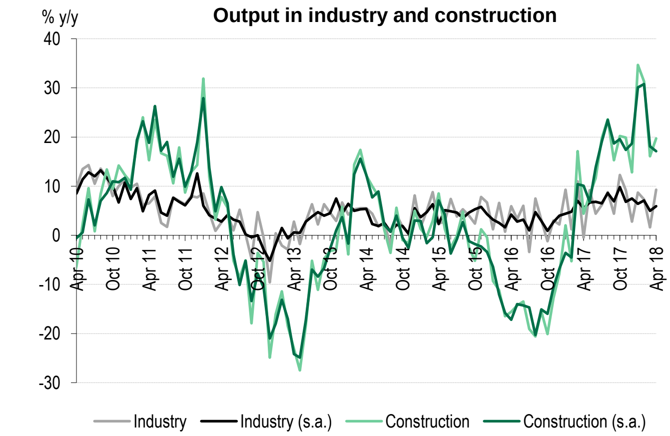
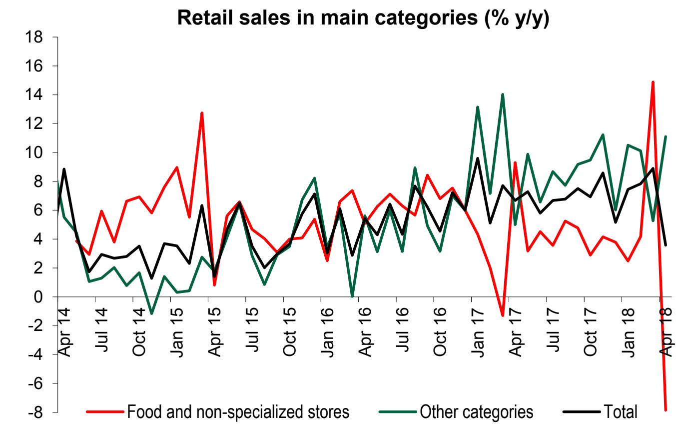
What's hot next week – Refuelled inflation



- CPI rebound should continue in May, mainly due to rising oil prices. Contribution of transport to y/y CPI growth might have risen by 0.4pp. in May, with fuel prices going up by 6% m/m and c9.5% y/y. In our view, some increase of core inflation also took place in May, marking a turning point after the three consecutive declines that reduced this measure from 1% y/y in January to 0.6% in April. We expect core CPI to rise above 1.5% this year.
- In 1H17 Polish PMI strayed away from the German index, but since 2H17 it is again following the same direction, albeit the Polish index is recently less volatile. The flash May reading for Germany disappointed, which is an argument to expect a decrease of the Polish index. On the other hand, business climate indicator prepared by Statistics Poland improved in May after two months of major declines.
- Detailed 1Q GDP data will be out this week. We expect the headline to be confirmed at 5.1%, private consumption to stay around 5% y/y and investments to accelerate to c10%.

Last week in economy – Sales down on Easter and trade ban, industry above expectations





- Industrial output expanded in April by 9.3% y/y versus 1.6% y/y one month earlier. Construction output rose by 19.7% y/y, much lower than market estimates (24.8% y/y). It could be a sign of supply side constraints in the sector, still seeing high demand, especially that construction prices rose by 2.1% y/y and this measure was at the highest level since January 2009. Read more here.
- Retail sales decelerated in April from 8.8% y/y to 4.0% y/y. Deceleration versus March was widely expected, given negative base effect due to Easter and Sunday trade ban (with shops closed on all April Sundays but one). Nevertheless, retail sales strongly surprised to the downside due to weak sales of food and in non-specialised stores. Meanwhile, the remaining categories bloomed. We maintain our view that private consumption will remain the main engine of economy growth this year, as it was in 2017, rising by c5%. We assume that retail sales growth will return to c7.0% y/y in the coming months. Read more here.
- Overall, the monthly data on output and sales did not make us revise our Poland GDP path still assuming gradual deceleration of an economic growth this year.
- Detailed data on wage growth in April confirmed that the acceleration to 7.8% y/y was driven by wage hikes in mining (+26.6% y/y). Growth in non-mining sector was just a notch higher, at 7.3% y/y versus 7.2% y/y in March.
- LFS unemployment rate went down to all-time low at 4.2% in 1Q2018. The employment growth stagnates, showing 0.4% y/y (vs average 1.4% y/y in 2017), while the number of the unemployed fell by as much as 23.4% y/y. At the same, economic activity indicator fell to 56.0% from 56.2% in 1Q17. Registered unemployment rate was confirmed by the Statistics Poland at 6.3% in April.

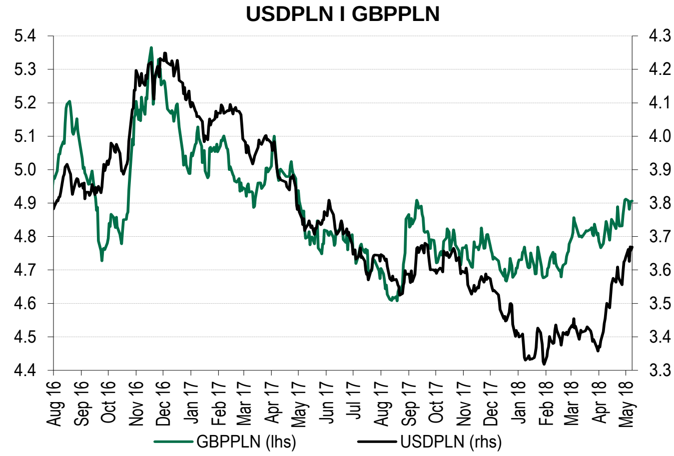
Quote of the week – Balance in the MPC has changed

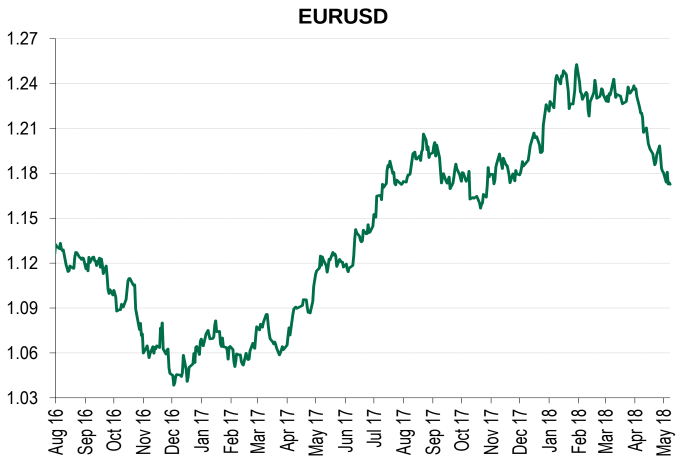
Kamil Zubelewicz, MPC member, PAP/Bloomberg, May 21

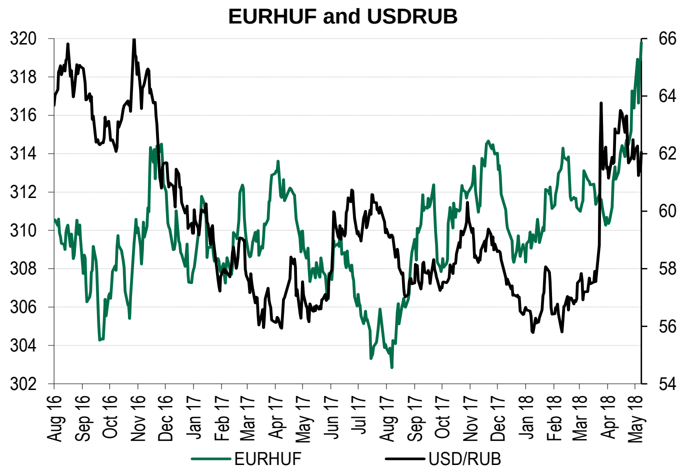
I get an impression that market has failed to notice the shift in Council's rhetoric: governor Glapiński clearly distanced himself from rate cuts; the call for cuts has not been present in the last MPC documents; the balance within the Council has shifted. Majority of earlier claims rates could be lowered has disappeared. (…) Raising interest rates to 2% and keeping them on that level would be the best solution. For now, the rates will be stable. (…) Three months ago, chances for rate hikes were slim, but now the situation within the council is very much balanced. The council will likely react when convincing proofs about risk factors for inflation growth appear. I think external factors receive more attention in Poland than the domestic ones, but both would have to appear simultaneously to see MPC react.

According to Kamil Zubelewicz chances for a rate hike rose recently but in his view no change should be expected. Zubelewicz's claim that the Council has recently become less dovish is quite surprising, given that we had just an opposite impression during the last press conference. Clearly, Zubelewicz has a better knowledge of what is happening during the MPC meetings than us, so we may have misinterpreted the evolution of the MPC bias. MPC minutes from the May meeting are due for release this week and we are curious to see whether this document will provide evidence for this shift in balance. With these remarks, Zubelewicz confirmed he is the most hawkish MPC member. We are of the opinion that majority for a hike could materialise in late 2019 at the earliest.

Foreign exchange market – EURPLN still high







EURPLN still high

- Polish currency remained under pressure of strong dollar and shaky global market sentiment amid poor European data and politicians' comments. As a result, EURPLN set a fresh 2018 peak at just below 4.32, USDPLN approached 3.70, CHFPLN jumped to 3.72 and GBPPLN stayed high at 4.92.
- EURPLN correlation with EURUSD remains high, with dollar appreciation clearly weighing on the zloty and its CEE peers. Globally, many US data that could drive EURUSD are on the agenda. As we write below, we think the dollar appreciation impulse is running out of steam and if this proves correct, the zloty might recover slightly, with EURPLN staying below 4.32.
- This week we will see detailed Polish 1Q GDP data but this should not trigger any material market reaction. At the same time, we think Poland CPI rose in May to just below 2.0% y/y and if the flash estimate confirms our call, this could provide some support for the zloty.
- However, the Thursday market holiday on Thursday in Poland is the risk factor to our scenario of stronger zloty. It is worth reminding that in early May the Polish currency got hit amid low liquidity when the domestic market was closed.
- First EURPLN resistance area to look at is 4.32-4.33. Support at 4.27.

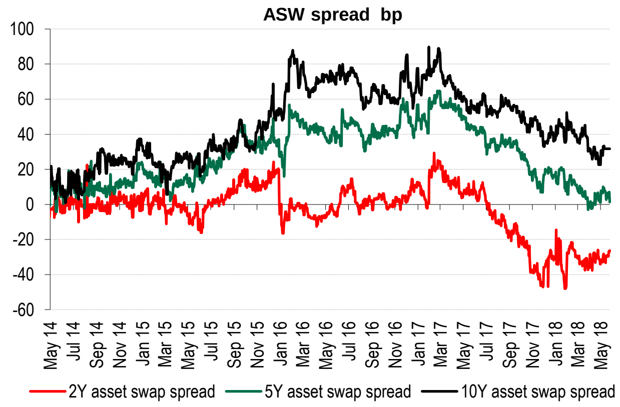
Poor data hit euro

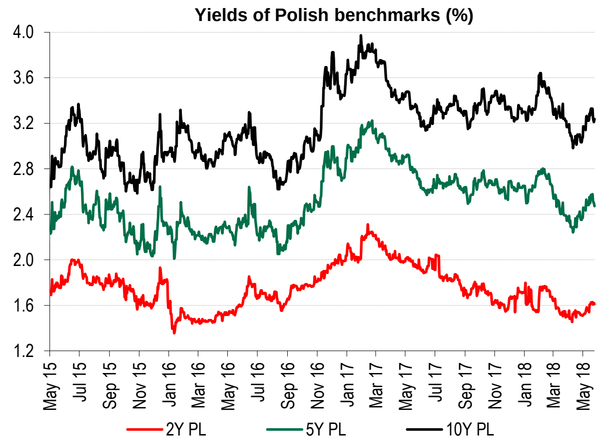
- EURUSD fell for the sixth week in a row amid deterioration of the global market sentiment and disappointing flash May PMIs released in Europe. As a result, the exchange rate was testing the 1.17 support and is close to this level at the end of the week.
- In the coming days, numerous US data will be released with the May non-farm payrolls due at the end of the week. This figure has disappointed in the previous two months and the market is hoping for an improvement this time as well.
- In our view, much of the last poor European data and the June Fed 25bp rate hike are already priced in, implying the potential for lower EURUSD is diminishing. Still, the risk factor to this scenario is Italian politics and any new controversial ideas presented by the coalition parties.

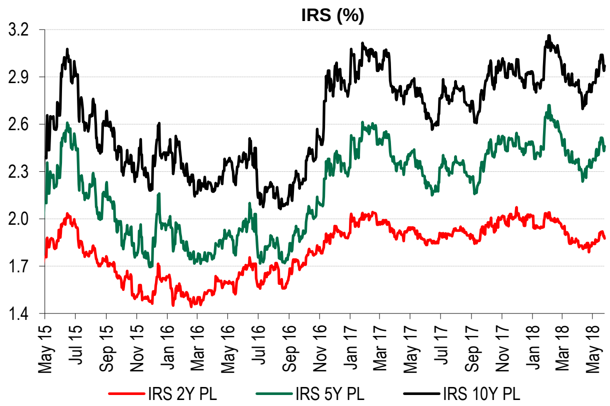
Forint underperforms amid dovish MNB

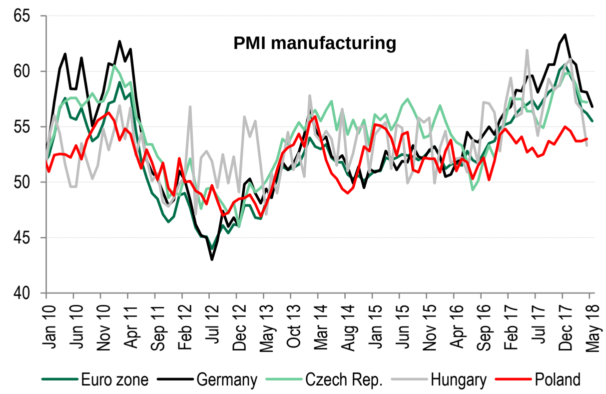
- Among the other CEE currencies, only the ruble gained as the oil prices remained high. EURCZK and EURHUF stayed in the up-trend and both exchange rates reached fresh 2018 highs. The forint was clearly underperforming as it depreciated to nearly 320 per euro, its weakest since mid-2016.
- Hungarian central bank (MNB) left interest rates unchanged, with the main rate still at 0.90%. In contrast to our expectations, the MNB rhetoric remained highly dovish despite the recent sharp forint depreciation and Hungarian yields jump. Maintaining the pledge to keep ease monetary conditions for an extended period might have negatively affected the forint last week.
- No important local data are on the agenda this week so the forint, koruna and ruble should stay highly sensitive to the global trend, particularly the dollar performance.

Interest rate market – Bonds supported by weaker leading indicators









Bonds prices higher amid cooling geopolitical tensions

- The past week saw the domestic t-bonds yields falling. The total decline was 10-14bp in the 5-10Y segment and 3bp in the short end. For the FRA curve, this translated into full pricing of the first hike in November 2019 (a week ago, the market was fully pricing in the first hike in August 2019) . These positive developments were caused by a slight weakening of geopolitical tensions (US-China tension cooling down as a result of formal negotiations) and insecurity in Europe, following the first decisions regarding the new Italian government. During the week, the debt and the interest rates derivatives market were supported by the weaker-than-expected PMI data from the euro area. Also, Statistics Poland business tendency were giving positive background for the improvement in domestic T-bonds pricing.

PMI pushes yields down

- This week we expect a further slight improvement in debt prices. We think that the yield curve will slide by 5-7 bp in the 5-10Y segment; this move should be accompanied by a slightly less downward move on the belly and long end of the IRS curve. On the short end of the yield and IRS curve, we expect a 3bp downward shift. As a result, we forecast the ASW spread to narrow by 2-3bp on the 5-10Y segment. For 10Y ASW spread it means returning to the level from the beginning of March, and 5Y ASW has a chance to break lows reported in June 2014.
- Decreases of bond yields, ASW spreads and IRS rates will be supported by the expected immunisation of financial assets to negative geopolitical signals. After the last few weeks when yields and spreads were being pulled up by shocks triggered by the political situation in Italy and the tensions connected with the US sanctions against Iran, as well as drastic changes in the US-China trade relations, we now expect this trend to reverse. The domestic bonds should be supported by Polish PMI data, which we expect to decrease in May, following the Eurozone PMI indices. The bonds will probably ignore the domestic inflation data for May. We anticipate the CPI to rise to 1.9% y/y in May, from 1.6% y/y in April, mainly owing to the rising oil prices, which is unlikely to worsen investors' moods. Moreover, in the domestic calendar, we will find the second reading of 1Q18 GDP, which is likely not to negatively affect the domestic bonds. The MPC minutes, Wednesday, will probably not threaten domestic bond valuations.
- Regarding global developments, there may be an adverse – but we believe temporary – effect, stemming from the release of US data (US non-farm payrolls). As for the PCE inflation as well as personal income and spending data, we expect no negative impact on debt, given the latest FOMC minutes, emphasising an absence of serious risks caused by inflation.

Regular auction

- On the Thursday's regular auction, the Ministry of Finance sold PLN3bn bonds, with 5Y fixed-coupon PS0123 being the most demanded one (cPLN1.4 sold). The bid-to-cover ratio was slightly above the last April level. After this auction, the Ministry of Finance covered 59% of its 2018 borrowing needs.

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