

WEEKLY ECONOMIC UPDATE

10 July – 16 July 2017

Global investors are still afraid of the possible turn in monetary policy of the main central banks towards less easing – which lies beneath the current sell-off on equities and bond markets. At the same time the Polish monetary policy still has a ‘scent of stability’ as the NBP governor Adam Glapiński called it at the MPC press conference last week. In line with our view, the changes in the NBP projections of GDP growth and inflation were minor and the stance of the Council was also practically unchanged. With central banks’ policy in the spotlight what will be particularly important for the markets in the coming week will be further remarks by Fed and ECB members (eg Janet Yellen’s testimony in the US Congress on Wednesday) and June inflation data (USA, Poland and other CEE countries).

This week we will learn what stood behind the strong decline in Poland’s CPI in June. It seems to us that the low CPI headline could not have been achieved without core inflation moving down. However, the CPI decline below 2% may prove temporary, as an opposite signal may be delivered by the new ‘road fee’ raising fuel prices by PLN 0.25. The bill introducing this new tax is already in the parliament and September 2017 is the earliest possible date of its entry into force, in our view. We expect the May 2017 data on balance of payments to show a major acceleration of exports and imports as well as current account surplus higher than market forecast.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (10 July)							
8:00	DE	Exports	May	% m/m	-	-	0.9
TUESDAY (11 July)							
9:00	HU	CPI	Jun	% y/y	2.0	-	2.1
14:00	PL	CPI	Jun	% y/y	1.5	1.5	1.9
WEDNESDAY (12 July)							
9:00	CZ	CPI	Jun	% y/y	2.3	-	2.4
11:00	EZ	Industrial output	May	% m/m	-	-	0.5
14:00	PL	Core inflation	Jun	% y/y	0.8	0.6	0.8
20:00	US	Fed Beige Book					
THURSDAY (13 July)							
14:30	US	Initial jobless claims	week	k	-	-	248
FRIDAY (14 July)							
14:00	PL	Current account	May	€m	247	609	-275
14:00	PL	Exports	May	€m	16 083	16 449	15 176
14:00	PL	Imports	May	€m	16 182	16 397	15 090
14:30	US	CPI	Jun	% m/m	0.1	-	-0.1
14:30	US	Retail sales	Jun	% m/m	0.1	-	-0.3
15:15	US	Industrial output	Jun	% m/m	0.3	-	0.0
16:00	US	Flash Michigan	Jul	pts	-	-	95.1

Source: BZ WBK, Reuters, Bloomberg

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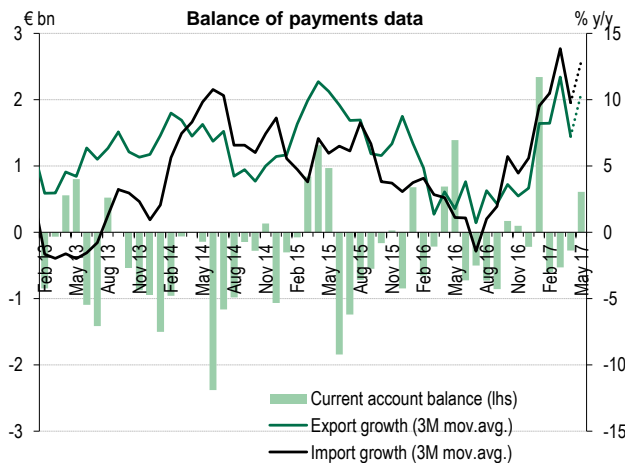
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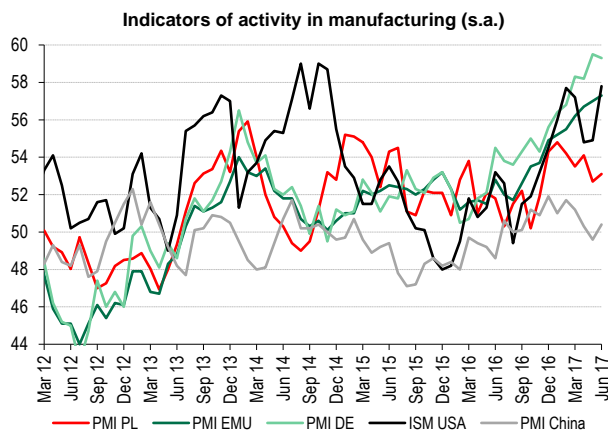
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What's hot next week – CPI and balance of payments

- Flash estimate of Polish June CPI, 1.5% y/y, was much below forecasts. This surprise made the full report a highly awaited release. Based on our calculations it seems likely that the low CPI headline could not have been achieved without core inflation moving down. Lower CPI in June may lower the whole path for the rest of 2017 (December is likely to show 1.2% y/y), but the new 'road fee' in fuel prices may make CPI go up by 0.4pp. At the same time, we expect core inflation to resume its upward trend in the upcoming months.

- BoP data from May will show a marked acceleration of both exports and imports to double-digit levels, in our view. Moreover, we are expecting a considerable surplus on the current account balance and our forecast is clearly above the consensus. We are expecting healthy growth rates of both exports and imports in the months to come. Yet, imports will be more dynamic, so trade balance will be less positive.

Last week in economy – PMI up slightly, NBP projections showing a bit stronger growth

- June manufacturing PMI rose from 52.7 to just 53.1 pts which means that the negative gap between the sentiment in Poland and the Euro zone remains historically quite high. The report accompanying the PMI release presents a positive picture with a substantial rebound of domestic new orders (this was the component responsible for causing a negative surprise in the previous release). Current output and total new orders are still rising, while the negative surprise with the headline might be related to weakness in employment sub-index (pointing to the weakest increase in almost 3 years). This confirms that the labour market is already tight in Poland, which could now be a bottle neck for further expansion, or at least could cap the local PMI. Let us note that other employment indicators also seem to lose steam and this may be putting a downward pressure on PMI in the months to come.

- The Monetary Policy Council kept the main interest rates unchanged, as expected. The new projection of the central bank showed higher GDP growth in 2017 than previously and its slowdown in the two following years towards the previously expected path. Meanwhile, inflation projection for 2017 has been lowered slightly, while in the next two years is similar as predicted in March. The tone of the MPC statement remained dovish, as we anticipated.

- To sum up, both the MPC statement and new inflation projection support our expectations that the monetary policy outlook in Poland remains unchanged. In our view, interest rates will go up in 4Q18.

	GDP growth			
	Jul 16	Nov 16	Mar 17	Jul 17
2017	2.4÷4.5	2.6÷4.5	3.4÷4.0	3.4÷4.7
2018	2.1÷4.3	2.2÷4.4	2.4÷4.5	2.5÷4.5
2019	-	-	2.3÷4.4	2.3÷4.3
	CPI Inflation			
	Jul 16	Nov 16	Mar 17	Jul 17
2017	0.3÷2.2	0.5÷2.0	1.6÷2.5	1.6÷2.3
2018	0.3÷2.6	0.3÷2.6	0.9÷2.9	1.1÷2.9
2019	-	-	1.2÷3.5	1.3÷3.6

Quote of the week – Scent of stability in Poland

Adam Glapiński, NBP president, 5 July 2017

I can say that it is highly probable that rates will remain unchanged in 2018. Yet I cannot rule out that discussion about hikes may start in 2H18. (...) There are no imbalances in the Polish economy, inflation is stable (...) There's a scent of stability in Poland.

Eugeniusz Gatnar, MPC member, 5 July 2017

Stabilisation of NBP rates means we will face 2.5-year long period of negative real interest rates. I am worried about that (...) we have already witnessed an outflow of deposits in May.

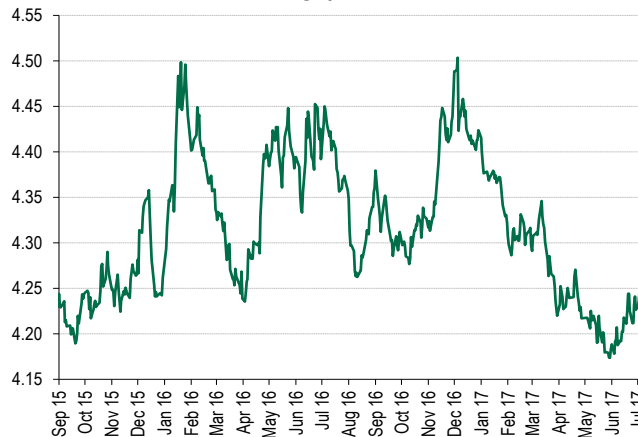
Kamil Zubelewicz, MPC member, 5 July 2017

The projection confirmed we are unlikely to exceed the target before 2019. Does it mean no rate changes? Not necessarily, as acceleration of price growth will be crucial.

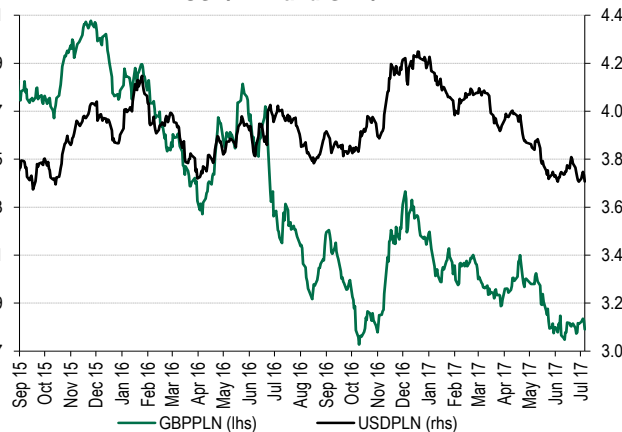
NBP president Adam Glapiński admitted that the internal discussions about monetary tightening in the Monetary Policy Council might start in mid-2018, even though he is a supporter of keeping rates unchanged. Comments of Zubelewicz and Gatnar show that the divergence of views in the rate-setting panel is already growing. In our view, inflation will be stay in 2H17, but then will rise in 2018 and this development will fuel a further rise in divergence between MPC members' views. Yet, the majority of the Council members should continue supporting the view presented by Glapiński, so rates will remain unchanged until 4Q18.

Foreign exchange market – Zloty stable again

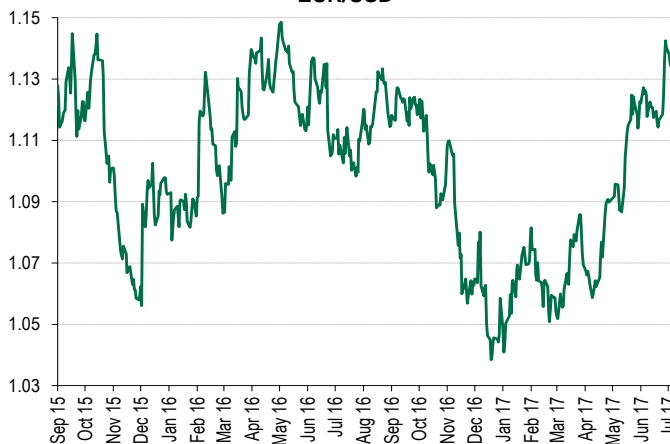
EUR/PLN



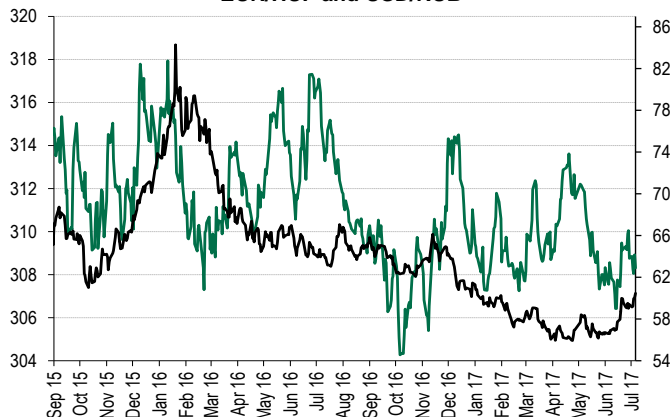
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



Zloty stable again

Since the beginning of the week EURPLN was very stable hovering around 4.24 and the weekly trading range has been the narrowest since June 2016. USDPLN stayed in the previous week's trading range (3.69-3.78). Polish currency remained fairly resilient to rather poor sentiment persisting on the global equity market and to a significant sell-off of Polish bonds.

Somewhat hawkish signals from the ECB and Fed have recently been an important factor driving the zloty. This week Janet Yellen will give a speech in the US Congress and her colleagues from the FOMC also have planned their speeches. All comments of the US central bankers should be viewed in the context of the most recent economic activity data, including the last rather optimistic monthly jobs report.

On the domestic side, May balance of payments data are due on Friday and we expect that the C/A surplus could be much bigger than the market expects. This figure might support the zloty at the end of the week. Final June CPI should be meaningless.

EURPLN's volatility has faded again in the recent weeks. 4.20 and 4.26 are important levels to watch, in our view, and we think that global trends shall remain the core factor driving the Polish currency.

EURUSD waits for a trigger

Last week EURUSD stabilized near the multi-month peak at c1.145 reached in late June after some hawkish signals from the ECB.

We think that the issue of monetary policy will continue to play the main role on the market. This week Fed's Yellen will give a speech in the US Congress but this will not be the only comment of the FOMC member planned for the coming days. EURUSD has recently rallied and if the market attention turns to the US and central bankers sound hawkish, then the dollar could recover vs the euro.

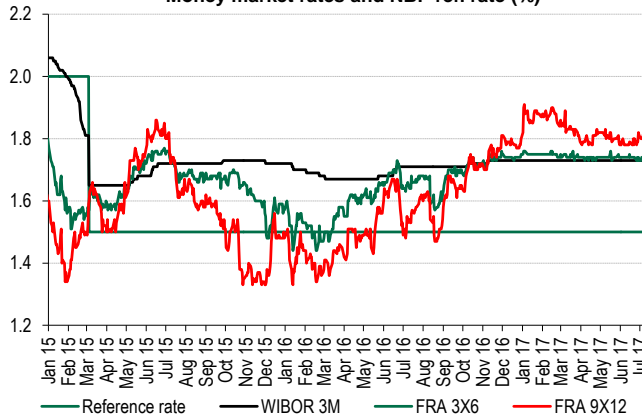
Ruble under pressure, koruna and forint wait for CPI

Last week the ruble was clearly underperforming its CEE peers. USDRUB rose slightly above 60.50 breaking the mid-June peak reached soon after the "hawkish" Fed rate hike. In the last few days the Russian currency was under an additional pressure of falling oil prices. At the same time, Czech koruna and Hungarian forint were pretty stable.

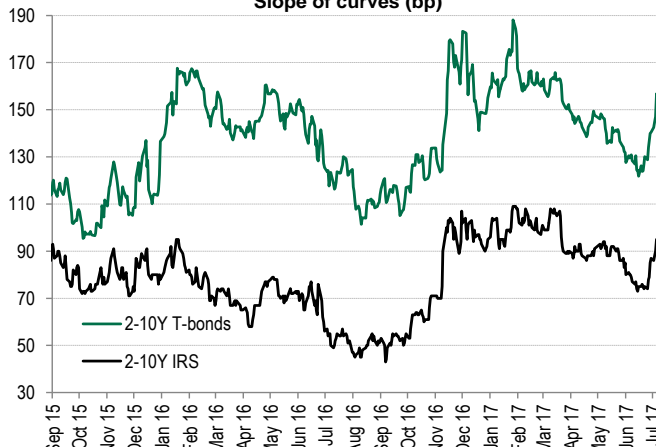
This week we will learn June CPI figures for Czechia and Hungary. National bank of the former has recently adopted a clear hawkish bias while the latter is still on the dovish side. In both cases, recent months saw inflation retreating slightly from the multi-month peaks and this week's releases could have a short-term impact on the forint and koruna.

Interest rate market – Central banks still in focus

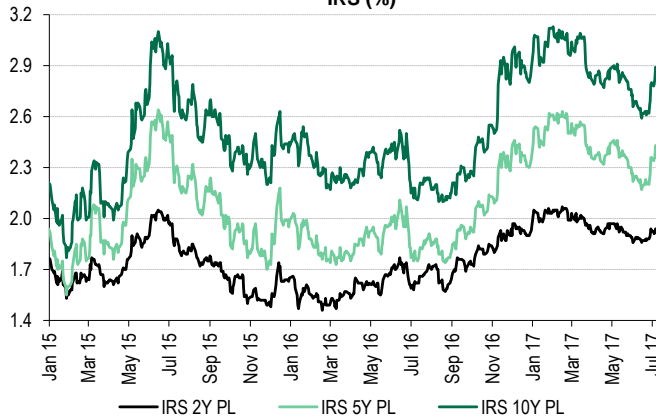
Money market rates and NBP refi rate (%)



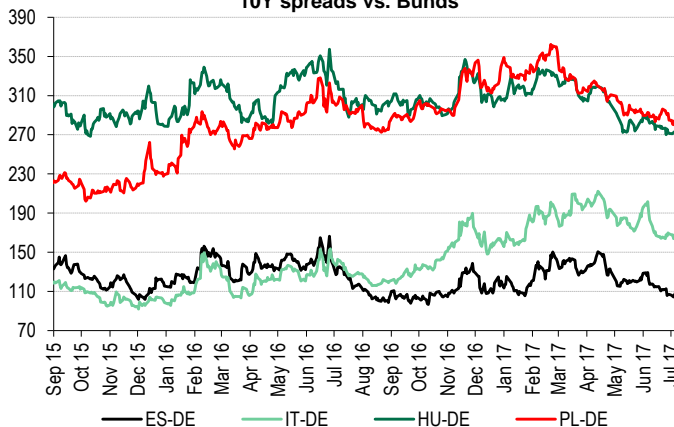
Slope of curves (bp)



IRS (%)



10Y spreads vs. Bunds



Upside pressure on rates continues

During the first week of July Polish bond and IRS curves have significantly steepened following the global trend. In reaction to hawkish minutes from Fed and EBC, the Bund and Treasury 10Y bond yield increased by nearly 9bp to 0.55% and 2.37%, respectively. Investors sold off EM bonds massively with Czech yields rising by 11bp and Hungarian by 12bp on weekly basis. In Poland, the 10Y bond yield rose 7bp to 3.37% (its highest since early May) and the respective IRS jumped 8bp to 2.88%. The 2-10Y bond spread rose to 157bp, the highest level since mid-March 2017 and respective spread for IRS approached 95bp. Polish bonds outperformed their German peers and the 10Y PL-DE spread tightened to c280bp, level not seen since September 2016.

The dovish MPC managed to anchor the market expectations for no interest rate changes for the extended time and as a result Polish 2Y bond yield fell 6bp to 1.82%, the lowest level since US elections. At the same time 2Y IRS rate rose by 5bp.

FRAs remained pretty stable last week as the MPC did not surprise with its rhetoric. Currently the market is pricing the first 25bp hike in 15 months which is roughly in line with our current base scenario.

Central banks still in focus

We think the market attention could remain focused on the direct signals from the central banks. This week Janet Yellen will give a speech in the US Congress and some other FOMC members will also express their opinions on the monetary policy outlook.

Recent market reaction to the signals from the ECB and Fed was already very sharp. This could give some room for recovery should next comments not be that hawkish but on the other hand for the time being the market is not pricing the December (not to mention September) Fed rate hike which implies there is still potential for higher market rates. This is our base case scenario for the coming months but some downside corrections should be expected (as the rebound in inflation does not seem to be persistent for now). Recall also that net debt supply in Poland will be negative in 3Q which would also work towards some recovery.

We do not think Polish macro data will have an important impact on the domestic IRS/yields this week.

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