Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

1 – 7 August 2016

The FOMC meeting, the most awaited event of the past week, failed to deliver a clear message on the most possible scenario in the US monetary policy. The mix of dovish and hawkish remarks found in the FOMC post-meeting statement resulted in sharp dollar depreciation, but failed to trigger any persistent moves on the interest rate and equity markets. On the one hand, the US central bankers stressed that the outlook for the US economy became more positive. On the other hand, however, the pace of rate hikes is expected to be still only gradual. We still expect the FOMC to raise rates by 25bp in December.

In Poland, EURPLN's weekly trading range was the lowest since early June despite the positive impact of the FOMC statement. At the same time, the IRS and bond yield curves moved slightly up on the heavy bond supply planned for the debt auction. However, the auction attracted strong demand, allowing the Ministry of Finance to successfully launch T-bonds worth nearly PLN8bn. As a result, Poland has covered c77% of this year's borrowing needs.

The FOMC's ambiguous post-meeting statement did not influence the market's pricing for the Fed rate hikes and chances stand at c35% for a 25bp hike in December, according to Bloomberg. This could change this week, in our view, as the US monthly non-farm payrolls and ISM for manufacturing are on the agenda. We think that strong US data could have a bigger impact on the zloty than weak releases. At the same time, we expect a rather calm week for the interest rate market as European data, which we view as key for the Polish FI market, shall not surprise much. Note, however, that the trading range for the 10Y bond yields in July was the narrowest since February 2012 and the falling volatility indicates that a more noticeable move could happen soon. Recall also that August is generally a rather poor month for the zloty – EURPLN fell that month only twice in the last ten years.

Economic calendar

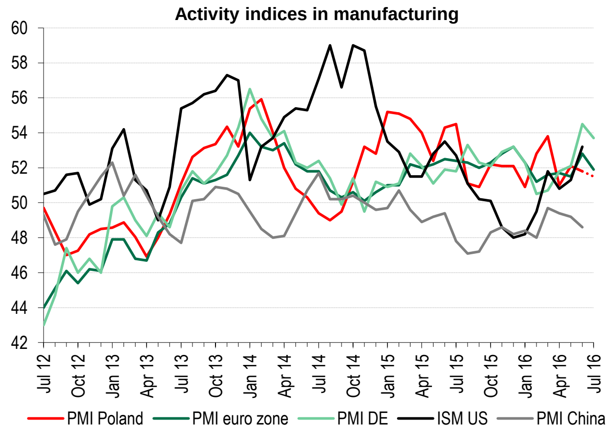
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (1 August)					
3:45	CN	PMI – manufacturing	Jul	pts	48.8	-	48.6
9:00	**PL**	**PMI – manufacturing**	**Jul**	**pts**	**51.6**	**51.5**	**51.8**
9:55	DE	PMI – manufacturing	Jul	pts	53.7	-	54.5
10:00	EZ	PMI – manufacturing	Jul	pts	51.9	-	52.8
16:00	US	ISM – manufacturing	Jul	pts	53.0	-	53.2
		TUESDAY (2 August)					
14:30	US	Personal income	Jun	% m/m	0.3	-	0.2
14:30	US	Consumer spending	Jun	% m/m	0.3	-	0.4
		WEDNESDAY (3 August)					
9:55	DE	PMI – services	Jul	pts	54.6	-	53.7
10:00	EZ	PMI – services	Jul	pts	52.7	-	52.8
14:15	US	ADP report	Jul	k	170	-	172
16:00	US	ISM – services	Jul	pts	56.0	-	56.5
		THURSDAY (4 August)					
13:00	GB	Central bank decision		%	0.25	-	0.50
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Initial jobless claims	week	k	-	-	266
16:00	US	Industrial orders	Jun	% m/m	-1.9	-	-1.0
		FRIDAY (5 August)					
8:00	DE	Factory orders	Jun	% m/m	0.5	-	0.0
14:30	US	Non-farm payrolls	Jul	k	180	-	287
14:30	US	Unemployment rate	Jul	%	4.8	-	4.9

Sources: 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

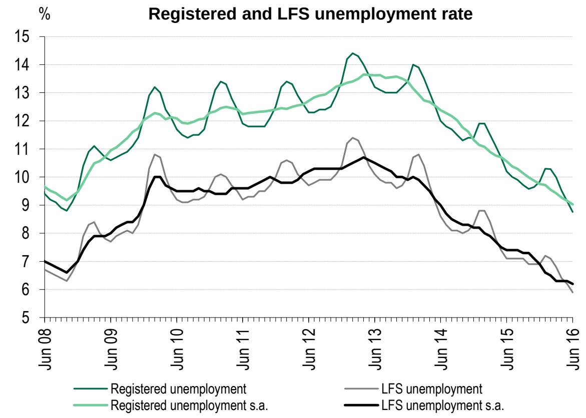
What's hot this week – PMI for Poland

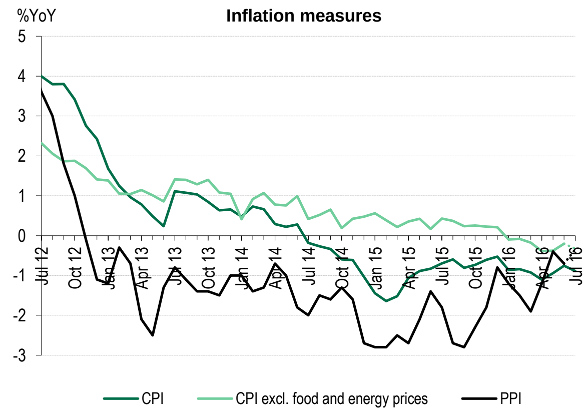


▪ We expect Poland's PMI index to inch down in July. We believe that it may have been dragged lower by the outcome of the UK referendum, as was the case of PMIs for the euro zone and Germany. However, let us keep in mind that economic climate indices for these countries fell less than expected, hence we do not expect a major drop in this gauge for Poland. Moreover, we do not see factors that may be pushing the PMI index higher, as we expect the country's economic growth to stabilise close to 3% y/y in the upcoming months.

▪ We do not rule out that the president will present his CHF loan conversion bill this week. Let us keep in mind that the president's advisors had suggested last week that the bill was almost ready and could be presented within a few days' time. On the other hand, the parliament is on a vacation break until September, so the presentation could be postponed until then.

Last week in the economy – Unemployment rate and flash CPI





▪ The unemployment rate fell to 8.8% in June from 9.1%. The number of the unemployed totalled 1392.5k vs 1456.9k in the previous month, with the jobless registrations at 155.5k in June (+5% y/y and +0.7% m/m). We think it is worth stressing that less people get removed from the unemployed rolls due to finding a non-subsidised job (-14% y/y) and the number of job offers also keeps on growing (to 113.6k, an all-time high). These trends suggest, in our view, that there are rising tensions on the labour market. The LFS unemployment rate fell to 6.2% in June, a new all-time low. Employment growth, derived from the LFS unemployment data, is at c1% y/y. We expect the unemployment rate to continue to fall in the months to come.

▪ Flash CPI for July fell to -0.9% y/y from -0.8% y/y in June. According to our estimates, CPI fell due to a decline in fuel prices and high base effects in health and communications. In our view, core inflation excluding food and energy prices inched down to -0.3% y/y in July. We expect inflation to remain close to its current level also in August and then to climb and turn positive at the year-end.

▪ Detailed data on June's employment showed that the substantial rise in the industrial sector (+19k m/m) stemmed largely from growth in manufacturing (+8k m/m). Such a significant hiring scale is surprising given the rising tensions in the labour market and weak numbers in the LFS statistics. In our view, this might have partly been due to changes in the forms of employment due to the new legal regulations, but we expected this to be rather the case in trade and supportive services, where the non-typical forms of employment are more common. The strong growth of wages in June (5.3% y/y) was partially due to delayed bonus payments in the manufacturing of coke and refined petroleum products (adding c1pp to the headline number).

Quote of the week – Ministry's growth estimate may go down

Paweł Szałamacha, finance minister, July 29, Puls Biznesu

We are implementing our tax collection improvement programme. This has to be correlated with our election promises. And this limits the possibility to cancel or lower the copper tax in 2017. At the start of August, the statistics office will show GDP data for Q2. Based on these, we will be able to present our revised estimates of GDP. We have already signaled that downward revisions cannot be ruled out.

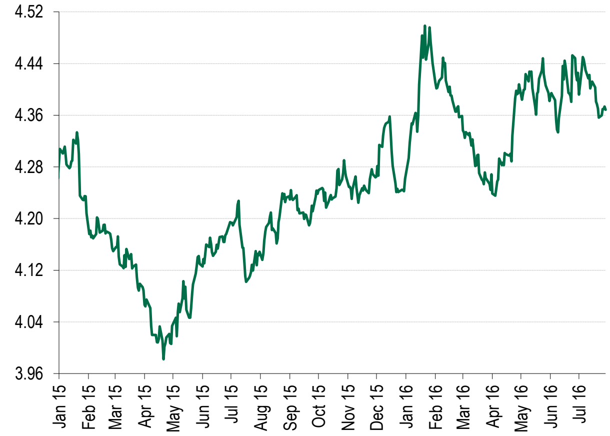
Wiesław Janczyk, deputy finance minister, July 25, PAP

We have the possibility to correct the banking tax (…) The year-end will be a good moment to review the law and initiate a possible revision. Any revisions will not be arbitrary, but based on the budget's spending needs.

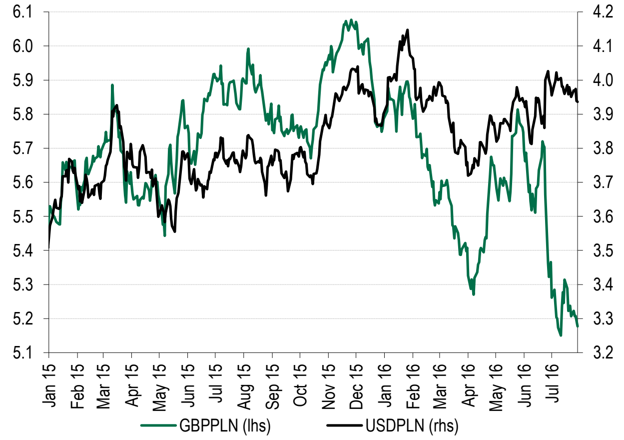
Comments of the Finance Ministry's officials have shed a bit more light on the 2017 budget. First, the automatic VAT cut is likely to be abandoned (Szałamacha suggested that earlier). Second, there will be no modifications in the copper tax (earlier the government suggested it could be lowered or even dropped). Third, the ministry's GDP growth forecasts may be revised down (currently at 3.9% y/y), which would be negative for the tax revenue forecasts. The ministry's Janczyk also suggested that the banking tax may be reviewed at the year-end and that the budget's spending needs could trigger changes in its rate. The Ministry seems to be clearly aware that the 2017 budget will be more difficult than the one in 2016, which was to a large extent supported by one-off revenue inflows.

Foreign exchange market – Key risk factor for PLN remains in place, focus on US job report

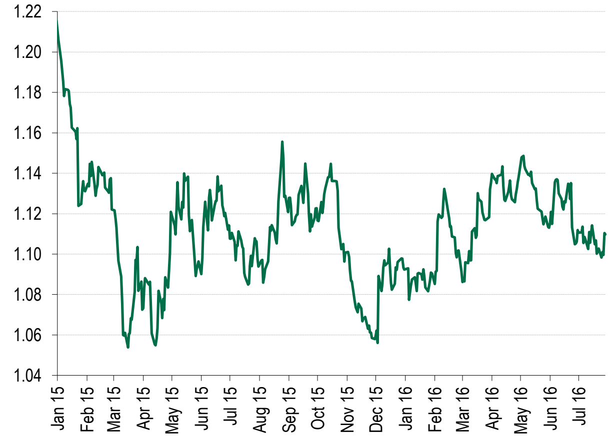
EURPLN



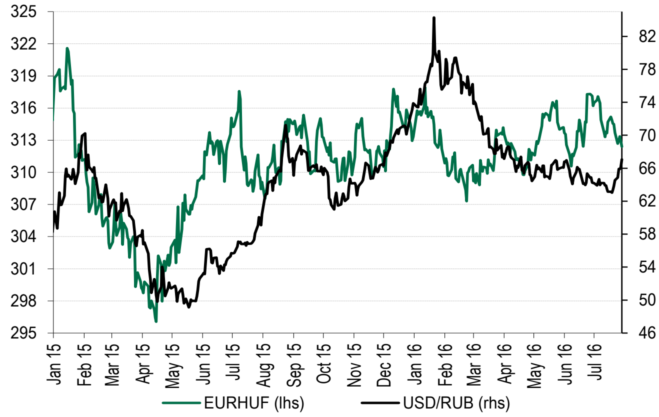
USDPLN and GBPPLN



EURUSD



EURHUF and USDRUB



Zloty quite strong, but sentiment fragile

- Poland's FX market was mixed this past week. EURPLN moved sideways, while USDPLN fell to 3.90 on a rising EURUSD. At the same time, CHFPLN fell below 4.00 for a while (after EURCHF rose well above 1.09) and GBPPLN fell below 5.16, not so far from this month's minimum level of 5.14. The Polish zloty benefited from the FOMC rhetoric, which was less hawkish than expected, but volatility on PLN was still very low last week as EURPLN traded in the 4.35-4.38 range.
- From the technical point of view, the EURPLN chart was little changed last week. The rate is anchoring close to the lower boundary of its short-term 4.35-4.38 range. This week's domestic macro calendar is quite light and only includes July's PMI for Poland's manufacturing sector at the start of the week. The downward correction in the PMI, spurred by the Brexit vote, should be muted in July, leading to a rather moderate market reaction, in our view. This also means that macro releases from Europe and the US will be the key factors for investors, including the non-farm payrolls data. We think that strong data from the US economy might renew expectations for an earlier rate hike by the Fed this year. This could pull the zloty down in the short run.
- On the domestic side, the final version of the president's CHF mortgage conversion bill remains the main risk factor for PLN in the mid- to long term. The zloty may weaken significantly (even above 4.40 against the euro) if the bill proves painful for the financial sector. The key levels for EURPLN are still at 4.33 and 4.43.

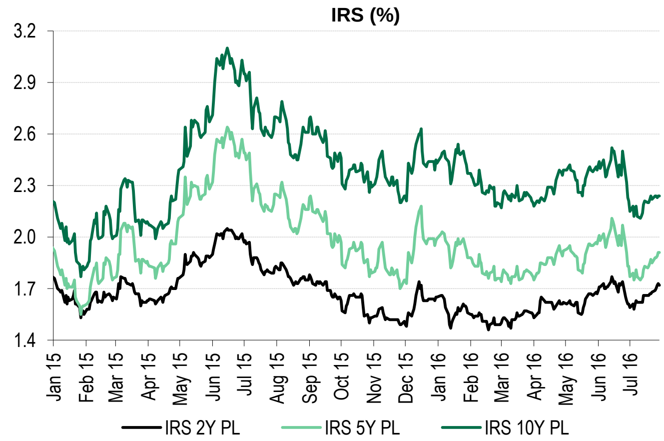
Fed likely to hike rate before year-end

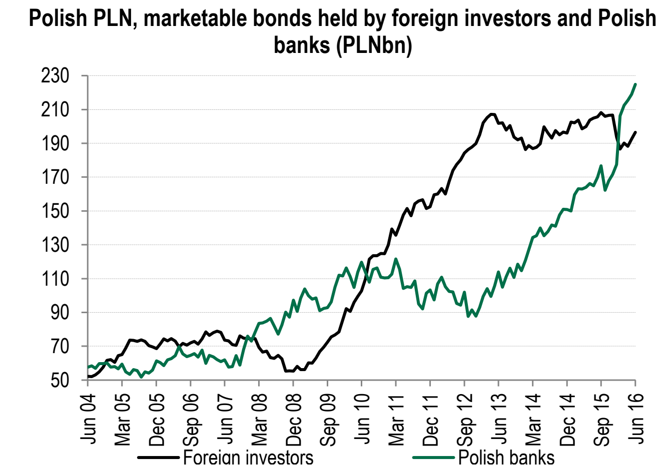
- EURUSD was in a narrow range of 1.096-1.103 ahead of the FOMC meeting. As expected, the Fed left the official rates unchanged and gave no clear hint of the timing of the next rate hike. However, the Committee's statement triggered a significant jump in EURUSD volatility – the dollar gained first probably on the one vote for a Fed rate hike already at this meeting, but, finally, the exchange rate increased above 1.11 (the highest level since mid-July) as the declaration to deliver only gradual rate hikes proved more important and after much weaker than expected the US GDP growth for 2Q16.
- The FOMC statement highlighted that that near-term risks to the economic outlook have diminished and this leaves the door wide open to a rate hike before the end of the year. We continue to expect the next move in December, but if US economic data hold up, a rate increase could come as early as September. Therefore, the July US job report due at the end of this week may be the key event for investors. If macro data confirm the US economic growth is healthy, expectations for an earlier monetary tightening in the US could be renewed, pushing USD higher.

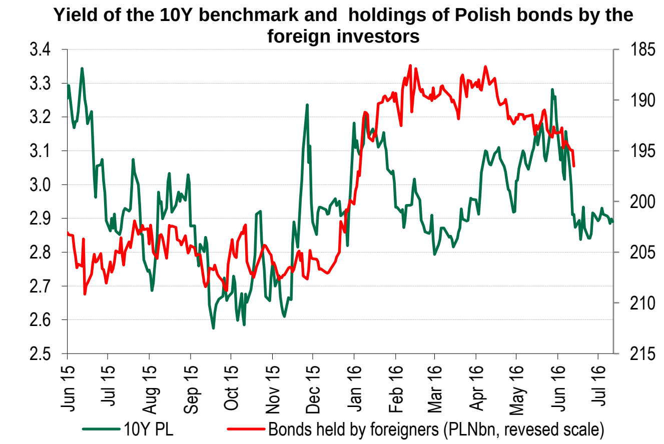
Stronger HUF, weaker RUB

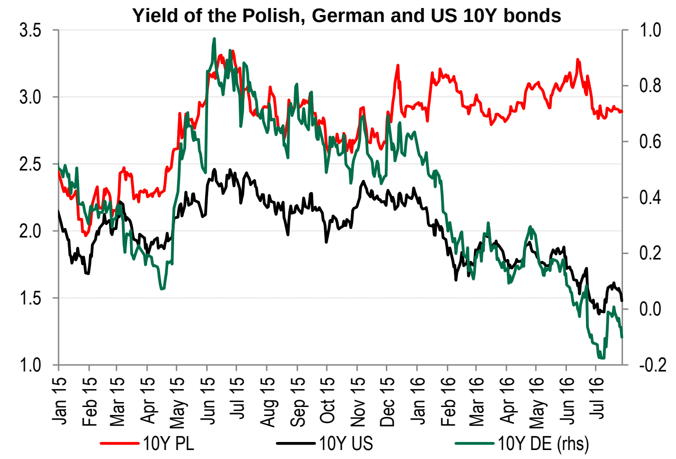
- The Hungarian forint strengthened noticeably over the past week, with EURHUF touching nearly 311 for a while, the lowest level since mid-June. This stemmed from the FOMC rhetoric. The Hungarian central bank's decision to keep monetary conditions unchanged was in line with expectations, with no impact on EURHUF. On a weekly basis HUF firmed 0.5% against the euro. At the same time, the Russian ruble lost ground as prices of Brent fell below USD43/bbl, the lowest level since mid-May. As a result, USDRUB rose slightly above 67 for the first time since early June, but trimmed part of earlier losses after the Russian central bank decision to keep rates stable.
- Global sentiment will be crucial for the CEE currencies, with the July US job report setting the market direction. The Czech central bank's meeting will be rather neutral as we expect it to keep its monetary policy unchanged.

Interest rate market – Calm weak ahead but volatility may rise soon









Rates up on heavy bond supply

▪ Polish IRS and bond yield curves moved up in the last week on a heavy bond supply outlook for the planned auction and despite falling rates on the core and peripheral bond markets in Europe. As a result, the 5Y IRS rose to 1.90%, while the 10Y rate neared 2.25% reaching their July peaks.

▪ Poland's Ministry of Finance tapped the primary market with bonds worth nearly PLN8bn, close to the upper limit of the planned offer. The 5Y benchmark PS0721 attracted most interest, with sales at more than PLN5bn. The average auction yield stood at 2.327%, slightly below the secondary market level at the opening of Thursday's session. We estimate that after this auction the Ministry of Finance has covered c77% of this year's borrowing needs.

Nonresidents, Polish banks accumulate bonds

▪ According to the most recent data released by the Ministry of Finance, non-residents bought Polish, PLN-denominated marketable bonds for PLN4bn in June and the nominal value of their portfolio reached PLN196.5bn. June was the eighth consecutive month characterised by aggressive buying on the part of Polish commercial banks and the nominal value of their portfolio rose by PLN5.9bn to a fresh all-time high at nearly PLN225bn.

▪ The Ministry of Finance said there would only be one bond auction in August, at which it planned to offer bonds worth PLN4-8bn.

Calm weak ahead but volatility may rise soon

▪ The FOMC's ambiguous post-meeting statement had no effect on the market pricing of Fed rate hikes. The market sees the chances at nearly 35% for a 25bp hike in December, according to Bloomberg. This could change this week, in our view, with the US monthly non-farm payrolls and ISM for manufacturing on the agenda.

▪ The most recent data was quite strong, with ISM rising to its highest since June 2015 and the non-farm payrolls recovering in June after a sharp deterioration in May. These releases pushed the 10Y US yield 15bp and the German 10bp up, while the Polish 10Y bond yield remained below its monthly peak at the end of this week. Perhaps this outperformance of the domestic market is due to the fact that the market in Europe is speculating on not "if", but "when" the ECB could extend its asset purchase program. At the same time, the Bank of England is on its way to cut rates, which is a completely different story than in the US. Note that in the course of the past month, the correlation between the 10Y Polish and German bonds fell to 0.36 from 0.70, while for the respective German and US benchmarks it is at nearly 1.

▪ If the reasoning outlined above is correct, then euro zone data should be more important for the Polish IRS and yields. July's final PMIs for manufacturing and services should not deviate much from the initial estimates and there are no other important releases on the agenda. Thus, this week could be rather calm for the Polish market.

▪ Note, however, that the trading range for the 10Y bond yields in July was the narrowest since February 2012 and the falling volatility indicates that a more noticeable move could happen soon.

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.