Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

14 – 20 May 2018

Past two weeks have been pretty volatile on the global market and this has had also a noticeable adverse impact on the EM currencies and bonds. Low liquidity on the Polish market in early May inflated changes on the Polish market pushing EURPLN to nearly 4.30 and 10Y yields by c30bp up. At the same time, Polish April's PMI surprised to the upside giving signal that there is no sharp economic slowdown just around the corner.

This week we will see Poland flash 1Q18 GDP data. We think the headline figure could stay close to 5% which might be positively received by investors. MPC rhetoric should not change much and be market-neutral. There are still geopolitical risks in the air and the markets may remain unstable in the short-term. As a result, we are reserved as regards the room for zloty appreciation and think bonds may perform quite well in the coming days.

Economic calendar

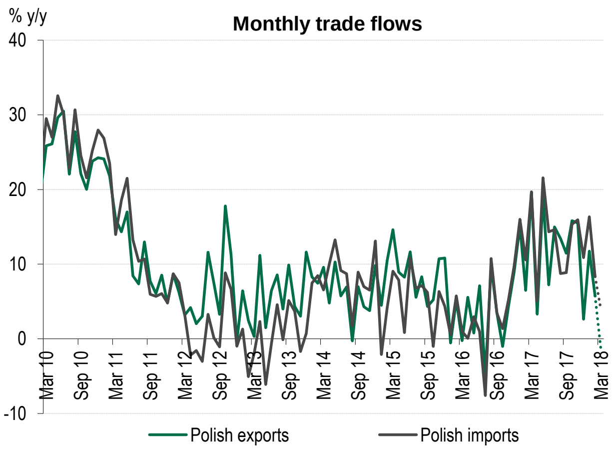
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 May)					
14:00	**PL**	**Current Account Balance**	**Mar**	**€mn**	**-1 088**	**-1 184**	**-1 017**
14:00	**PL**	**Trade Balance**	**Mar**	**€mn**	**-502**	**-625**	**-573**
14:00	**PL**	**Exports**	**Mar**	**€mn**	**18 075**	**18 230**	**16 271**
14:00	**PL**	**Imports**	**Mar**	**€mn**	**18 522**	**18 855**	**16 844**
		TUESDAY (15 May)					
08:00	DE	GDP WDA	1Q	% y/y	2.4	-	2.9
09:00	CZ	GDP SA	1Q	% y/y	4.8	-	5.5
09:00	HU	GDP	1Q	% y/y	4.2	-	4.4
10:00	**PL**	**CPI**	**Apr**	**% y/y**	**1.6**	**1.6**	**1.4**
10:00	**PL**	**GDP**	**1Q**	**% y/y**	**4.8**	**4.9**	**4.9**
11:00	EZ	GDP SA	1Q	% y/y	2.5	-	2.5
11:00	EZ	Industrial Production SA	Mar	% m/m	0.6	-	-0.8
11:00	DE	ZEW Survey Current Situation	May	pts	86.2	-	87.9
14:30	US	Retail Sales Advance	Apr	% m/m	0.4	-	0.6
		WEDNESDAY (16 May)					
	PL	**Poland Base Rate Announcement**		**%**	**1.5**	**1.5**	**1.5**
08:00	DE	HICP	Apr	% m/m	-0.1	-	-0.1
11:00	EZ	HICP	Apr	% y/y	1.2	-	1.2
14:00	**PL**	**CPI Core**	**Apr**	**% y/y**	**0.6**	**0.7**	**0.7**
14:30	US	Housing Starts	Apr	% m/m	0.1	-	1.9
15:15	US	Industrial Production	Apr	% m/m	0.6	-	0.5
		THURSDAY (17 May)					
14:30	US	Philly Fed index	May	pts	21.7	-	23.2
14:30	US	Initial Jobless Claims	week	k	219	-	211
		FRIDAY (18 May)					
10:00	**PL**	**Employment in corporate sector**	**Apr**	**% y/y**	**3.7**	**3.7**	**3.7**
10:00	**PL**	**Average Gross Wages**	**Apr**	**% y/y**	**7.1**	**7.4**	**6.7**

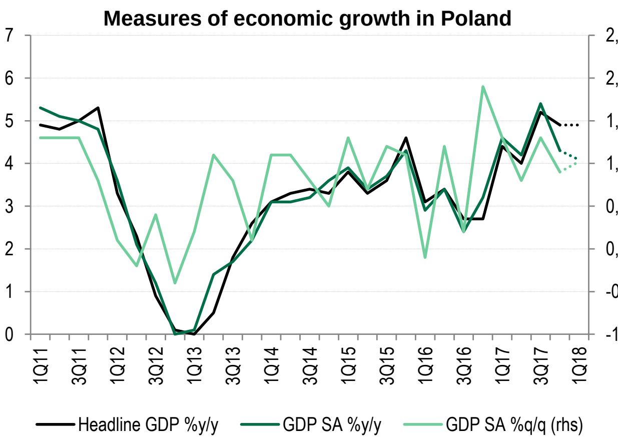
Source: BZ WBK, Reuters, Bloomberg

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 – MPC meeting, flash GDP, inflation and balance of payments





- We are expecting the MPC meeting to be a non-event. During the last meeting in April Polish central bankers were super-dovish and since then there was no information that could have possibly affected this bias.
- In our view, March current account deficit will be close to EUR1.2bn. The deterioration versus the last year (EUR0.3bn) will be mostly due to changes in the goods balance, with exports falling by c1.5% y/y and imports rising by c3.5% y/y. Note that exports were surprising to the downside for the last three months, showing that their path in 2018 is way lower than market analysts had expected. Product breakdown shows that most disappointing results were recorded by transport equipment and industrial supplies, i.e. by sectors being a part of global production chains and thus most correlated with the global business climate.
- April's flash CPI reading for Poland was 1.6% y/y and we are expecting this reading to be confirmed by Statistics Poland. According to flash number, the rise in inflation was attributable to non-core components, especially fuels. April's Core CPI estimate based on partial information from the flash release is 0.6-0.7% y/y - basically unchanged compared with March's 0.65%. We expect core inflation to begin systematically to rise soon, possibly exceeding 1.5% y/y this year. In our view, headline inflation will recover further in the months to come, rising above 2% for a couple of months around mid-2018, before descending to 1.8% y/y by year end.
- We are expecting the GDP growth to stay at 4.9% y/y, unchanged versus 4Q17. Detailed breakdown will not be released until the end of May, but in our view it will prove similar to that observed recently, with private consumption being the main contributor. We are expecting investment to revive further, possibly reaching a double-digit growth.

Last two weeks in economy – PMI inched up, unemployment rate down at slower rate

- Polish manufacturing PMI has beaten expectations with its April reading of 53.9 points (market consensus was 53.2 points, while the previous reading was 53.7 points). As in the case of some Euro zone PMIs, the rebound in April is small compared to the scale of the decline seen in business sentiment indicators in 1Q (the Polish PMI was 55 points in December). The PMI report stresses a somewhat stronger current output, the still strong employment component, plus some improvement in new export orders.
- According to the Labour Ministry, in April the registered unemployment rate fell to 6.3% from 6.6% in March, in line with our forecast. In monthly terms, the number of unemployed fell by 48k, i.e. visibly less than one year ago (72k). Downward trend of unemployment is slowing down, we are expecting the figure to be slightly below 6.0% at the year-end.

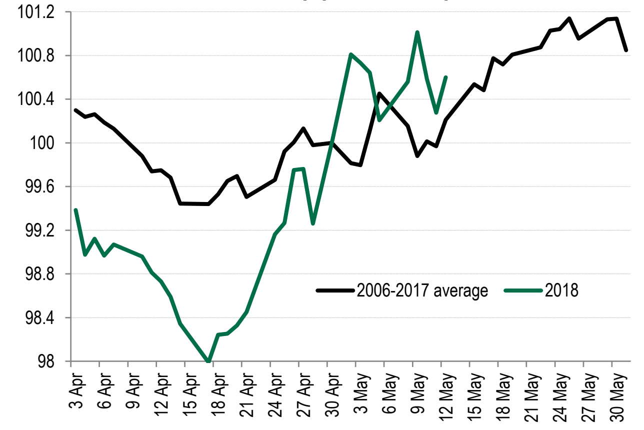
Quote of the last two weeks – Generalised deficiencies as regards the rule of law

European Commission, EU budget draft presentation, May 2
The proposal envisages measures proportionate to the generalised deficiencies as regards the rule of law, including the suspension, and reduction of funding under existing commitments, or the prohibition to conclude new commitments with specific categories of recipients.
A major innovation in the proposed budget is the strengthened link between EU funding and the rule of law. Respect for the rule of law is an essential precondition for sound financial management and effective EU funding.
Věra Jourová, EU Justice Commissioner, May 2
European taxpayers' money cannot be used in a member state that doesn't respect the rule of law. It would be theoretically possible to launch the new procedure for Poland if it was already in force.

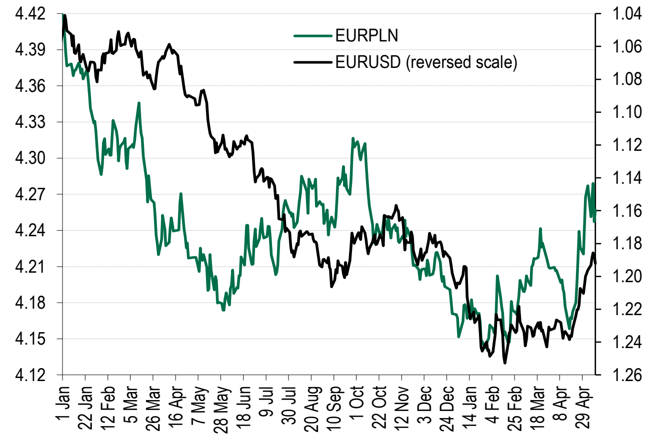
According to European Commission's draft, EU budget for 2021-2017 will be EUR1.279trn – nominally more than the 2014-2020 framework, despite Brexit. However, the policies that made Poland a huge net beneficiary will see reduced allocations. Cohesion policy is to receive 7% (or 12%, according to other sources) less than in the 2014-2020 budget and Common Agricultural Policy 5% (possibly even 20%) less. The distribution of 80% of funds under the cohesion policy will still be based on relative wealth – and Poland made much progress in this respect (which means it could receive a smaller share, but pay a larger contribution, also linked to GDP). On top of this Poland is at risk of having its allocated funds frozen or even taken away if the rule of law issue between Poland and the EC is not resolved. Country allocations should be announced between May 29 and June 12.

Foreign exchange market – Volatile turn of the month

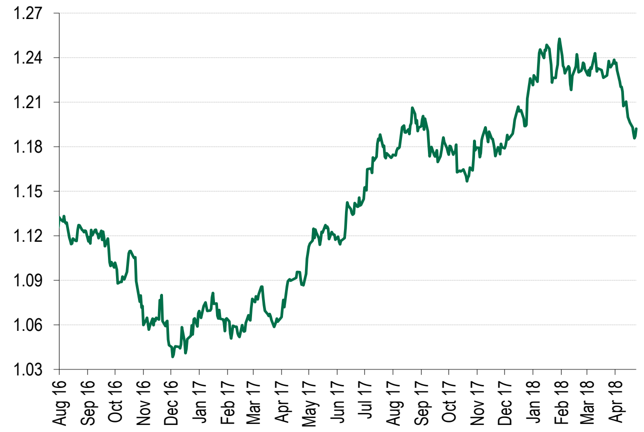
EURPLN (April 30 = 100)



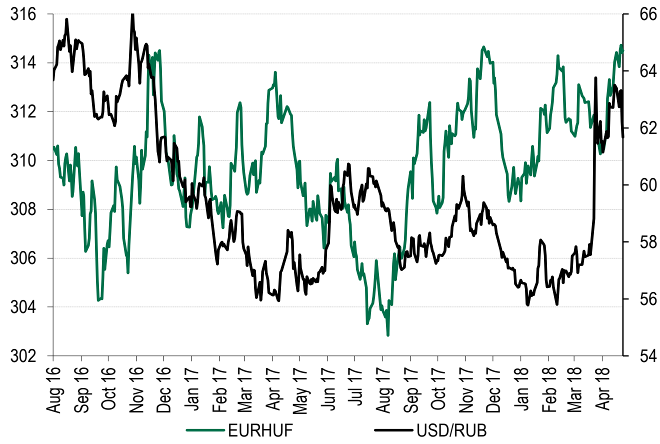
EURPLN and EURUSD



EURUSD



EURHUF and USDRUB



Zloty under pressure

- In the last two weeks, the zloty remained on the back foot as the dollar continued to gain on the global market weighing on the EM currencies. The zloty was one of the worst performers and this might have been due to lower liquidity on the domestic market in early May and fact that the zloty appreciated much in 2017 which might have made him sensitive to jumps in the global market volatility. As a result, EURPLN neared 4.30 and USDPLN skyrocketed above 3.63, their highest level for months.
- Statistically, May is rather unfavourable month for the zloty. In the last nine years, Polish currency ended that month with a gain versus the euro and the dollar only twice. The first chart shows that only within the first two weeks of May this year EURPLN recorded a rise typical for whole month in the previous years. This gives hope that the exchange rate may now stabilize and investors take opportunity from cheap currency and higher bond yields.
- The dollar performance has also had an impact on the zloty. Like we write below, it looks there is little room for lower EURUSD in the short term and should the exchange rate rebound, this can also give a relief for the zloty and its EM peers.
- This week we will see Poland flash 1Q18 GDP data. We think the headline figure should stay close to 5% which might be positively received by investors. However, the geopolitical risks are still in the air and we are reserved as regards the room for zloty appreciation. MPC rhetoric should not change much, which should be market-neutral.
- We think EURPLN may stay above 4.23-4.24 area in the weeks to come.

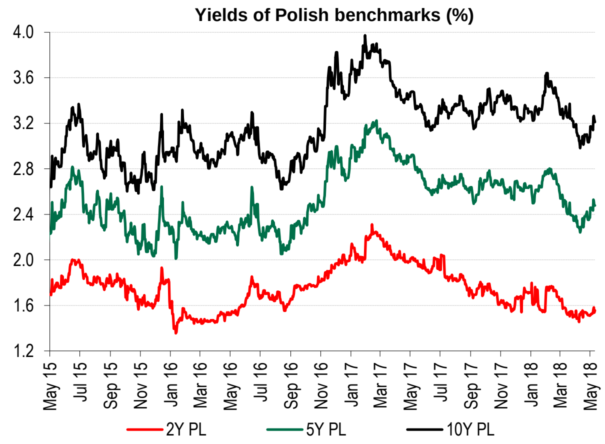
Macro data pull EURUSD down

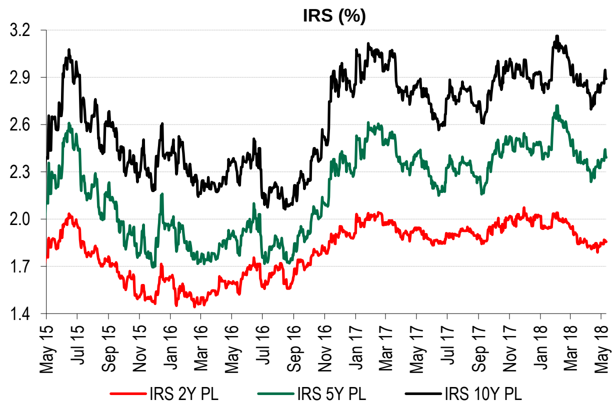
- EURUSD horizontal trend observed since the beginning of the year terminated as some above-consensus US releases boosted the dollar and the European economic activity data disappointed on many fronts hitting the euro. As a result, the exchange rate fell to c1.18, its lowest since December.
- We think the dollar could keep its gains in the short-term but soon the euro should start to recover. We assume that the recent single currency depreciation was overdone given the expected economic trend – we expect activity in the euro zone to remain decent in the months to come.
- This week, market attention should focus on the US data and speeches of the FOMC members. After the recent dollar rally, we think there could be bigger market reaction to below-consensus readings rather than to positive surprises as the market has nearly priced-in the June Fed 25bp rate hike.

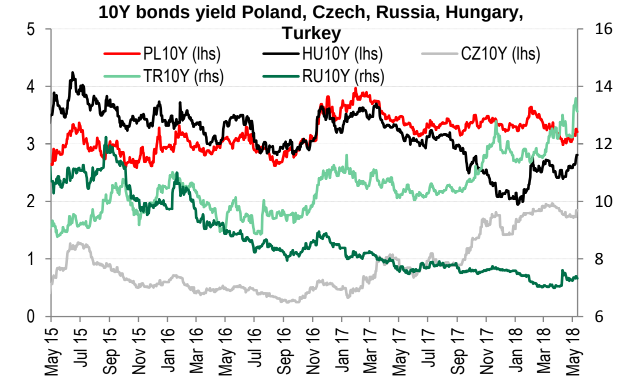
Mixed performance of CEE currencies

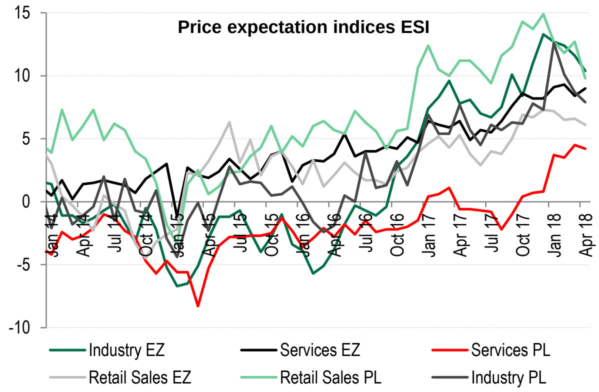
- In Looking at the forint, koruna and ruble, the latter outperformed as the oil price was on the rise keeping USDRUB below April peak at 65. EURCZK jumped above 25.8 only for a while and soon corrected below 25.6. At the same time, EURHUF stayed in the up-trend and broke 315.5 for a while reaching its highest since July 2016.
- In early May, the Czech National Bank (CNB) refrained from hiking rates and the main refi rate is still at 0.75%. CNB head, Jiri Rusnok, said that one 25bp hike could be expected at the year-end but slower koruna appreciation might bring the decision forward. The central bank's EUR/CZK year-end forecast is 25.0 and we think the Czech currency may gain less resulting in earlier hike.

Interest rate market – Back to lower yields









On the geopolitical swing

- Last two weeks saw elevated volatility on the Polish bond market. Information about the US president Donald Trump decision to withdraw US from the Iranian nuclear deal hit the market. As a result, the US dollar strengthened rapidly and some emerging market assets were sold massively. Consequently yields of Polish t-bonds surged by c30bp in the 5-10Y segment and 10bp in the 2Y segment. In mid-May, the geopolitical tension decreased (after the information about planned meeting of US president Donald Trump and North Korea Leader Kim Jong-un and about progress in trade negotiation between US and China). The dollar gave up part of its gains which helped the bonds to recover somewhat. Additionally, the US CPI data release (where most of the measures surprised to the downside) supported Polish bonds.

Waiting for the inflation data

- This week we expect the yields decrease to continue, as a recovery after the early May's bonds sell-off. We believe that some stabilization of geopolitical situation should keep the dollar weaker improving mood on the CEE market. Moreover, the Eurozone CPI (the business survey data release suggest a bit lower or in line with forecast release) will probably push the domestic yields down.
- Most of the domestic events scheduled for this week should be neutral for Polish debt market (GDP, CPI, MPC meeting). In our opinion, Polish flash 1Q18 GDP should not deviate much from the consensus and will only be "historical" from the investors' point of view. At the MPC press conference we do not expect any surprises, and consequently, the outcome of the meeting should be neutral for the domestic yield curve. Similarly, Polish inflation should have a negligible influence on the domestic t-bonds. Even if the data surprise to the upside (it is not our base scenario) – due to the higher oil prices – it should not have any permanent impact on bonds.

Oil prices could be a risk factor

- The risk factor for the further yield decreases could be Polish wages data (scheduled for Friday), where we can expect the surprise on the positive side. However, we believe that potential sell-off will be marginal and temporary.
- In the coming weeks, we believe that moderately positive mood on the domestic debt market will persist. The industrial production data for April, although better than March reading, will be largely determined by the seasonal factors. In our opinion, other data that will be released by the end of the month, will be positive (PMI, Ifo) or neutral (domestic retail sales, German 1Q18 GDP) for the Polish bond 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