

WEEKLY ECONOMIC UPDATE

8 – 14 August 2016

The key event last week was the (long-awaited) announcement of the President's plan regarding CHF-loans. The proposal was positively received by the market (EURPLN below 4.30, 10Y yield at c2.7%), as the scenario of a forced one-off conversion of FX-loans is off cards. Giving back bid/offer FX spreads to clients will be the only element addressed by the legislation (cost estimated by authorities at cPLN4bn). However, uncertainty as regards CHF-loans still exists as later this year banks will be incentivised by the introduction of regulatory measures (higher risk weights, capital requirements for FX-loans) to offer a conversion to clients. This conversion will be probably gradual (impact on FX market and losses for the banking sector spread over time) and much will depend on the final recommendation presented by authorities this autumn. That is why we see further gains for the zloty as rather limited in the next few weeks/months.

This week the Polish macro data calendar is rather heavy with releases concentrated on Friday, out of which the key will be the Q2 GDP. We do not expect a significant recovery from 3% in Q1 and our forecast of 3.1% is below market consensus. We also see only a stabilisation of the economic growth in the following quarters (below consensus), which may revive market expectations for some easing by the Polish Central Bank (being also negative for the zloty). The scenario of no GDP growth recovery was also suggested by the sharp fall of July's PMI to almost 50pts.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (8 August)							
8:00	GE	Industrial output	Jun	% m/m	0.9	-	-1.3
9:00	CZ	Industrial output	Jun	% y/y	2.2	-	8.6
TUESDAY (9 August)							
8:00	GE	Exports	Jun	% m/m	1.4	-	-1.9
9:00	CZ	CPI	Jul	% y/y	0.3	-	0.1
9:00	HU	CPI	Jul	% y/y	-0.1	-	-0.2
WEDNESDAY (10 August)							
No important data							
THURSDAY (11 August)							
14:30	US	Initial jobless claims	week	k	-	-	269
FRIDAY (12 August)							
8:00	GE	Flash GDP	2Q	% y/y	-	-	1.3
9:00	HU	Flash GDP	2Q	% y/y	1.7	-	0.9
10:00	PL	Flash GDP	2Q	% y/y	3.3	3.1	3.0
11:00	EZ	Flash GDP	2Q	% y/y	1.6	-	1.7
14:00	PL	CPI	Jul	% y/y	-	-0.9	-0.8
14:00	PL	Money supply M3	Jul	% y/y	11.2	11.2	11.4
14:00	PL	Current account balance	Jun	€ mn	-52	-36	495
14:00	PL	Exports	Jun	€ mn	14 753	14 790	13 351
14:00	PL	Imports	Jun	€ mn	14 388	14 607	13 224
14:30	US	Retail sales	Jul	% m/m	0.2	-	0.6
16:00	US	Flash Michigan	Aug	pts	92.0	-	90.0

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

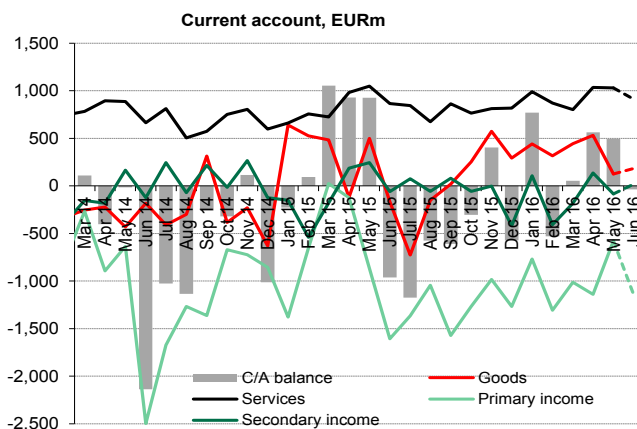
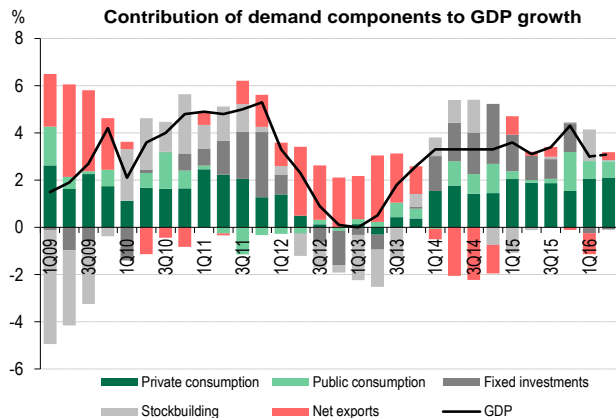
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

Wrocław +48 71 369 9400

What's hot this week – Lots of domestic data

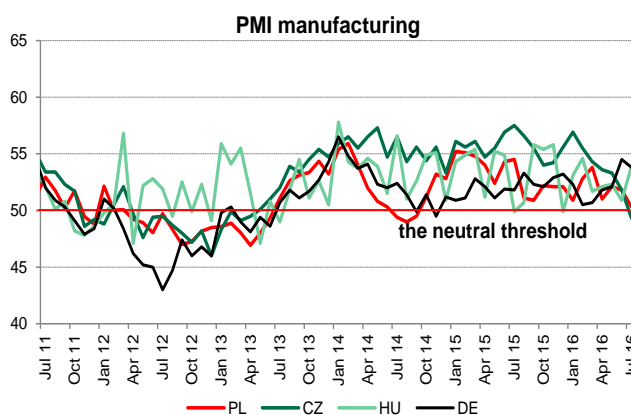
■ This week is quite heavy with domestic macro releases. The flash GDP for Q2 seems to be the key number. The recently released monthly macro data support our belief that GDP growth in 2Q16 was not significantly better than in 1Q (near 3% y/y). In our view, private consumption remained the main driver of Poland's economic growth, while investment growth was negative again, though at a much lower scale than in Q1 (nevertheless, the market consensus expects a moderately positive figure).

■ Deputy PM and minister for development, Mateusz Morawiecki, still expects GDP growth of more than 3% for 2Q and 3.5% for the whole 2016. Although our forecast for 2Q is at 3.1%, we are less optimistic than Morawiecki on growth in the entire year. Weaker business confidence due to the Brexit and foreign growth prospects fuelled mainly by internal consumption (to a lesser extent by exports) make us cautious regarding a possible GDP acceleration in the quarters to come. July's PMI for manufacturing (see details below) seems to confirm that it may be hard of economic activity to pick up in the nearest future.

■ We expect the final July CPI reading to be confirmed at -0.9% y/y. This release should not attract much market attention as the MPC has already reiterated several times that it is the pace of GDP growth that is their particular concern now.

■ For the current account data we predict a small deficit as primary income may show a deficit that is twice as high as in May. However, we should see a moderate trade surplus, as we expect exports to recover after their y/y contraction in May.

■ Loan growth will be the most important element as far as the M3 money supply is concerned.

Last week in the economy – PMI close to 50 pts threshold

■ Polish manufacturing PMI disappointed in July by falling much more than expected. The drop to 50.3pts from 51.8pts dragged the index down to its lowest since September 2014.

■ The biggest negative contribution came from new orders, which fell for the first time since September 2014, including new exports orders, which contracted for the first time since September 2015. The falling orders led to stagnation in output, but employment continued to grow. The lower number of orders, particularly for exports, confirms that Polish companies may be concerned about the consequences of the UK referendum.

■ The reading confirms our scenario of no acceleration in the pace of economic growth this year.

Quote of the week – President reveals plans of addressing FX loans**Adam Glapiński, NBP President, August 2, Reuters**

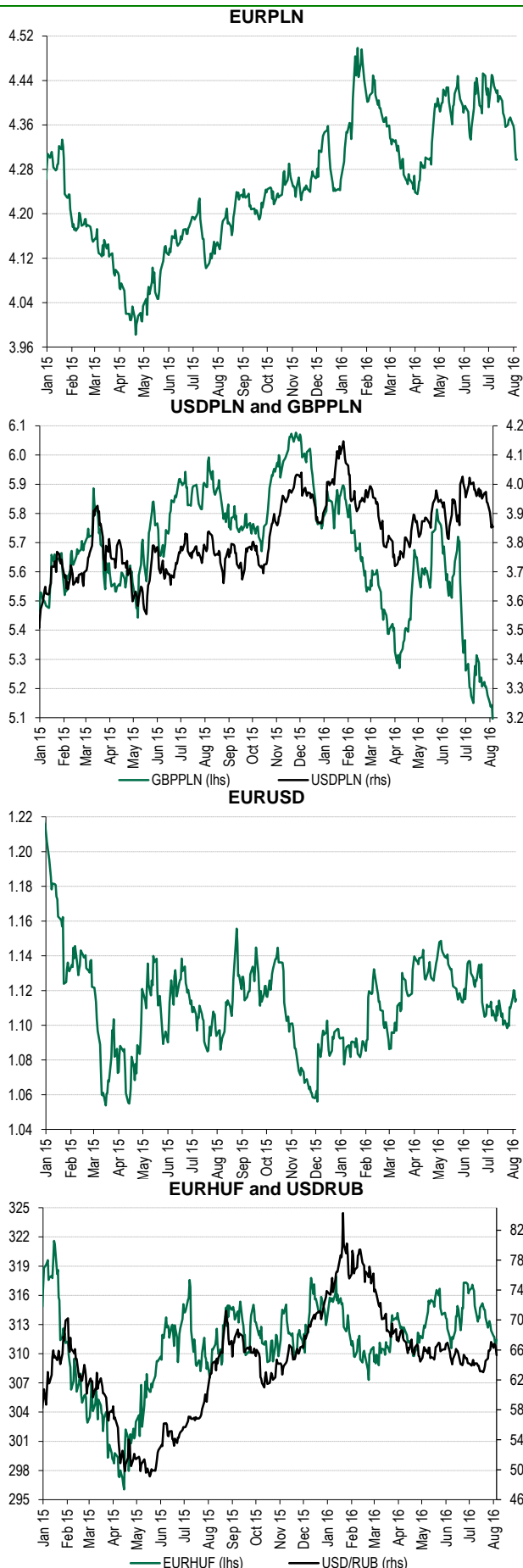
FX mortgages do not generate a risk for the banking sector's stability for now. I asked the president to refrain from the re-denomination of FX loans that he had planned and replace it with another solution. Banks will have to increase risk weights if they are not converting FX loans, so they will be forced to offer attractive solutions to their clients. Re-denomination will be spread over time-not too long, not too short. A conversion should, however, take place within a reasonable time frame, and this will happen. Banks may choose ways other than FX-loan re-denomination to meet the additional capital requirements.

Maciej Łopiński, minister in Chancellery of the President, August 2

Financial regulator KNF will encourage banks to voluntarily offer FX loan re-denomination. If the effects of voluntary re-denomination prove unsatisfactory, it may choose to enforce it with legislation.

The President outlined his proposal to solve the issue of FX mortgage loans. The case of the bid-offer spreads would be solved through the bill: banks would be required to give back a portion of the spreads back to their customers, including interest, amounts which would lower the principal amounts of the mortgage loans outstanding (or in cash if the loan had already been paid back). According to officials, the cost for banks would range between PLN3.6 and 4bn – less than the previous proposal, which is likely the result of introducing a cap on the loan's size, allowing banks to retain a portion of the spreads earned. The issue of conversion would be addressed in a regulatory manner and would be voluntarily conducted by the banks themselves. New regulatory requirements with respect to FX loans (higher and rising risk weights and capital requirements) would provide incentives for the conversion. On August 10, the Financial Stability Committee will meet to begin discussions on the capital requirements. Central bank Governor Adam Glapiński said that the final proposal should be ready in October.

Foreign exchange market – Very positive reaction to CHF-loan proposals



Zloty gains, EURPLN below 4.30

Polish events continue to play the main role on the domestic FX market. Back in mid-July EURPLN fell sharply after Fitch decided to keep Poland's rating and outlook unchanged and after a period of stabilisation near 4.35 the exchange rate now plummeted below 4.30. This came with the release of the President's idea on how to solve the issue of FX mortgages. A positive reaction to this was also visible on USDPLN that fell to 3.84 from c3.90, CHFPLN that eased to 3.93 from 4.03 or GBPPLN that dropped to 5.10 from 5.15. Interestingly, there was no big market reaction to the decision by Bank of England, which decided to cut rates and extend its asset purchase programme.

Since the beginning of the month, the zloty has been the 3rd strongest EM currency vs the euro, dollar, Swiss franc and British pound, but we do not expect this trend to continue in the nearest future. The risk of a gradual conversion in the following quarters still exists and much will depend on the final recommendation presented this fall. Please note also that, statistically, the summer is not very positive for the zloty. In the last ten years, the zloty only gained vs the euro twice in the month of August. Although it could be hard for EURPLN to rise (significantly) above 4.35, this seasonal pattern could at least limit the scope for further appreciation (4.26 may work as strong support in the short term).

Polish events may again have the key impact on the zloty this week as flash 2Q GDP will be released and there are no vital data on the agenda abroad. Our forecast for GDP is below the market consensus and if it proves correct it might be negative for the zloty. Also, amid expectations for more monetary policy easing, it could hit the zloty.

Dollar could regain ground

In the first days of the past week EURUSD continued the upside move triggered on the previous Friday after the much worse-than-expected advance US 2Q GDP data. The exchange rate reached 1.123 with the euro recovering already more than half of its losses suffered after the UK referendum. However, decent data from the US released in the next days supported the dollar and at the end of the week EURUSD neared 1.115 again.

The coming week is rather light in terms of important data releases (only the US nonfarm payrolls look like a potential market driver) and there are also no important speeches by speakers on the agenda. Since late July the euro gained vs the dollar and the US currency could regain some ground if there are no fresh impulses that could fuel the upside trend in EURUSD.

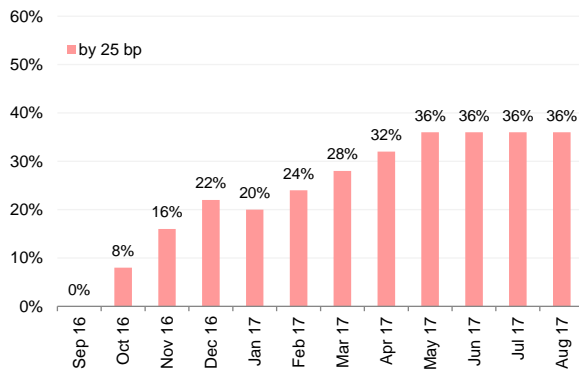
Falling oil price hits ruble

The ruble remained on the back foot against the dollar and the past week was already third in a row of a rising USDRUB (a longer losing streak was last seen in January). The Brent price reached its fresh local low at cUS\$41.5/bbl and this might have been one of the factors driving the ruble lower.

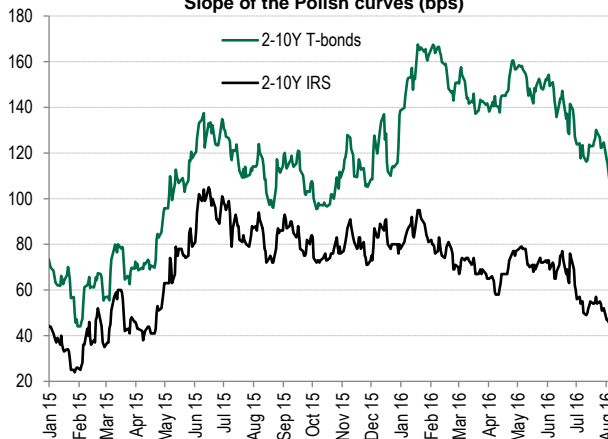
In the meantime, EURHUF remained stable near the local bottom at 310 reached in the previous week.

Interest rate market – Yields hit this year's lows

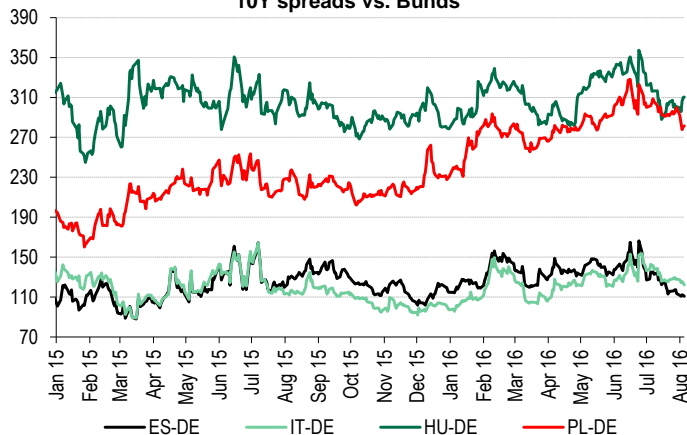
Probability of rate cuts
(implied by FRA rates on August 5)



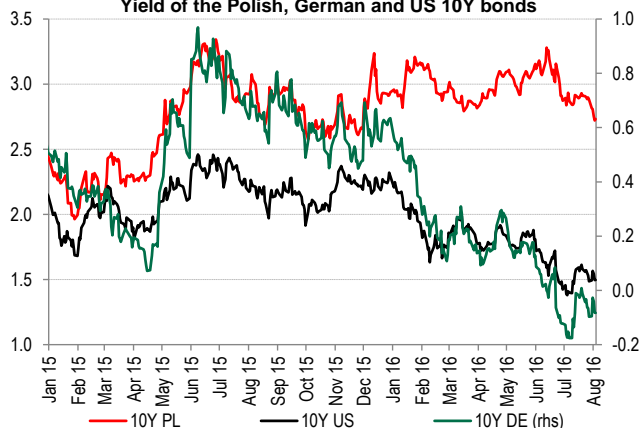
Slope of the Polish curves (bps)



10Y spreads vs. Bunds



Yield of the Polish, German and US 10Y bonds



Strong rally thanks to new FX mortgage relief proposals

▪ The start of August was good for Polish assets. Both T-bonds and IRS gained significantly on the released new version of the presidential bill aimed at helping FX mortgage borrowers. The announcement removed some uncertainty for the Polish assets, as the new plan is more benign for the banking sector than had been expected. Consequently, the 10Y benchmark yield hit a fresh low of the year at nearly 2.70% (temporarily). At the same time, the 10Y IRS rate fell again below 2.20%, its lowest since mid-July. Additionally, the core markets were strong, also supporting Poland's curves.

▪ On a weekly basis, both the yield and IRS curves shifted down, with the long end of the curves outperforming other sectors. As a result, we saw a bull flattener, with the 2-10Y spread tightening to 108 bp for T-bonds and to 47 bp for IRS. It is also worth mentioning that the bond market rallied more strongly than swaps, which narrowed the asset spread, especially in the 10Y sector. What is more, the risk premium for Poland's assets also shrank on the announcement of the new FX mortgage relief bill, pushing the spread over the Bund for the 10Y sector down, below 280 bp, its lowest since mid-May.

▪ On the money market WIBORs were unchanged, with the FRA rates slightly lower over the past week, keeping the spread over WIBOR 3M negative (in the range of 3-9 bp). That said, the market is now pricing in a touch less monetary easing compared with the end of July. The market currently sees less than a 30% chance that rates will be cut by 25bp until year-end.

Flash GDP data in Europe to set market direction

▪ This week will be rich in events, particularly on Friday, when the first set of domestic macro data is due to be released. Flash 2Q16 GDP data will be the key release, in our view, as the MPC pays very close attention to economic growth data (amid the persistent deflation). We expect the 2Q16 GDP growth to be slightly lower than the market consensus (3.1% y/y vs 3.3% y/y according to Bloomberg and vs 3% in 1Q16). If we are proven correct, there will be some room for further falls in the FRA rates. Moreover, there may be a bull steepening of the curve if expectations for NBP interest rate cuts start building up again on the weaker GDP growth story. At the same time, the final CPI reading for July will likely be rather neutral for the market, as we expect the headline number to be in line with the flash outcome.

▪ Global factors will also play an important role for the Polish assets, with investors awaiting further direction after the July job report in USA. It should be remembered that expectations for monetary tightening by the Fed later this year have faded after the much-weaker-than-expected first release of 2Q16 GDP growth in the US. The market currently sees less than a 40% chance that rates will be hiked by the FOMC this year. In our view, rate hike expectations may bloom again on strong non-farm payrolls. As a consequence, yields on the core market might rise, which could indirectly deteriorate sentiment on the Polish debt market, especially on the long end of the curve. However, room for growth in the 10Y Bund yield is rather limited as the ECB, like the BoE, may ease its monetary policy further due to the Brexit prospects. Therefore, flash GDP growth for 2Q16 in the euro zone and in Germany might be an important issue for investors globally.

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>.