Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

4 – 10 June 2018

Concerns about political situation in Italy and Spain triggered risk aversion last week but the market stabilized on Friday after the Italian populist parties formed a government and Spanish PM was replaced. The robust US data also supported the mood. As a result, this week starts amid positive global market sentiment.

Domestic calendar contains only two important events. The MPC meeting shall not bring any new information. Despite Kamil Zubelewicz's suggestion that there has been a shift of opinion within the MPC, minutes of May meeting do not seem to confirm this hypothesis. We think Adam Glapiński will again dominate the press conference with his dovish remarks. On Friday after session close Fitch will release Poland rating update. We see some chance for the outlook upgrade from stable to positive after S&P took such decision in April. The agency may be encouraged by very good domestic economic and fiscal data. Currently, Fitch holds Poland at A- with stable outlook, between the grades attributed by S&P and Moody's.

We see potential for a stronger zloty this week, given that EURUSD downward momentum has gone out of fuel. Core bond yields climbed recently, but Polish papers are supported by low inflation, this week's MPC meeting and low T-bond supply in June. As a consequence, we see room for strengthening of Polish bonds this week.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (4 June)					
16:00	US	Durable Goods Orders	Apr	% m/m	-	-	-1.7
16:00	US	Factory Orders	Apr	% m/m	-0.5	-	1.6
		TUESDAY (5 June)					
03:45	CH	Caixin China PMI Services	May	pts	52.9	-	52.9
09:00	HU	GDP	1Q	% y/y	4.4	-	4.4
09:55	DE	Markit Germany Services PMI	May	pts	52.1	-	52.1
10:00	EZ	Eurozone Services PMI	May	pts	53.9	-	53.9
11:00	EZ	Retail Sales	Apr	% m/m	0.5	-	0.1
16:00	US	ISM services	May	pts	57.6	-	56.8
		WEDNESDAY (6 June)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
09:00	CZ	Industrial Production	Apr	% y/y	9.0	-	-1.1
09:00	HU	Industrial Production SA	Apr	% y/y	-	-	1.9
		THURSDAY (7 June)					
08:00	DE	Factory Orders	Apr	% m/m	0.8	-	-0.9
11:00	EZ	GDP SA	1Q	% y/y	2.5	-	2.5
14:30	US	Initial Jobless Claims		k	228	-	234
		FRIDAY (8 June)					
	PL	**Fitch Rating Review**					
08:00	DE	Exports SA	Apr	% m/m	-0.3	-	1.8
08:00	DE	Industrial Production SA	Apr	% m/m	0.3	-	1.0
09:00	HU	CPI	May	% y/y	2.6	-	2.3

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

Konrad Soszyński +48 22 534 18 86

Marcin Sulewski +48 22 534 18 84

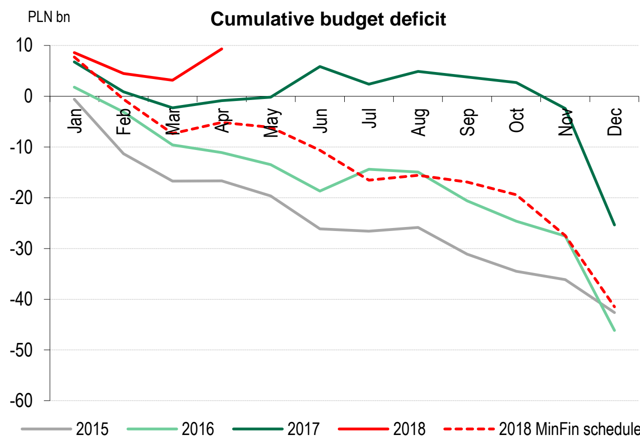
TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

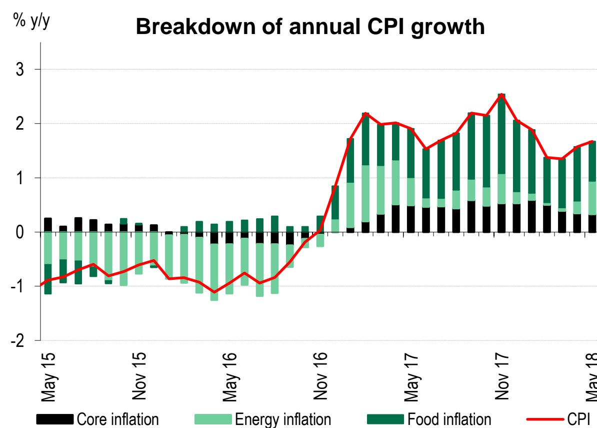
Wrocław +48 71 369 9400

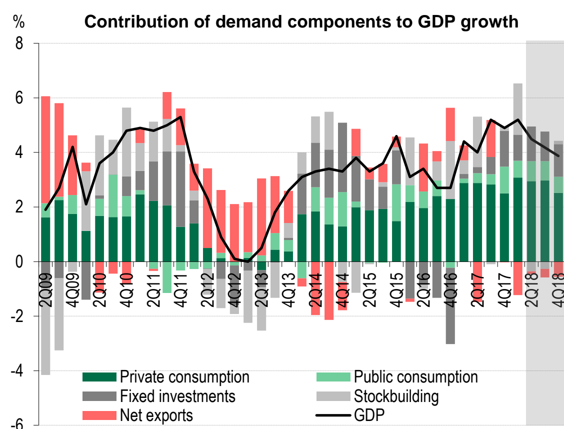
What's hot next week – Fitch opinion, MPC decision



- In April Moody's rating agency kept Poland at A2/stable while S&P maintained their BBB+ grade, but upgraded the outlook from stable to positive. Fitch announces its decision late next Friday. The agency holds Poland at A-, which is between the grades attributed by the other two institutions. This suggests it might go for an outlook upgrade as well. Fitch decisions are more correlated with S&P than with Moody's. In March 2005, both Fitch and S&P changed their outlook of the Polish rating (BBB+ at that time) from positive to stable. In 1Q07 both placed Poland at A-/stable, one notch up. Data-wise, since the S&P decision fiscal performance has got even better and GDP posted yet another upside surprise.
- Despite Kamil Zubelewicz's suggestion that markets overlooked a change of rhetoric to somewhat more hawkish at the May meeting, we think NBP governor Adam Glapiński will maintain a very dovish rhetoric at the press conference after the MPC meeting.

Last week in economy – GDP above, CPI below forecasts, again





- Flash CPI inflation rose in May to 1.7% y/y from April's 1.6% y/y. Once again, inflation data were lower than expected. Our forecast and market consensus were 1.9% y/y. The slower-than-expected rise in May was mainly due to the unexpected drop in food prices by 0.3% m/m. High fuel prices and the base effect should push CPI slightly above 2% in the next two months but later in the year inflation is likely to return below this level despite the gradual rise of core inflation (it was either flat in May, at 0.6% y/y, or a tad lower).
- GDP growth accelerated in 1Q18 to 5.2% y/y, the peak from 3Q17. Once again the headline surprised to the upside, as the flash estimate released two weeks ago was 5.1%. The growth breakdown looks a bit disappointing - surge in inventories was the only source of the positive surprise, adding as much as 1.9pp, while the remaining components disappointed, especially net exports stealing 1.2pp from the headline growth. Exports and imports growth decelerated sharply, the former down to 1.1% y/y, the slowest pace since 2009. The private consumption growth decelerated to 4.8% y/y from 5.0% y/y in 4Q17 (our forecast: 5.3% y/y), despite the accelerating growth of households income and record high consumer confidence. Gross investments growth accelerated to 8.1% y/y from 5.4% in 4Q17, while we had expected 10%.
- Local governments' investments rose by 83% y/y in 1Q vs over 40% y/y in the two previous quarters. In 1Q18, local governments contributed c3pp to total investment growth, in our view. Private investments may have risen by 5% y/y.
- We maintain our view that it will be difficult to sustain 5-percent pace of growth in the quarters to come. Still, the slowdown should be very gradual and the total 2018 growth should be only slightly below 4.6% seen in 2017.

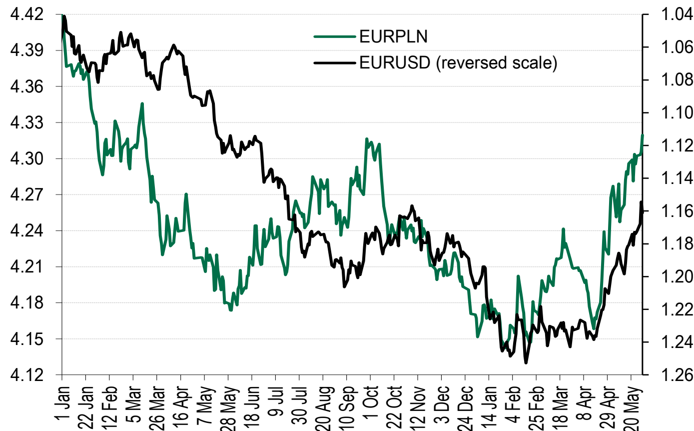
Quote of the week – EU cohesion funds allocation for Poland lower by 23%

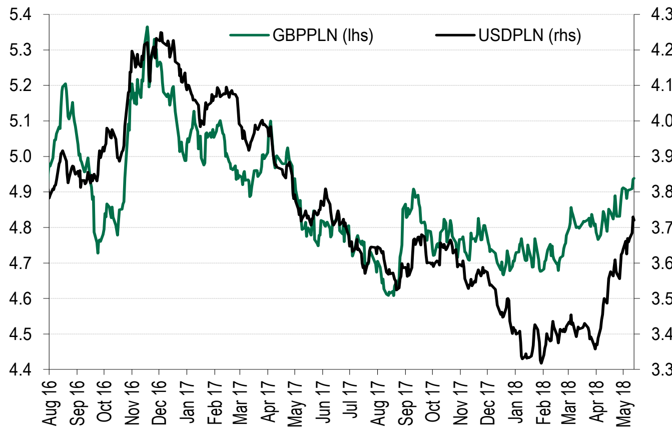
PAP comment on EC budget proposal, PAP, 30 May 2018

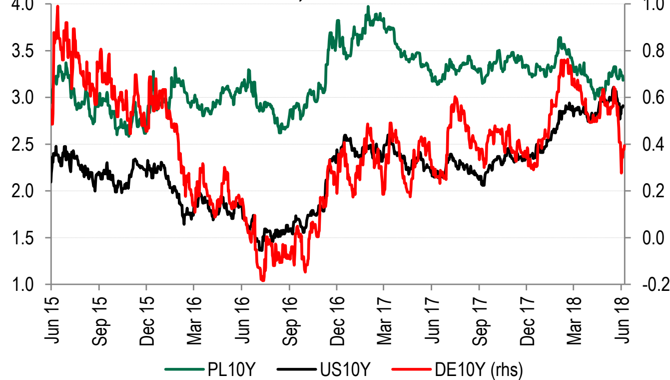
The main rationale for the adjustment was the decrease of funds after Brexit . . . New mechanisms for cohesion funds allocation – presented by EC – still base on relative wealth of the regions, but there are additional criteria such as youth unemployment, education level, climate change and hosting and integrating migrants. Total cohesion budget for EU for years 2021-2027 is to reach €373bn in commitments in current prices (accounting for inflation). Poland, which is the largest new country in the EU, is to get the largest share, €64.39bn in 2018 prices and €72.7bn in current prices . . . Regional development commissioner Corina Cretu indicated that many EU countries made great social and Economic progress, but at the same time many regions still suffer from high unemployment especially among the youth.

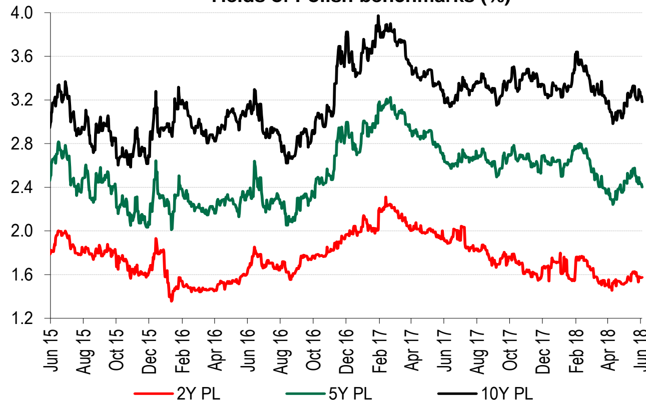
Total EU Cohesion Funds are to be cut by c10% in real terms in 2021-2027 Financial Framework, according to EC proposal. On top of this, Poland is going to lose additional 13% (so 23% in total) due to its economic expansion over the last years and higher weight of non-GDP indicators, such as youth unemployment, attained education or immigration. Proposal assumes around 20% cut in cohesion funds for many other countries (Czechia, Estonia, Lithuania, Hungary, Malta, Slovakia and Germany), so it is difficult to say that the reduction for Poland was exceptionally strong. Now the budget and the allocation will be negotiated and talks may last at least until 2019. The budget needs to be approved unequivocally, but the allocation by qualified majority. Polish PM Mateusz Morawiecki already announced he had no intention to back the EC proposal.

FX and FI market – Zloty and bonds may gain









EURPLN peak

- Global risk aversion related to situation in Italy continued to boost the dollar which in turn weighed on the zloty in the first part of the week. As a result, EURPLN jumped temporarily to c4.34 (its highest since March 2017), USDPLN broke 3.76 for a while (its highest since June 2017), GBPPLN jumped temporarily above 4.98 (highest since mid-2017) and CHFPLN neared 3.81 (highest since July 2017). At the end of the week, the zloty recovered slightly with EURPLN returning to 4.30. Polish GDP and CPI data provided little support for the zloty.
- Last week the Polish currency outperformed its CEE peers and the Hungarian forint was doing the worst vs the dollar and euro.
- Like in the previous weeks, EURPLN and EURUSD correlation remains high and we still think the global events will be crucial for the zloty. In our view, there is limited room for EURUSD to fall further – the pace of the down trend started in early May is getting high in terms of historical experience and technical analysis oscillators show there is little room for the trend to strengthen. Also, political situation in Europe looks to have stabilized increasing changes for the euro to take breath vs the dollar, making room for stronger zloty.
- This week's economic calendar is light with not too many important data releases. Situation in Italy looks to have stabilized after the new government has been established and Polish May PMI surprised to the upside and this could be positive for the Polish currency. Also, Fitch may release Poland rating update on Friday and market may price that the agency will follow April decision of Moody's to upgrade the outlook to positive.

Geopolitical tension drive debt market

- The first part of the last week, the bond yields and IRS rates were rising. The curve surge was mainly driven by high political tension in Italy and Spain. However, at the end of the week, the political tension eased which helped to move the yields down. Domestic CPI release (1.7% y/y vs. 1.9% y/y forecast) as well as GDP release (5.2% y/y vs. expected 5.1% y/y) had little impact on the debt market.
- This week we expect some downward correction on the domestic yield curve. The downshift will be supported by an improvement in the market's mood after the last week's political uncertainty in Italy had discouraged investors to buy risky assets. We think that the positive background for decreases in yields was built by domestic and European PMI data released last week, where the reading was clearly lower than April's one. Moreover, the Polish Flash CPI data release for May (1.7% y/y vs 1.9% y/y expectations), released last Wednesday, as well as information about planned supply on the June regular bond auction (PLN0-3bn, scheduled for 28 June) generated a bond-friendly environment.
- We think that this week the economic events calendar will have a positive impact on the domestic debt. In our opinion, on the Wednesday's MPC conference the Council will maintain its declaration to keep the interest rates on the current level at least up to H2 2019. Also, other events in this week economic-calendar (PMI-services release, where we expect a low reading, as well as rating revision by Fitch) are likely to help push valuations up. In the 3-4 weeks horizon we believe that likely lower industrial production data (which will be released in the 2H June), as well as wages data release (both possibly below expectations), will push the yield down. Regarding the ECB conference, we expect no negative surprises. In our opinion, the ECB conference will be focused on the tariffs on European products to be imposed by US and weak European PMI data release.

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