

WEEKLY ECONOMIC UPDATE

9 – 15 May 2016

Market sentiment deteriorated last week, which was reflected in the weakening of the Polish currency and bonds. While a shaky global sentiment could have played a role, local risks certainly added to the market's nervousness, especially the upcoming decision of Moody's next week and the persistent significant uncertainty about the FX mortgage issue. While some news on the latter did appear recently, suggesting that a conversion of the loans may not take place, it seems that we will have to wait a few more weeks to see the final proposal of the President's working group.

In the meantime, Moody's decision on Poland's sovereign credit risk is set to be the main event (Friday, the 13th!). Looking at Moody's four main rating factors, "economic strength" and "fiscal strength" should be neutral (the former even positive) for the rating. The "institutional strength" factor might be a downside risk, though the rule of law is only one of four weight-wise. Finally, "susceptibility to event risk" (political, banking, among others) will probably be negative for the assessment due to risks connected with the FX loans. We expect the agency to cut Poland's outlook but keep the rating unchanged. If our call proves correct, there could be room for Polish asset strengthening (EURPLN and the spread of the 10Y yield to the German Bunds down).

A number of Polish data will also be released at the end of the week (including CPI, flash GDP), but they will probably be of minor importance (confirming deeper deflation in April and relatively solid economic growth).

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (9 May)							
8:00	DE	Industrial orders	Mar	% m/m	0.7	-	-1.2
9:00	CZ	Industrial output	Mar	% y/y	1.4	-	5.6
TUESDAY (10 May)							
8:00	DE	Industrial output	Mar	% m/m	-0.3	-	-0.5
8:00	DE	Exports	Mar	% m/m	-0.3	-	1.3
9:00	CZ	CPI	Apr	% y/y	0.3	-	0.3
9:00	HU	CPI	Apr	% y/y	-0.1	-	-0.2
WEDNESDAY (11 May)							
No important events to be released							
THURSDAY (12 May)							
11:00	EZ	Industrial output	Mar	% m/m	0.0	-	-0.8
14:00	PL	CPI	Apr	% y/y	-1.1	-1.1	-0.9
14:30	US	Initial jobless claims	w/e	k	-	-	274
FRIDAY (13 May)							
	PL	Moody's decision on Poland rating					
8:00	DE	Flash GDP	1Q	% y/y	1.2	-	2.1
9:00	HU	Flash GDP	1Q	% y/y	2.4	-	3.2
10:00	PL	Flash GDP	1Q	% y/y	3.4	3.6	4.3
14:00	PL	Current account balance	Mar	€ mn	385	141	-383
14:00	PL	Exports	Mar	€ mn	15421	15316	14466
14:00	PL	Imports	Mar	€ mn	15168	14991	14125
14:00	PL	Money supply M3	Apr	% y/y	9.7	10.6	9.0
14:00	PL	Core CPI excluding food and energy prices	Apr	% y/y	-0.3	-0.3	-0.2
14:30	US	Retail sales	Apr	% m/m	0.9	-	-0.3
16:00	US	Flash Michigan	May	pts	89.9	-	89

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>

Maciej Reluga (Chief Economist) +48 22 534 18 88

Piotr Bielski +48 22 534 18 87

Agnieszka Decewicz +48 22 534 18 86

Marcin Luziński +48 22 534 18 85

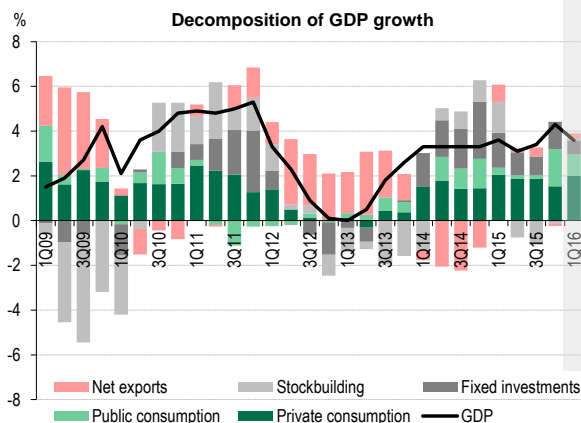
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

What's hot this week – Friday is the key day**Sovereign ratings**

	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	BBB+	negative	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	stable	Ba1	positive	BB+	positive
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA	negative	Aa2	stable	AA	stable
UK	AAA	negative	Aa1	stable	AA+	stable
Greece	B-	stable	Caa3	stable	CCC	stable
Ireland	A+	stable	Baa1	positive	A	stable
Italy	BBB-	stable	Baa2	stable	BBB+	stable
Portugal	BB+	stable	Ba1	stable	BB+	stable
Spain	BBB+	stable	Baa2	stable	BBB+	stable

■ CPI inflation for April is due on Thursday. This number will not be crucial, since we already got to see the flash reading at -1.1% y/y. Friday's calendar is really packed with Polish data, including GDP, current account, core CPI, M3 and Moody's decision on top of that.

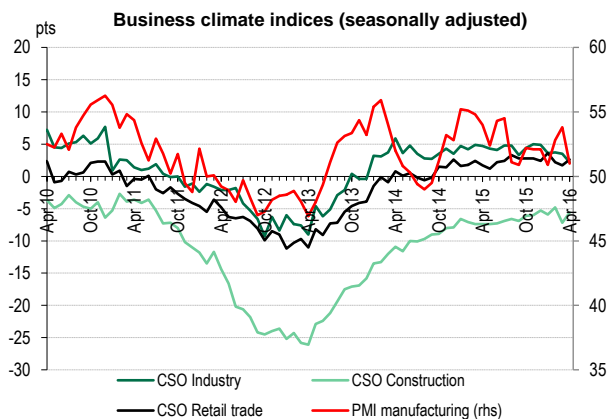
■ Our estimate for April's core CPI sits at -0.3% y/y, the lowest level since comparable data are available (2001). However, our forecast might change after detailed CPI numbers are released. In any case, it is hard to see an upward pressure on prices.

■ We expect GDP growth at a solid 3.6% in 1Q2016, driven mostly by private consumption, with quite a moderate rise in investment and positive contribution of net exports. GDP breakdown is due for release at the end of May.

■ Balance of payments data for March are likely to show a slight improvement in the C/A balance versus February, mainly on the back of a lower income deficit, improved by stronger inflows of EU funds. Exports will be the key statistics, especially in light of the recent deterioration in the business climate indicators.

■ M3 money supply for April will be eyed for statistics on loan growth given the recent slight deceleration in this area and rather weak results of the lending policy survey.

■ Moody's decision will most likely be the most important event of the week. Looking at Moody's four main rating factors, "economic strength" and "fiscal strength" should be neutral (the former even positive) for the rating. The "institutional strength" factor might be a downside risk, though the rule of law is only one of four weight-wise. Finally, "susceptibility to event risk" (political, banking, among others) will probably be negative for the assessment due to risks connected with the FX loans. We expect the agency to cut Poland's outlook but keep the rating unchanged.

Last week in the economy – PMI, a major disappointment

■ Poland's manufacturing PMI fell sharply in April (to 51.0 vs consensus 53.0) back to January's level after a strong performance in February-March. The report sounded quite gloomy, showing a sharp slowdown in output, new orders and employment growth. New orders inflow was the slowest in 19 months. It is a worry since evidence of a slowdown in the Polish industry has been accumulating: industrial production data for March was very weak and in April not only the PMI but also other leading indicators (ESI, GUS) recorded deterioration. We still believe that the euro zone's solid economic growth (Poland's main trading partner) and weak zloty should support Polish production and exports in the months to come. However, the fact is that the start of the year was quite poor for the Polish industry and the repetitive signs of weakness raise our uncertainty about the rest of the year.

Quote of the week – Will the new NBP Governor bring a new toolbox?**Chancellery of the President, 6 May**

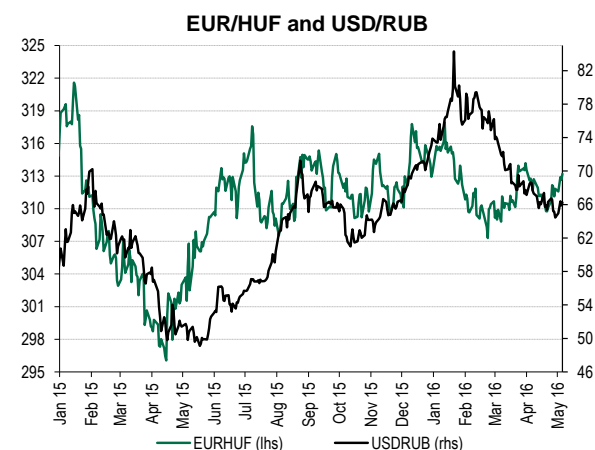
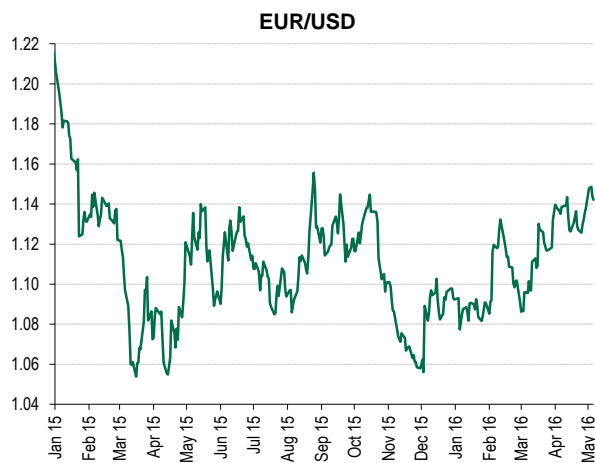
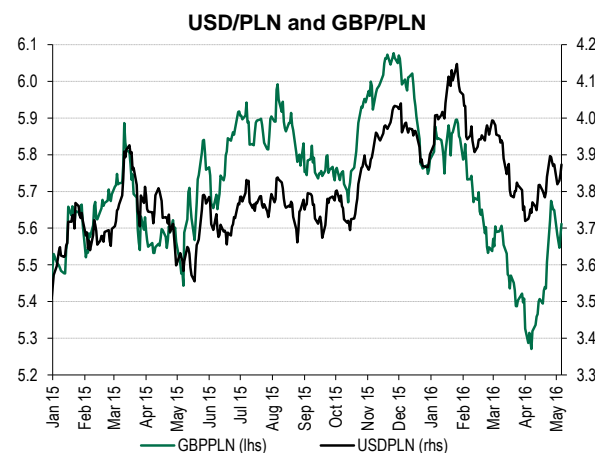
President Andrzej Duda will file a motion with the Sejm to appoint Adam Glapiński as NBP president.

Mateusz Morawiecki, deputy prime minister, 6 May, PAP

The NBP should be able to use instruments used by central banks in mature economies. I would like to stress that the central bank's independence is secure, but the bank should update its toolbox.

The President confirmed that Adam Glapiński is his candidate for the post of NBP Governor, in line with expectations. Glapiński served as MPC member in 2010-2016, was then nominated to the NBP Board. Deputy PM Morawiecki's comment suggests that the NBP's toolbox might change with the Governor. He did not reveal, however, which new instruments he would like the central bank to adopt. One has to remember that the NBP's toolbox is not as humble as it might seem at first glance. It is worth remembering that back in 2008, in response to the financial crisis, the MPC introduced the so-called "structural operations", i.e. buying/selling instruments on the secondary market. There was simply no need to use such non-standard measures. However, the bank's Monetary Policy Guidelines for 2016 also list flexibility in shaping NBP's instruments to ensure that its response to market changes is optimal (and assures macro and financial stability).

Foreign exchange market – Crucial events ahead



Crucial events ahead

▪ Last week the zloty remained under pressure amid a rather shaky global market sentiment and worries about Moody's looming decision on the Polish rating. As a result, EURPLN rose temporarily above 4.43, its highest since mid-February. The zloty also lost ground vs the greenback, with the dollar's gains vs the euro pushing USDPLN up to 3.89 from 3.77.

▪ When we look at the economic calendar, it seems this week starts and ends on Friday with all the crucial events due on that very day. Poland's flash 1Q GDP will likely allow for some assessment of how the Polish economy has been performing during the first three months of the year. On the same day, Moody's may announce its decision on the Polish credit outlook or rating. Our GDP forecast is slightly above the consensus and this could potentially provide some support for the zloty. However, this would only be possible if Moody's does not go for a downgrade. In fact, we think that the ratings agency will only change Poland's outlook to "negative" from "stable" and this could be moderately positive for the zloty as the market has recently been pricing in a cut in the country's credit grade. There were also some supportive rumours about the FX loan issue last week, saying that the government was thinking of withdrawing from the idea of converting FX mortgages, which helped the zloty gain temporarily.

▪ Although there are numerous vital events on the agenda this week and uncertainty is high, we see chances that their net effect could be in fact positive for the zloty, providing at least some short-term support. However, we remain cautious for the next months as we are still waiting for the final solution of the FX mortgage problem. The budget could also attract market attention in 2H16.

EURUSD awaiting FOMC speakers

▪ EURUSD was quite volatile last week. It first jumped to 1.16 (its highest since late August) and then fell to 1.14 on hawkish comments of FOMC members, who did not rule out a rate hike in June.

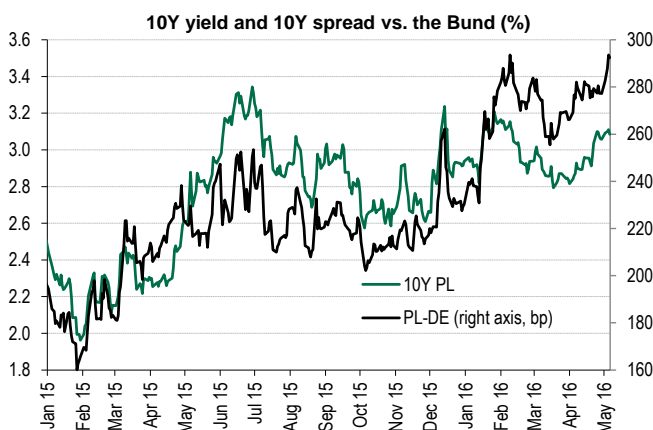
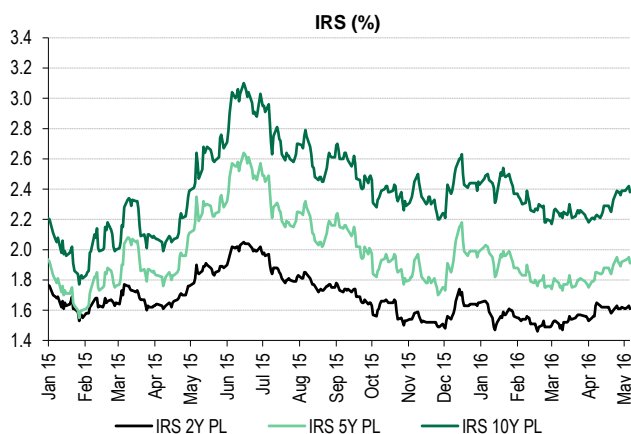
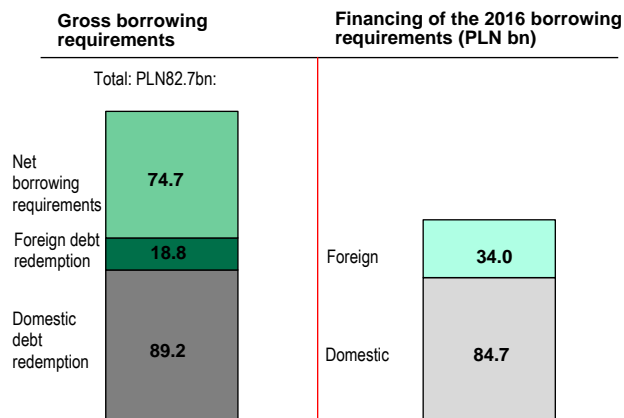
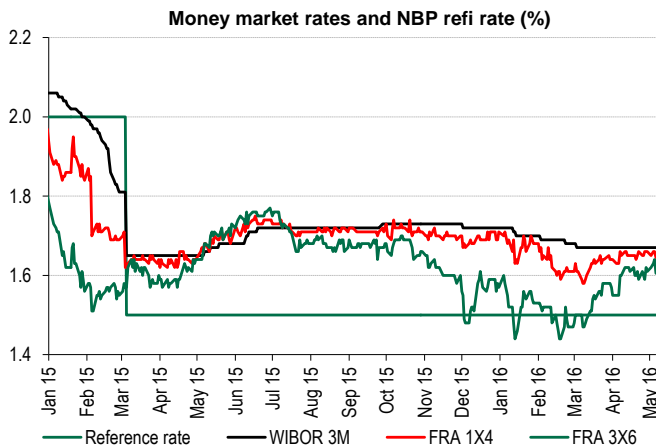
▪ This week should be rather calm with data releases, but numerous FOMC members (both voters and non-voters) are due to speak. As mentioned above, the recent comments were rather hawkish, but after the disappointing April nonfarm payrolls the opinions should sound rather more reserved and this might favour the euro.

Czech rates unchanged, CPI data ahead

▪ In line with expectations, the Czech central bank left interest rates unchanged. The reference remains at 0.05%. It said though that it may decide on weakening the currency (moving EURCZK's floor higher) if inflation expectations continue to fall. The FX rate did not react to this and is still hovering close to 27.0. After the meeting CNB's vice-governor Vladimír Tomsík said that there was no need for a serious debate on introducing negative interest rates at the moment.

▪ CEE CPI numbers are on the agenda this week. Inflation trends have been so far one of the key drivers for the Czech and Hungarian central bank decisions, so the incoming data could affect market expectations on the monetary policy outlook.

Interest rate market – Moody's decision in focus



High volatility remains

Poland's interest rate market was quite volatile last week. Polish bonds lost ground ahead of Thursday's auction (details below), but also due to significant weakening of the zloty. As a result, the 10Y benchmark yield rose to 3.14% for a while (the highest level since early February). However, gains on the core market (yield of the 10Y Bund again fell to c0.15%) at the end of the week helped Polish assets gradually recover, with the 10Y benchmark yield falling below 3.10%. Thanks to the rebound at the end of the week, the IRS rates returned to levels observed a week earlier after reaching a local high at 1.95% for 5Y and 2.42% for 10Y earlier last week. The MPC's decision to keep rates unchanged was neutral for Polish assets.

Both the IRS and bond yield curves slightly steepened over the past week due to visible 5-10Y spread widening. Moreover, the risk premium rose markedly with the spread vs the Bund for the 10Y sector for a while at nearly 295bp, the highest level since early February.

Poland's ministry of finance successfully placed short- and long-term bonds at its regular auction. It sold 2Y OK1018 and 10Y DS0726 worth PLN4.7bn in total, slightly above the upper band of the planned supply at PLN4.5bn. Nearly PLN3bn from the issue came from the 10Y benchmark DS0726. Demand was solid at PLN7.1bn and was solid. Yields at the auction were close to levels on the secondary market and amounted to 1.645% for OK1018 and 3.134% for DS0726. We estimate that this year's borrowing needs are now covered in nearly 65%.

On the money market, WIBORs were roughly stable (the 1M rate grew just 1bp on a weekly basis), while the FRA rates were 2-4bp up across the board, with the long-term rates increasing the most. However, the FRA market is still pricing in some monetary easing in the coming months, though investors have scaled back their expectations of rate cuts, seeing a c60% chance that rates will fall by 25bp in the next nine months.

Local risks still point to a higher risk premium

Important domestic macro data (including final CPI, flash 1Q16 GDP) and events (Moody's decision on Poland's rating) are due this week but all at the end of the week (Thursday-Friday). While April's final CPI reading is rather a no event as it is likely to be close to the flash number (-1.1% y/y), the flash GDP data for 1Q16 could be the most important since the MPC pays more attention to economic growth than to CPI inflation. We and the market expect to see a moderate slowdown in economic activity in 1Q, but the scale of this slowdown could be crucial for the Council. In our view, only a significant disappointment in the GDP numbers (closer 3% than 3.5%) would provide grounds for a bullish curve steepening (raising the probability of rate cuts).

Domestic risks (rating, uncertainty about FX loan conversion) will probably keep the risk premium for Polish assets high. Nervousness on the market can also persist ahead of Moody's decision and can push the spread over the Bund further up. In our view, it could be a good opportunity to cumulate Polish assets just ahead of Moody's decision as the market could blow this issue out of proportion. In our view, Moody's is likely to cut the outlook rather than downgrade Poland's rating. It is worth mentioning that Moody's, similarly to S&P, will release its statement after the Polish market close.

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. Rates Area, Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, <http://www.bzwbk.pl>.