Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

11 – 17 June 2018

The passing week brought a relief for the risky assets as the political situation in Europe calmed after Italy established a new government. This factor, together with some hawkish signals from the ECB, had a positive impact on the euro versus the dollar which in turn supported CEE currencies. However, lower demand for safe assets and increased chances for withdrawing the QE program in Europe as planned (despite recent weak macro data) weighed on bonds. In Poland, the MPC did not surprise and maintained its dovish bias calling for stable interest rates in the foreseeable future.

Already this week on Friday, we expect Fitch agency to revise Poland credit rating outlook to "positive" which could be supportive for the zloty and fairly neutral for bonds. The impact of such decision could be short lived given the important events scheduled for the coming days.

Next week, market attention will likely focus on the ECB and Fed meetings. The market is fully pricing the June 25bp Fed rate hike and the key issue for investors will be the updated "dot chart". The ECB is expected to give some guidance on the process of QE program termination, which could further support the euro vs the dollar. We think that any release of more details on the end of the asset purchase program will be supplemented by comments confirming that rate hikes are not a scenario for the nearest future, which could help bonds to recover.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
			MONDAY (11 June)				
9:00	CZ	CPI	May	% y/y	-	-	1.9
			TUESDAY (12 June)				
11:00	DE	ZEW Survey Current Situation	Jun	pts	-	-	87.4
14:30	US	CPI	May	% m/m	0.2	-	0.2
			WEDNESDAY (13 June)				
11:00	EZ	Industrial Production SA	Apr	% m/m	-	-	0.5
14:00	**PL**	**Current Account Balance**	**Apr**	**€mn**	**-535**	**-237**	**-982**
14:00	**PL**	**Trade Balance**	**Apr**	**€mn**	**-100**	**-20**	**-317**
14:00	**PL**	**Exports**	**Apr**	**€mn**	**17 299**	**17 288**	**18 117**
14:00	**PL**	**Imports**	**Apr**	**€mn**	**17 499**	**17 308**	**18 434**
20:00	US	FOMC decision		%	1.75-2.0	-	1.50-1.75
			THURSDAY (14 June)				
8:00	DE	HICP	May	% m/m	-		0.6
10:00	**PL**	**CPI**	**May**	**% y/y**	**-**	**1.7**	**1.7**
13:45	EZ	ECB Main Refinancing Rate		%	-	-	0.0
14:30	US	Initial Jobless Claims	week	k	220	-	221
14:30	US	Retail Sales Advance	May	% m/m	0.35	-	0.2
			FRIDAY (15 June)				
11:00	EZ	HICP	May	% y/y	-	-	1.9
14:00	**PL**	**CPI Core**	**May**	**% y/y**	**0.6**	**0.6**	**0.6**
15:15	US	Industrial Production	May	% m/m	0.3	-	0.72
16:00	US	Michigan index	Jun	pts	98.2	-	98.0

Source: BZ WBK, Reuters, Bloomberg

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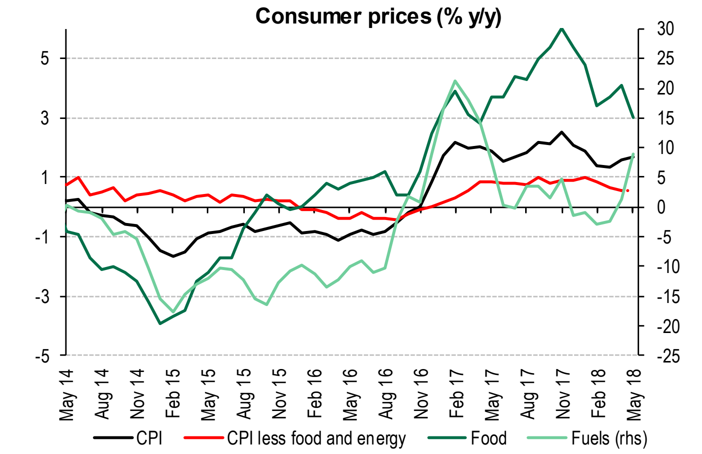
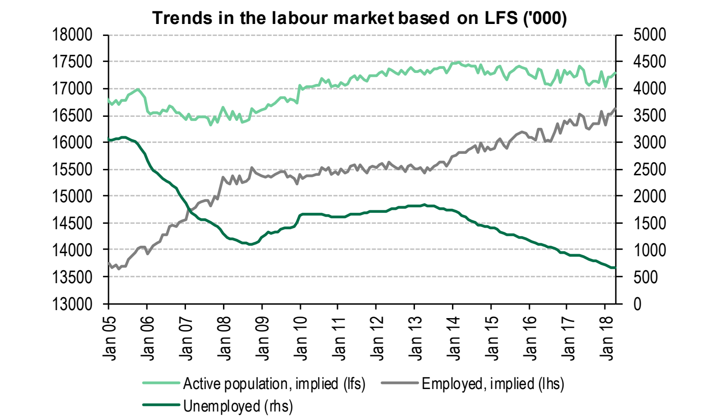
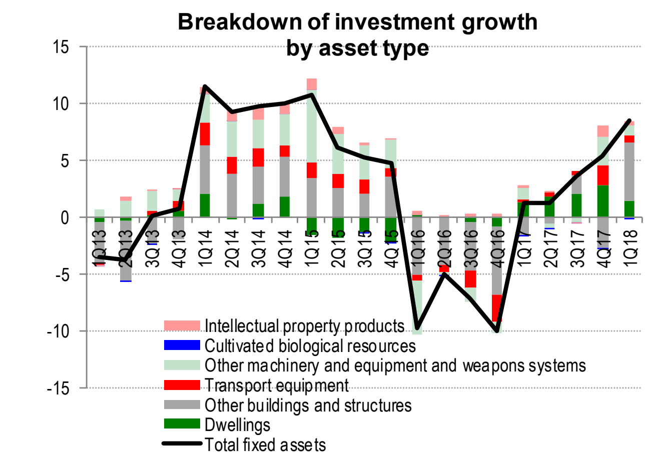
What's hot next week – Local data to be overshadowed by central bank meetings



- ECB and FOMC meetings will be the key events of the week, overshadowing local data releases.
- The balance of payments data for April should look quite positive, in our view, showing a much lower current account gap than in the last few months and a rebound in export/import growth (even though partly attributable to low base effect).
- Core inflation data should be more important than the headline CPI numbers. After the flash CPI release showed a smaller-than-expected rise to 1.7% y/y in May, our estimates of core inflation ex food and energy are on the verge between 0.5% and 0.6% y/y (with the latter being more likely). The inflationary picture will be supplemented by the Eurostat's HICP data on Friday.
- Revised quarterly GDP data for 2013-17 will be released on Friday. We are not sure if (and in what direction) the data could be changed vs. previous estimates.

Last week in economy – Unemployment at new record low, interest rates on hold





- The seasonally-adjusted LFS unemployment rate fell in April to all-time low at 3.8%, and the data for the previous months have been revised downwards. The (unadjusted) number of unemployed was at merely 643k in April, down by 242k y/y, which means that the reserves of spare domestic labour force are nearly depleted. There are two buffers still preventing the labour market from hitting the wall: the substantial inflow of migrant workers and the potential rise in labour participation amid growing wages. Having said that, it has to be noted that the active population, derived the from LFS data, fell by 432k y/y in April.
- Eurostat's data on investment breakdown by asset type showed that 1Q was mostly about infrastructure, with a lower contribution than previously from machinery and equipment.
- The MPC left rates unchanged, in line with expectations. The statement was shortened further, which we read as a signal that the internal consensus in the Council to keep rates stable for a prolonged period is quite broad. During the press conference, NBP governor Adam Glapiński stated that higher oil prices, wage growth and the weaker zloty have not put upward pressure on inflation. In the central bank governor's view, July's NBP projection for the CPI path could be lower than the previous projection from March. Glapiński commented that wage growth had decreased recently, which is not what we saw in the data (corporate wage growth up from 6.7% y/y to 7.8% in April, more than expected). In his view, stable rates in the monetary policy horizon are obvious, unless there are new shocks. E. Gatnar, considered a hawk, said that he would consider a rate hike if inflation intensified, but that there were no signs this could happen any time soon, and that wage pressure was weaker than he had expected. We maintain our view that the next rate adjustment could be a hike in late 2019.

Quote of the week – Sufficient progress to warrant gradual QE unwinding?

Peter Praet, ECB Chief Economist, Bloomberg, Reuters, 6 Jun

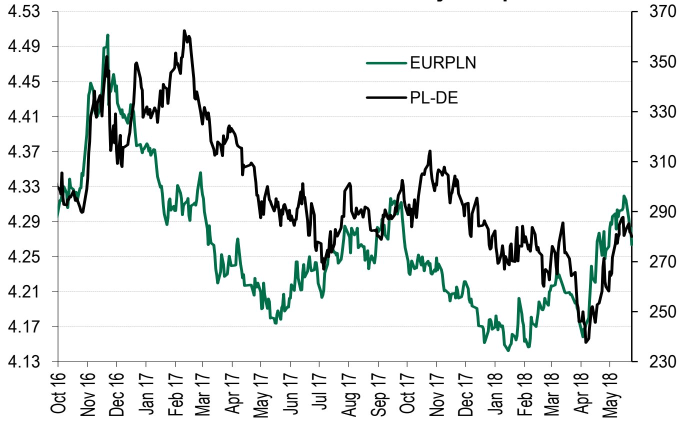
It is clear that next week the Governing Council will have to make this assessment, the assessment on whether the progress so far has been sufficient to warrant a gradual unwinding of our net asset purchases.

Signals showing the convergence of inflation toward our aim have been improving, and both the underlying strength in the euro area economy and the fact that such strength is increasingly affecting wage formation supports our confidence that inflation will reach a level of below, but close to, 2 percent over the medium term.

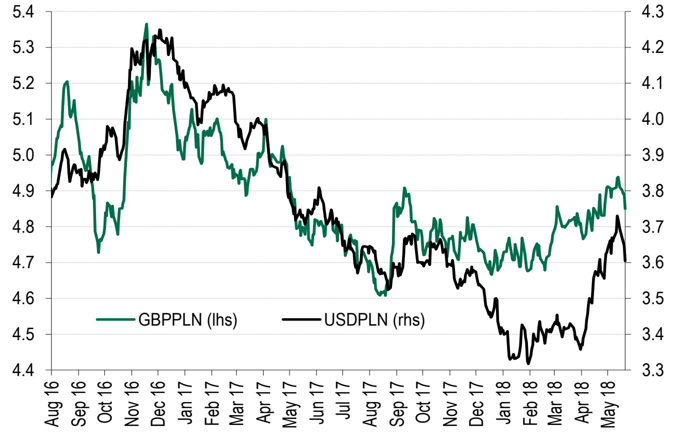
Recent comments from the anonymous ECB officials and then from the bank's Chief Economist, confirming that the ECB is ready to discuss the end of the asset purchase programme have sparked a significant market reaction. Apparently, many investors were hoping that the ECB's QE would be extended, especially in the context of recent turmoil related to situation in Italy. While such scenario cannot be ruled out completely, our baseline scenario assumes that the bank will indeed signal in June it is going to start reducing its asset purchases after September and end EAPP by year-end.

FX and FI market – ECB may support Polish assets

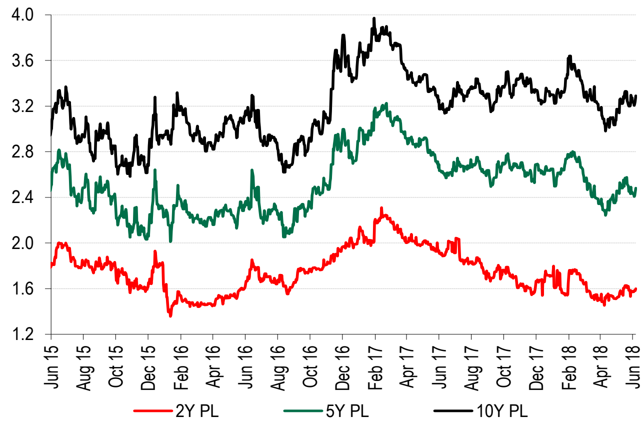
EURPLN and PL-DE 10Y bond yield spread



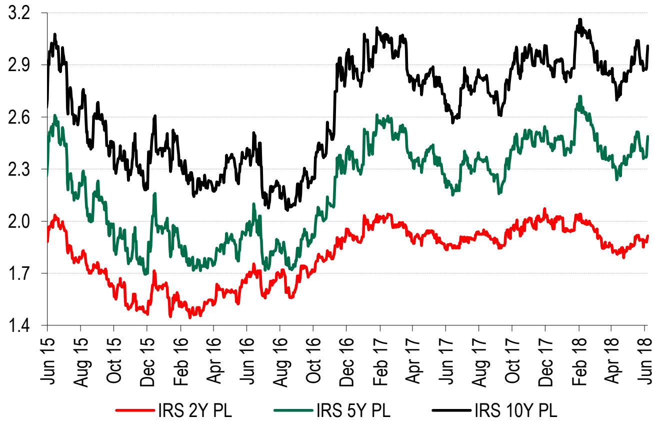
USDPLN and GBPPLN



Yields of Polish benchmarks (%)



IRS (%)



External factors boost zloty

- Just like we had expected, the zloty gained last week, benefiting from a pretty good global market sentiment and the weaker dollar. As a result, EURPLN fell for the second week in a row breaking 4.26, USDPLN plummeted to 3.60 from 3.69, GBPPLN dropped to 4.84 from 4.92 and CHFPLN to 3.66 from 3.72.
- Although the zloty recovered somewhat at the beginning of June, Polish currency is still the fifth weakest among its emerging market peers when we look at the performance since mid-April when the sell-off started. Within this time frame, however, we saw quite supportive news flowing from Poland: 1Q18 GDP surprised to the upside, CPI rebounded and is expected to rise to 2% in the months to come, the state budget continued its outstanding performance and we think it is likely that Fitch will improve Poland's rating outlook to "positive" this Friday.
- We see that Polish bonds look pretty attractive as the PL-DE 10Y bond yield spread reached c300bp, its highest for nearly a year and this could encourage investors to buy domestic debt supporting the zloty.
- Next week, the ECB is expected to give some guidance on the process of QE program termination, which could further support the euro vs the dollar. ECB chief economist has recently said that inflation is heading towards its target suggesting that the central bank rhetoric may be tilted towards hawkish at the June press conference. Should this happen, EURUSD could rise further above 1.18 giving relief for the EM currencies. Risk factor to this scenario is a more hawkish rhetoric from the FOMC after the expected 25bp rate hike on Wednesday.
- We remain positive on the zloty and think EURPLN could ease forward towards 4.23-4.24 in the weeks to come.

Focus on ECB

- At the beginning of the passing week, domestic bonds gained, especially in the belly and the long end of the curve (yields in this segment dropped by 6-7bp). The drop was a consequence of easing of political risk in the eurozone after the period of uncertainty related with the new Italian government formation. Later in the week, bonds gave up their gains amid market speculation about the ECB conference. Moreover, the debt market was negatively affected by the outlook for the G7 summit (scheduled for this weekend), where the tariff negotiations between the US and EU will continue.
- This week, the crucial events for financial markets will be the main central bank meetings. In the case of Fed the 25bp rate hike is fully discounted. In the case of ECB, prior to the meeting we anticipate continued speculations about normalization of the monetary policy. Therefore we expect the belly and the long end to stay on the elevated level at least until the Thursday's ECB press conference. In our opinion the expected Friday's Fitch decision to make an upward revision of outlook of Polish rating from neutral to positive will disappear in the information noise of global markets. At the end of the week, we expect a slight improvement of valuations as a reaction to the ECB press conference, which is likely to calm the markets.
- We think that any release of more details on the process of the QE program termination will be supplemented by comments confirming that rate hikes are not a scenario for the nearest future amid growing risk factors (escalation of trade war, falling economic confidence indexes in the eurozone).
- Against this background, we think Polish bond yields could start to descend later next week towards 3.20% for 10Y, 2.40% for 5Y while the 2Y yield should stay fairly stable.

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