BIWEEKLY ECONOMIC UPDATE

23 May – 5 June 2016

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (23 May)					
9:30/10:00	DE / EZ	Flash PMI – manufacturing	May	pts	52.0/51.9	-	51.8/51.7
		TUESDAY (24 May)					
8:00	DE	GDP	Q1	% y/y	1.3	-	2.1
11:00	DE	ZEW index	May	pts	49.3	-	47.7
14:00	HU	Central bank decision		%	0.90	-	1.05
16:00	US	New home sales	Apr	k	520	-	511
		WEDNESDAY (25 May)					
10:00	**PL**	**Unemployment rate**	**April**	**%**	**9.6**	**9.5**	**10.0**
10:00	DE	Ifo index	May	pts	106.8	-	106.6
11:00	**PL**	**Bond auction**					
		THURSDAY (26 May)					
	PL	**Market holiday**				-	
14:30	US	Durable goods orders	Apr	**% m/m**	0.3	-	0.8
16:00	US	Pending home sales	Apr	**% m/m**	0.6		1.4
		FRIDAY (27 May)					
14:00	**PL**	**MPC minutes**				-	
14:30	US	Preliminary GDP	Q1	% y/y	0.8	-	0.5
16:00	US	Michigan index	May	pts	95.8		89.0
		TUESDAY (31 May)					
10:00	**PL**	**GDP**	**Q1**	**% y/y**	**3.0**	**3.0**	**4.3**
10:00	**PL**	**Fixed investment**	**Q1**	**% y/y**		**3.8**	**4.4**
10:00	**PL**	**Private consumption**	**Q1**	**% y/y**	-	**3.2**	**3.0**
11:00	EZ	Flash HICP	May	% y/y			
14:00	**PL**	**Flash CPI**	**May**	**% y/y**	-	**-0.8**	**-1.1**
14:30	US	Personal income / Consumer spending	Apr	% m/m	-	-	
16:00	US	Consumer confidence index	May	pts			
		WEDNESDAY (1 June)				-	
3:45	CN	PMI – manufacturing	May	pts	49.3	-	49.4
9:00	**PL**	**PMI – manufacturing**	**May**	**pts**		**51.4**	**51.0**
9:55/10:00	DE/EZ	PMI – manufacturing	May	pts	-	-	51.8/51.7
16:00	US	ISM – manufacturing	May	pts	-	-	50.8
20:00	US	Fed Beige Book					
		THURSDAY (2 June)					
13:45	EZ	ECB decision	Jun	%	-	-	0.00
14:15	US	ADP report	May	k	-	-	156
		FRIDAY (3 June)					
9:55/10:00	DE/EZ	PMI – services	May	pts	-	-	55/53.1
14:30	US	Non-farm payrolls	May	k	-	-	160
14:30	US	ISM – services	May	% y/y	-	-	55.7

Source: BZ WBK, Reuters, Bloomberg

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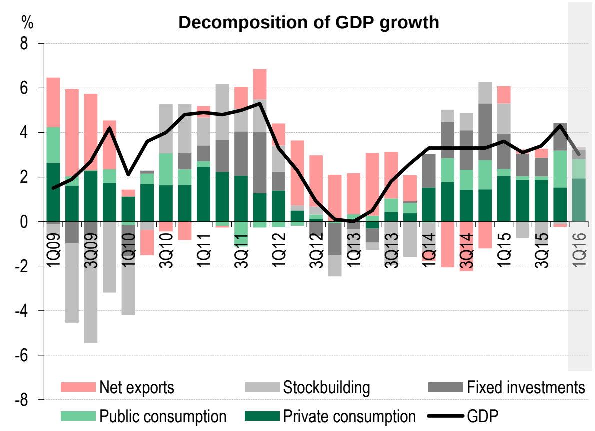
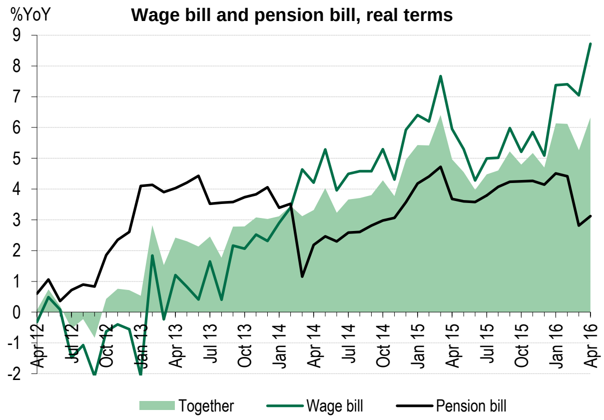
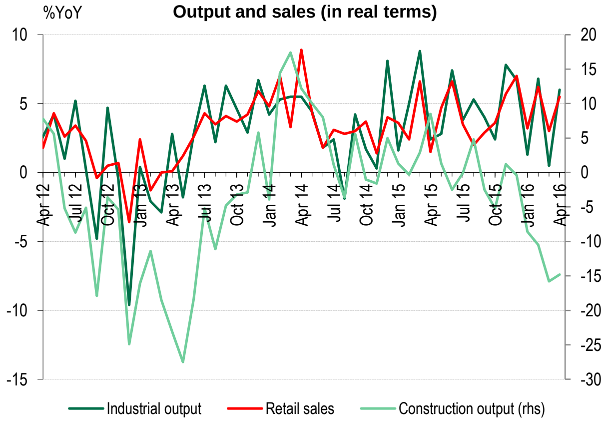
What's hot in next two weeks – GDP breakdown for Q1, unemployment, PMI and flash CPI



- We forecast the registered unemployment rate to fall to 9.5% in April (below the Labour Ministry's 9.6% forecast).
- We expect PMI to rebound in May after its surprising fall in April, reaffirming that the industry outlook remains positive.
- CPI in May climbed to -0.8% y/y, in our view. However, our forecast may need to be revised in the days to come.
- Economic growth was at 3.0% y/y in 1Q16, according to the flash estimate, and we expect the reading to be confirmed. We expect private consumption to stay at c3% y/y, a similar level to the previous quarters. However, the contribution of investments and net exports most probably weakened versus 4Q2015. Data from the start of Q2 (details below) suggest that this was only a temporary slowdown (in Q1) and that the quite robust growth in the euro zone and the relatively weak PLN will be supporting Poland's economic growth ahead.

Last week in the economy – Start of Q2 brings good data





- Corporate sector employment rose 0.1% m/m and 2.8% y/y in April, in line with our forecasts. It was the fastest annual gain since late 2011. The fact that companies' demand for new workers remains strong suggests, in our view, that the underlying economic growth remains decent.
- Average wage growth in the corporate sector accelerated in April to 4.6% y/y from 3.3% y/y in March, and was clearly above expectations. This probably reflects a broad-based trend of salary increases, not a one-off in one or two sectors. We expect the solid wage growth to continue in the coming months due to shortages of available workforce.
- Industrial output growth accelerated in April to 6.0% y/y, considerably above market forecasts. Growth in manufacturing reached 8.3% y/y, its highest since December. Most significantly, the growth rates were recorded in most of the export-oriented sectors: furniture (18.4% y/y), cars (12.5% y/y), metals manufacturing (11.8% y/y), computer and electronic appliances (11.3% y/y).
- Conditions in the construction sector are way less optimistic, with output falling 14.8% y/y (the weakest result since mid-2013). Falls were recorded in all the construction sectors, but were the most severe in civil engineering: 31.5% y/y.
- Retail sales in constant prices rose 5.5% y/y in April, close to expectations. The Easter effect lowered April's growth of sales of food and in non-specialised shops, but boosted sales of clothing and footwear and household appliances. Solid growth (the highest this year) was also recorded in the sales of motor vehicles. We expect retail sales growth to remain at c.4-5% y/y in the following months, which will reflect solid private consumption growth.

Quote of the week – Fiscal policy easing could be the trigger

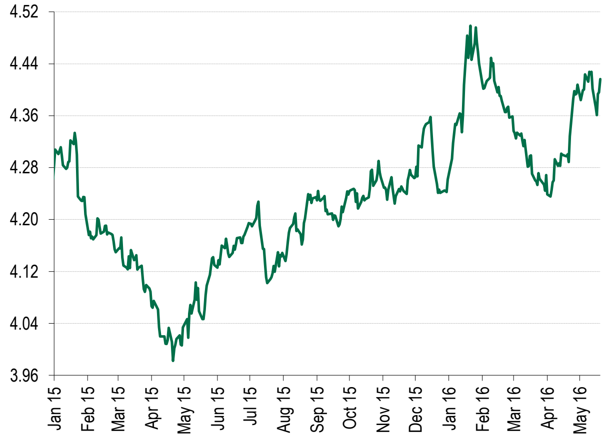
Fitch ratings, 18 May

Poland's reliance on rapid GDP growth to meet fiscal targets, and potential political pressure on the government to deliver on electoral promises, mean that any economic slowdown, such as that seen in first quarter of 2016, increases fiscal risks (…) Compliance with the SGP's deficit criterion is an important benchmark for Fitch in assessing the Polish authorities' fiscal stance. Indications that its relevance as a fiscal anchor was weakening would be a credit negative signal. (…) Meanwhile, this month's large demonstration in Warsaw against the ruling Law and Justice (PiS) party is a reminder that the more confrontational governing style since the 2015 election, notably over the functioning of the Constitutional Tribunal, has increased the polarisation of Polish society and could fuel political instability. Along with a deterioration in relations with some key economic partners in the European Union, this raises risks to the investment and macro outlooks. (…) When we affirmed Poland's 'A-'/Stable rating in January, we identified relaxation of the fiscal stance that worsens the government debt trajectory, or a weakening of policy credibility or economic performance, as triggers for a possible negative rating action.

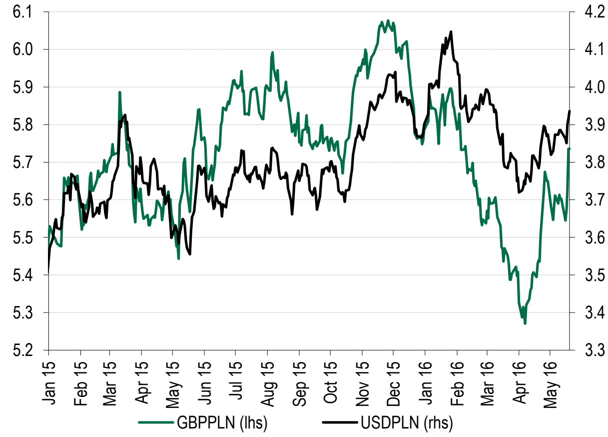
Following Moody's decision to change Poland's rating outlook to negative, it is now Fitch that is in the spotlight (its decision on Poland's rating is expected on July 15). In January, Fitch pointed out that Poland's fiscal policy easing, weaker economic performance or weaker policy credibility may trigger a negative rating action. Since then, the government has continued to promise to keep the fiscal deficit below 3% of GDP (to avoid EDP), but uncertainty about a number of policy measures has grown (retirement age, CHF-loans, 2017 budget). Poland's economic performance also weakened (GDP slowdown in Q1), which was already reflected in changes to Fitch's economic growth forecasts for Polish economic growth in 2016 (to 3.2%). However, we do not think these factors affect the debt trajectory significantly and weaker economic performance in Q1 was most likely only temporary. Last week's signals from Fitch could be read as a prelude of a change to the rating's outlook to negative, but we think that the government's decisions in the upcoming weeks (about the above-mentioned issues) will the key.

Foreign exchange market – US data to be key

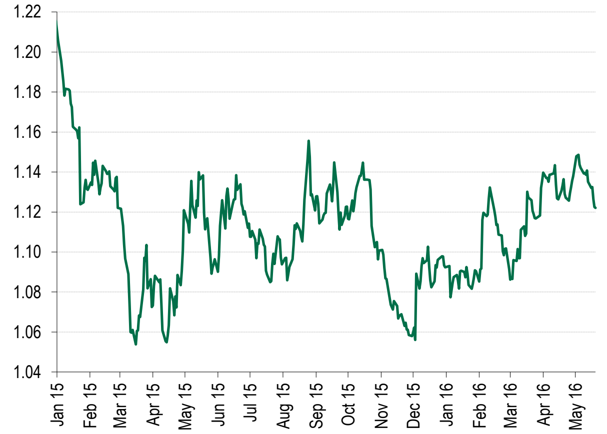
EURPLN



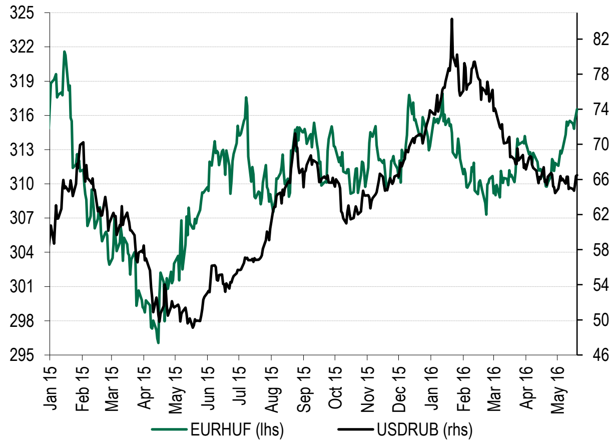
USD/PLN and GBP/PLN



EUR/USD



EUR/HUF and USD/RUB



US data crucial for the zloty

- For the better part of the week, EUR/PLN was hovering within the 4.36-4.44 range, which has been in place since mid-April. The exchange rate opened the week with a down gap thanks to the Moody's decision, but the following days saw it rise to 4.42 from c4.36 on hawkish signals from the FOMC that hit the global market sentiment. USD/PLN rose for the third consecutive week and broke 3.93, reaching its highest level since mid-March. The biggest move was recorded on GBP/PLN that surged to 5.75 from 5.55, its highest since early February. The pound was gaining on public opinion polls showing rising support for the UK remaining in the EU and on strong British macro data.
- The next two weeks will bring many important data and events. The ECB will hold a meeting, but we do not expect it to change its monetary policy parameters as the bank remains focused on implementing measures announced in March. The ECB is waiting for the effects of its larger scale of monetary easing. Thus, it seems that the market's attention will remain focused on the US where preliminary 2Q GDP and non-farm payrolls will be released in the next two weeks. After the clearly more hawkish-than-expected comments of the Committee's members and the FOMC minutes, the market started to price-in a higher probability of a Fed rate hike in June/July (28%/47% vs just 4%/18% a week earlier, according to Bloomberg). The unexpected hawkish signals from the FOMC weighed on the risky assets and, in our view, this effect may persist should more strong US data be released in the next two weeks. At the same time, we do not expect EUR/PLN to rise above 4.50.

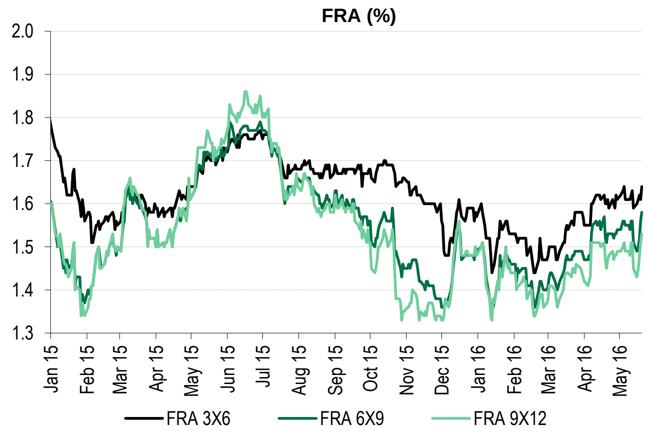
Fed's monetary policy remains key

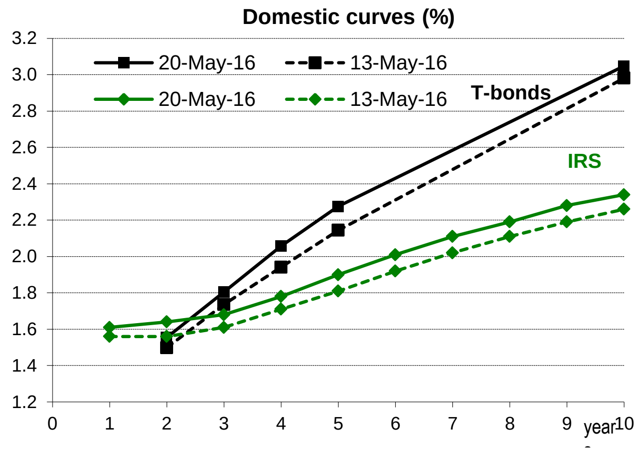
- EUR/USD fell for the third week in a row to reach its lowest level since early April. The dollar's appreciation to 1.118 against the euro was fueled mainly by the hawkish tone of the FOMC minutes.
- We think that issues related to US monetary policy will remain the core driver of EUR/USD in the next two weeks as the ECB is likely to refrain from taking any action amid the exchange getting closer to 1.10, seen in March, when the bank decided to extend its stimulus package (so there is no big need for any strong verbal intervention). Should the US data surprise to the upside, EUR/USD could head lower in the short term.

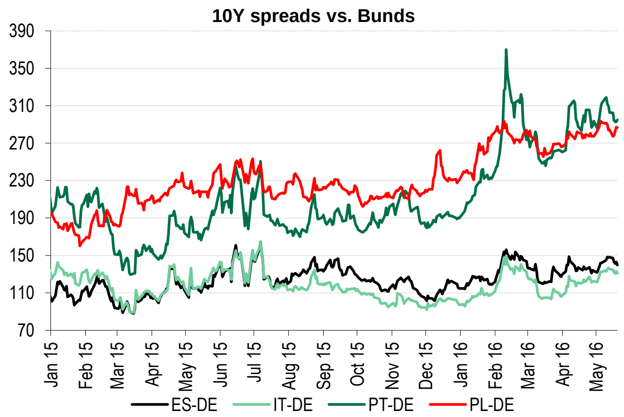
HUF and RUB pressured by concern about EMs

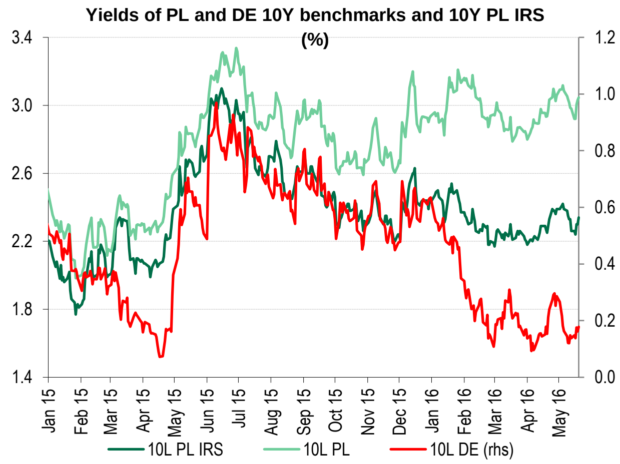
- The ruble and forint weakened last week on market concerns about the EM currencies amid the growing probability of a Fed rate hike. RUB was additionally pressured by a slight decline in the oil price. As a result, EUR/HUF touched 317, its highest since mid-January, and USD/RUB broke 67, its highest since mid-April.
- The Hungarian central bank will decide on rates this week. The market anticipates another 15bp cut, but it seems that the post-meeting statement will be more important. In the last few weeks, MNB's officials were suggesting that there was limited room for more cuts and the market will look for hints on the nearing end of the easing cycle in MNB's communication.

Interest rate market – Volatility of Polish assets is likely to remain elevated









Rates up on hawkish Fed and strong data

- Poland's interest rate market was under pressure last week from a growing probability of imminent interest rate rises by the Fed. The market could get additionally pressured by Fitch (which suggested it could change Poland's ratings outlook to negative in mid-July) and statements by the MPC members. As a consequence, investors took profit, pushing yields and IRS rates up, even higher than last Friday before the Moody's decision.
- On a weekly basis, both the yield and IRS curves shifted up and steepened after some flattening at the start of the week. What is more, the risk premium again rose to nearly 290bp (from 277bp) on Fitch, which raised investor worries that another ratings agency, after Moody's and Standard and Poor's, could change its attitude towards Poland's rating.
- On the money market, WIBORs were stable, while the FRA rates rose visibly on stronger-than-expected macroeconomic data (wages, industrial output and retail sales). This, together with statements from the MPC members, resulted in the scaling back of investor expectations of rate cut later this year. The FRA market currently sees a c65% probability of rates falling 25bp in the next nine months (up from nearly 100% at the start of the week).

Bond auction and US data to set market direction

- The upcoming two weeks will be full of macro data releases (including Poland's unemployment data, detailed GDP data for 1Q16, flash May CPI and PMI, and also the labour market report in the US) and events (domestic T-bond auction, debt issuance plan for June, ECB meeting). Wednesday's bond auction will be one of the key events. At the start of the week, Poland's Ministry of Finance will announce the bonds on offer and its final supply details. We expect the ministry to offer 5Y benchmark PS0721 and probably floaters. 5Y PS0721 bonds were sold at 2.32% at the previous auction in April. Since then, yields on the belly of the curve have dropped c7bp. We expect the domestic banks and non-residents to focus on the 5Y benchmark, since they were the largest holders of the PS0721 bonds (c44% of the outstanding bonds in case of the banks and c30% in case of the foreign investors) at the end of March. We think that the final supply level will settle close to the initial level of PLN2.0-6.0bn, but we do not rule out some narrowing, which we had in the previous months. We expect quite a healthy demand, which should allow the ministry to launch the maximum level of the offer. What is more, at the end of the month, we will get to see the issuance plan for June. The final offer for next month should be in line with the 2Q issuance plan - a regular and/or switch tenders are planned for June. Taking into account the current level of financing and the government's 2016 borrowing needs (c65% already met), we think that the ministry may adopt a flexible approach to offering bonds next month.
- Turning to the domestic data releases, we think that the flash CPI for May will be rather neutral for the market as the MPC seems more focused on GDP growth than inflation. We, therefore, think that the May PMI reading might be more interesting for investors. All in all, given the upcoming domestic macro data releases and events, we expect volatility of the Polish assets to remain elevated.
- Global factors are still key for the domestic assets, just like we saw last week. US macro data releases will, therefore, be in focus. Building up of expectations of earlier monetary tightening by the Fed (the FOMC minutes raised the probability of a rate hike in July to nearly 50% from 18% a week ago) has pushed yields on the core market higher, which also translated into higher Polish yields. Therefore, if the May non-farm payrolls in the US confirm the approaching monetary normalisation by the FOMC, Poland's yields might continue their upward trend, in particular on the long end.

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.