Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

18 – 24 July 2016

Foreign trade data for May were a clear disappointment, reflecting a significant slowdown in Polish exports and imports. This seems to support our view that GDP growth in Q2 did not improve much compared with Q1. Slowing loan growth, mainly in the corporate world, does not bode well for the GDP outlook either because it suggests that a pickup in investments is nowhere to be seen on the horizon. Inflation in June reached -0.8% y/y, in line with expectations, and we expect it to gradually pick up in the following months.

Fresh Polish data to be released this week should be relatively strong, partly due to positive working-day effects in June. Our forecast of industrial production is slightly above the market consensus, while for retail sales – below. However, in both cases we see an upward risk after the car market watchdog said there was a very strong rise in car production and sales in June. Solid data may be moderately supportive for the zloty and may (temporarily) lower market expectations for interest rate cuts in Poland, especially that the MPC members uphold their very hawkish rhetoric. But we think such expectations will be revived later this year, as economic growth in the coming quarters is likely to disappoint. The zloty's strengthening (if any) is also not going to be persistent, we think, as some local risk factors continue to weigh on the currency (FX loan proposal being the most important).

Fresh business climate indicators for July should be watched closely, as they will offer the first hints on possible changes in business confidence in Europe after the UK Brexit vote. Next week's ECB meeting will be another key event abroad to follow closely. While no policy change is expected from the ECB, the tone of Mario Dragi's comments at the press conference may be an important determinant of market sentiment in the second part of the week.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 July)					
14:00	**PL**	**Employment in corporate sector**	**Jun**	**% y/y**	**2.9**	**2.9**	**2.8**
14:00	**PL**	**Wages in corporate sector**	**Jun**	**% y/y**	**4.9**	**4.8**	**4.1**
		TUESDAY (19 July)					
11:00	DE	ZEW	Jun	pts.	8.0	-	19.2
14:00	**PL**	**Industrial output**	**Jun**	**% y/y**	**5.8**	**6.4**	**3.5**
14:00	**PL**	**Construction and assembly output**	**Jun**	**% y/y**	**-9.8**	**-10.9**	**13.7**
14:00	**PL**	**Retail sales (constant prices)**	**Jun**	**% y/y**	**5.9**	**5.5**	**4.3**
14:00	**PL**	**PPI**	**Jun**	**% y/y**	**-1.0**	**-1.1**	**-0.7**
14:30	US	House starts	Jun	k	1170	-	1164
14:30	US	Building permits	Jun	k	1150	-	1138
		WEDNESDAY (20 July)					
16:00	EZ	Consumer confidence	Jul	pts.	-8.3	-	-7.3
		THURSDAY (21 July)					
13:45	EZ	ECB decision		%	0.0	-	0.0
14:30	US	Initial jobless claims	week	k	-	-	254
14:30	US	Philadelphia Fed index	Jul	pts.	5.0	-	4.7
16:00	US	Home sales	Jun	m	5.47	-	5.53
		FRIDAY (22 July)					
9:30	DE	Flash PMI – manufacturing	Jul	pts.	53.9	-	54.5
10:00	EZ	Flash PMI – manufacturing	Jul	pts.	52.0	-	52.8

Sources: BZ WBK. Reuters. Bloomberg

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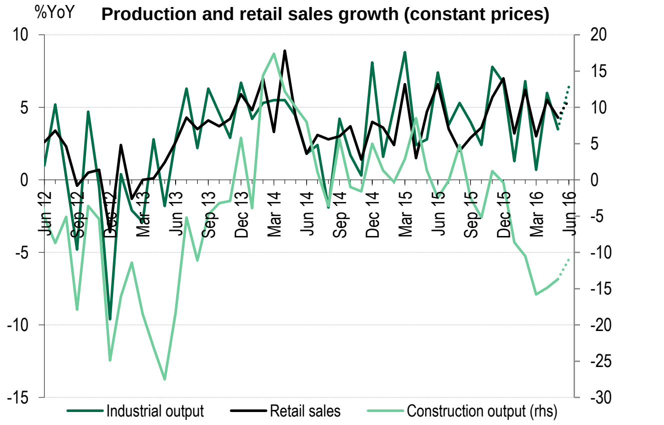
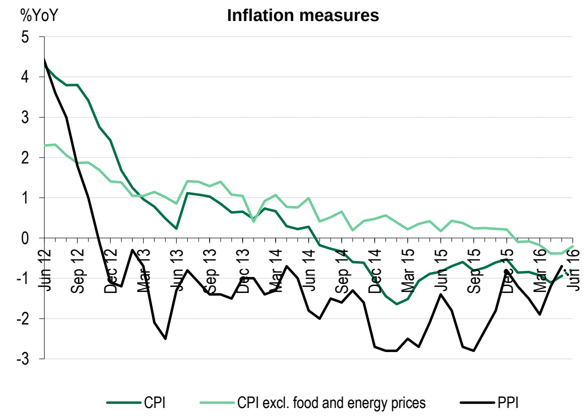
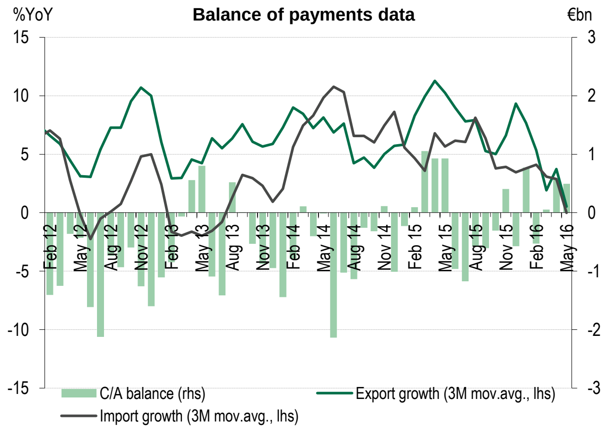
What's hot this week – Strong macro data come in bunches?



- We expect June's labour market data to show accelerating employment and wages (thanks to a positive working-day effect). The nominal wage bill growth is likely to be the highest since 2011.
- Industrial output in June rose faster than in May, according to our forecast. The sector was supported by a positive working-day effect. Data from car analyst Samar showed high output in the automotive sector in June (+23.9% y/y), creating some upward risk for our forecast. There are no signs of a revival in construction and we expect output in this sector to remain under water.
- Retail sales are also likely to show good performance in June, given the absence of long weekends, which weighed on sales in May, and consumption thanks to the 500+ programme.
- In general, data released this week may be quite strong.

Last week in the economy – CPI slightly up, disappointing balance of payments





- June's headline CPI reached -0.8% y/y, in line with our forecast and the flash reading. On a monthly basis, the inflation rate rose 0.2% m/m. Core inflation excluding food and energy prices inched up to -0.2% y/y.
- Changes in the specific categories were in line with our expectations. The rise in food prices (+0.2% m/m), which was larger than in the previous years, is worth noting, however. This was mainly due to higher sugar (0.7% m/m) and meat (0.6% m/m) prices. But a significant rise was also recorded for fruit (2.3% m/m), though in line with seasonal patterns. There was also a bigger rise in fuel prices than we had expected (2.8% m/m). We expect the headline CPI to stay below zero in the upcoming months and to reach positive territory at the end of this year.
- May's balance of payments disappointed. Even though the current account balance at €495mn was a bit better than expected, exports disappointed strongly (€13.4bn vs the consensus at €14.3bn, down 4.2% y/y). Imports were also lower than expected and reached €13.2bn vs expectations of €13.9bn (-1.6% y/y). There was a clear deceleration of foreign trade growth against April, given the negative working-day effect and weak industrial output, but its scale came as a surprise. In our view, these results were caused by weaker trends in global trade and may weigh on Poland's GDP growth. The data seem to confirm our worries that GDP growth may fail to accelerate in Q2 and in the following quarters. We have recently trimmed our GDP growth forecast by 0.3-0.4pp to 3.1% in 2016 and 2.9% in 2017.
- M3 money supply growth was at 11.4% y/y in June, in line with expectations. At the same time, loan growth continued to decelerate (to 4.7 y/y, its lowest in 30 months).

Quote of the week – NBP projection overly pessimistic

Jerzy Kropiwnicki, MPC member, 12 July, PAP

The NBP projection is too pessimistic on GDP growth. Monetary policy will not change until the end of the year.

Eugeniusz Gatnar, MPC member, 13 July, PAP

Uncertainty about the Brexit is an argument for longer stabilisation of rates. There should be no revolution in monetary policy guidelines in 2017.

Grażyna Ancyparowicz, MPC member, 14 July, PAP

Due to a lack of information about the actual effects of the new economic policies, the "wait and see" approach is the best strategy. Deflation cannot be combated with interest rate cuts.

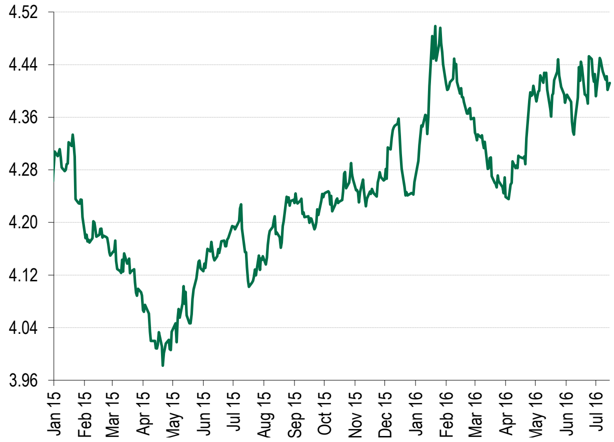
Kamil Zubelewicz, MPC member, 14 July, PAP, Bloomberg

The MPC should consider lowering the inflation target. The pace of the rebound in prices may be accelerating, so cutting rates now would be irresponsible. Rate cuts are out of the question unless the economy collapses suddenly and without any warning.

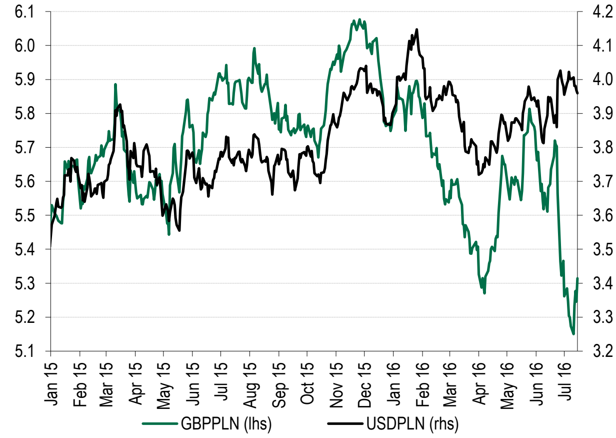
Recent comments of the MPC members contained some interesting views: 1) the central bankers confirmed Glapiński's view that the MPC was more optimistic about economic growth than the NBP projection, 2) they think reducing rates would affect neither economic growth nor inflation, so monetary policy is actually ineffective, 3) Kamil Zubelewicz would like to lower the inflation target, but it seems that this view has failed to attract many supporters within the MPC. In general, all these issues are related to the MPC's credibility. Lowering of the NBP's target, while inflation is persistently running below it, would most likely damage the MPC's image. Moreover, it could make monetary policy less effective and raise the probability of hitting the ZLB. Admitting that the MPC is unable to do anything is also doing no good to its credibility. And neither does being overly optimistic about economic growth without providing any reliable rationale for such a belief.

Foreign exchange market – Awaiting a trigger

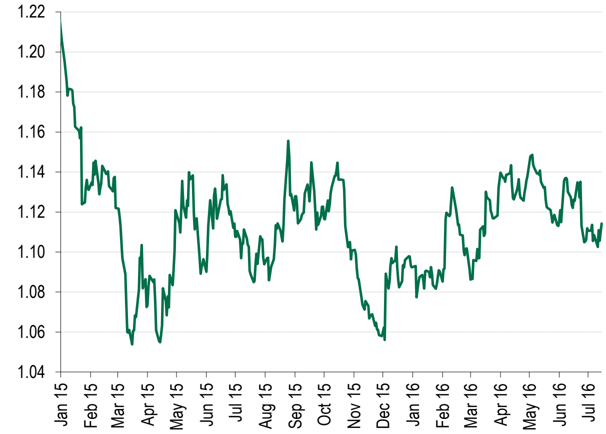
EURPLN



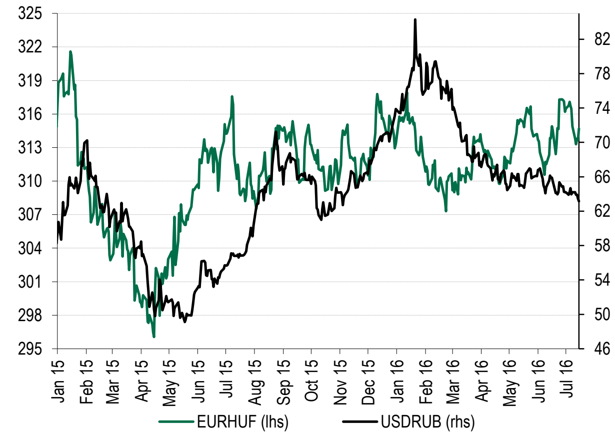
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



No big changes, still

- The Polish FX market was very calm this past week. EURPLN's trading range was the narrowest since early June, with the exchange rate fluctuating near 4.40 in the last days.
- We think that this week's global events will likely be key for the Polish FX market. All eyes will most likely be on the ECB, the Fed's monetary policy and economic outlook. Last week, the Bank of England refrained from announcing any additional stimulus and this proved somewhat disappointing for the market. The ECB holds its meeting this week, but we expect it to be action-less as well, which should come as a smaller surprise after the stand-by approach adopted by the BoE. This means that Mario Draghi's press conference will likely attract the most attention. The European and US macro data should also draw market attention and be positive for the zloty if they surprise to the upside.
- We have just revised down our GDP forecasts for 2016-2017, but monthly data to be released this week should be relatively strong and should have no negative impact on the zloty. Our estimate for industrial growth is above the consensus, while our retail sales forecast below. However, in both cases, we see an upward risk on news of very strong car sales and production in June. Overall, Poland's macro releases due this week may be slightly supportive for the zloty.
- Fitch will announce its decision on Poland's rating today, after the session's close. We expect the agency to keep both Poland's rating and outlook unchanged at A-/stable, even though we see a downward risk for the outlook. Nevertheless, even a revision to negative is unlikely to have a long-lasting negative impact on the zloty, in our view, as similar decisions have already been taken by S&P and Moody's. A similar move by Fitch would, therefore, not change Poland's perception abroad.
- EURPLN is consolidating in a narrowing range with 4.36 and 4.46 as the nearest levels to watch.

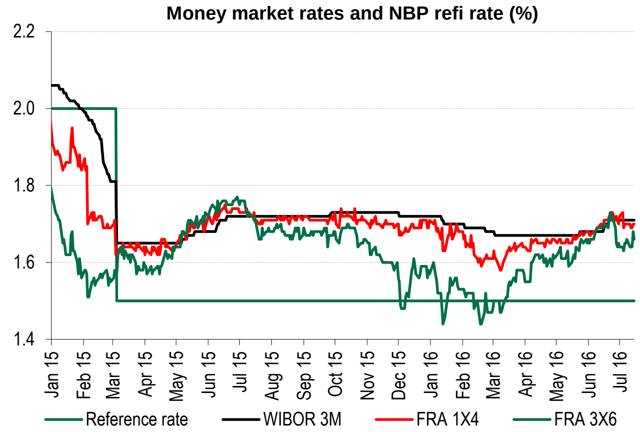
Awaiting a trigger

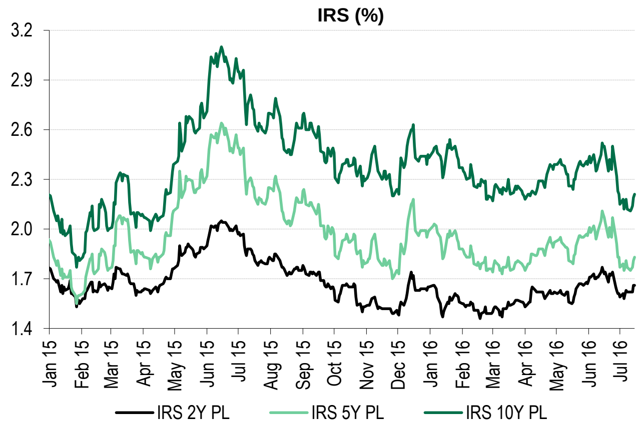
- The past week was already the third in a row of falling EURUSD volatility – the high-low spread for the last days was the lowest since late May. This shows that the market is need of stability following the sharp moves triggered by the Brexit vote.
- Flash PMIs for Germany and the euro zone are on the agenda at the end of the week and they may show whether the Brexit vote has already been affecting business sentiment. Earlier, the market's attention will likely focus on US numbers. Chances for a 25bp Fed rate hike this year have grown on the surprisingly strong June nonfarm payrolls (to c35%, according to Bloomberg), but this did not help the dollar as demand for safe assets fell pushing EURUSD to 1.115 from 1.10 since then. It seems that more US data are needed to support the dollar and this week's releases may have at last a short-term impact on the exchange rate.

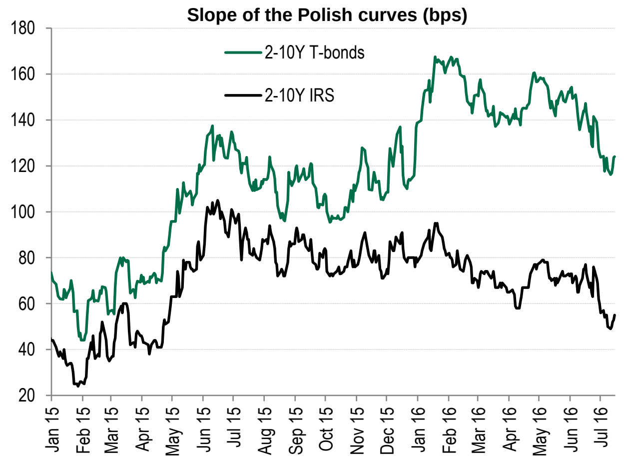
RUB gains on weak USD

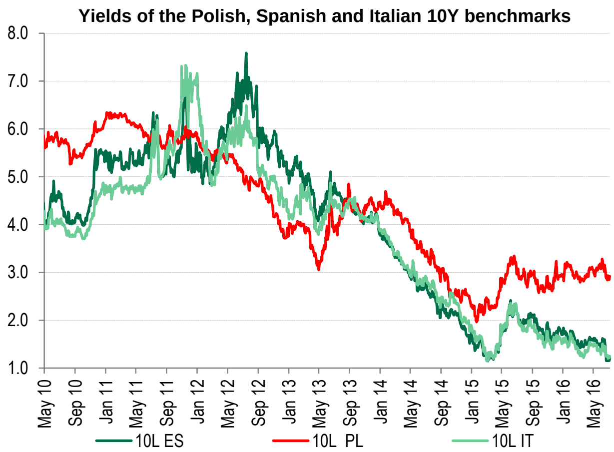
- The Russian ruble was the best performing CEE currency this past week. USDRUB fell below the local low, testing 63.0 and reaching its lowest level since November. The move must have been largely driven by the dollar's weakness in the global market since oil prices stayed put last week.

Interest rate market – ECB set to limit upside potential for rates









Rates up on BoE…

- The decision of the Bank of England had the biggest impact on the Polish (and global) FI market last week. The Brexit vote has made the market speculate that the global central banks would provide more monetary policy stimulus to prevent negative consequences of the UK referendum, which led to a substantial fall in rates. But when the BoE left its monetary policy parameters unchanged last week, it triggered an upside move on the IRS and yields worldwide, including Poland. As a result, the 10Y IRS neared 2.20% (+9bp on weekly basis), while the 5Y rate reached 1.80% (+6bp).
- Hawkish comments of the Polish MPC members failed to have any impact on WIBORs this time, but FRAs rose a few bps on a weekly basis (probably on the rising IRS rather than on the opinions expressed by the Council's members).

… but the ECB should limit the upside potential

- Looking at one-month correlations for the 10Y bonds, it seems that European debt moves are very similar – the correlation between Polish and German bonds settles at 70%. The case of US bonds is similar. The correlation between Polish and Spanish or Hungarian debt settles even above 90%.
- There are important global events on the agenda this week, which are likely to drive both the core and peripheral markets.
- The US nonfarm payrolls surprised well to the upside in the previous week, but failed to trigger any noticeable and persistent upside move in rates as global concerns about the Brexit's impact proved more important. If this continues to be the case, then incoming US data would need to be even more upbeat to make this year's Fed rate hike more likely and push the IRS/yields higher.
- This could be hard to achieve already this week with the ECB holding its meeting. We do not expect the bank to announce any more measures already this week, but the governor is unlikely to sound hawkish at the press conference given the fragile global sentiment. Hence, we think that room for higher Polish IRS and yields is limited in the days to come.
- As both industrial production and retail sales data for June should be quite strong, it may be slightly negative for the short end of the yield curve, in our view, trimming investors' expectations for interest rate cuts. For the long end, global trends should be more important.
- Fitch's decision on Poland's rating should not have a long-lasting impact on the bond market, in our view.

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