

WEEKLY ECONOMIC UPDATE

5 – 11 June 2017

The recent data from the Polish economy were a mixed bag. They confirmed a solid 4% GDP growth in the first quarter, yet with a disappointing breakdown (no rebound in investments yet), a surprising drop in the manufacturing PMI in May, and a decline in the headline inflation rate to 1.9% y/y in May. We expect economic growth to stabilise near 4% this year, while inflation to hover near 2% in the nearest months, with a likely decline to 1.7% in December due to high base effect. In such environment, we do not expect the Polish central bank to hurry with tightening the monetary policy.

Therefore, the nearest meetings of the Monetary Policy Council will continue as not too exciting for the market. The Polish central bank is likely to keep its monetary policy unchanged, repeating its mantra that there are no reasons to worry about the inflation outlook and the negative real interest rates have no adverse effect on the economy. Potentially, the meeting of the European Central Bank could potentially turn out much more interesting. The recent economic recovery in the euro zone combined with the diminishing European geopolitical uncertainty raised the market speculation about more hawkish tone at the June ECB meeting. In our view, chances that the ECB will dare to change their forward guidance to signal that QE tapering is coming have been reduced after a soft Mario Draghi speech and a surprising drop in the Euro zone inflation in May. The Thursday meeting can, however, have a significant impact on the Polish currency and assets. The probability of a hawkish move is limited but non-negligible. The ECB will update its macroeconomic forecasts with possible upward revisions so it seems to an opportunity to upgrade the macro assessment part of the statement. That said, we think the ECB will prefer to stay very cautious.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (5 June)							
16:00	US	ISM – services	May	pts	57.0	-	57.5
16:00	US	Industrial orders	Apr	% m/m	-0.2	-	0.2
16:00	US	Durable goods orders	Apr	% m/m		-	-0.7
TUESDAY (6 June)							
9:55	DE	PMI – services	May	pts	55.2	-	55.4
10:00	EZ	PMI – services	May	pts	56.2	-	56.4
WEDNESDAY (7 June)							
	PL	MPC decision					
8:00	DE	Industrial orders	Apr	% m/m	0.0	-	1.0
9:00	CZ	Industrial output	Apr	% y/y	-1.0	-	10.9
11:00	EZ	GDP	Q1	% y/y	1.7	-	1.8
THURSDAY (8 June)							
8:00	DE	Industrial output	Apr	% m/m	0.5	-	-0.4
9:00	HU	CPI	May	% y/y	2.2	-	2.2
11:30	PL	Bond auction					
13:45	EZ	Central bank decision			0.0	-	0.0
FRIDAY (9 June)							
8:00	DE	Exports	Apr	% m/m	0.4	-	0.4
9:00	CZ	CPI	May	% y/y	2.1	-	2.0

Source: BZ WBK, Reuters, Bloomberg

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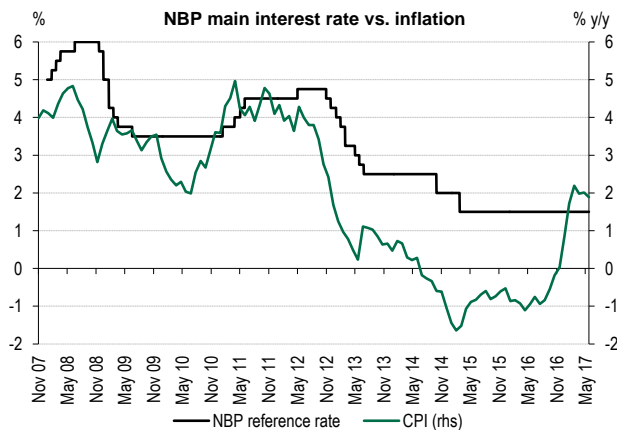
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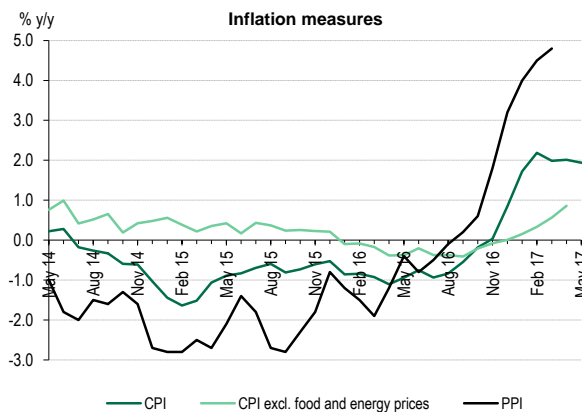
What's hot next week – ECB likely to shake markets, reaction to NBP unlikely



- The MPC meets this week to decide on monetary policy. Meetings with a high chance of rate changes are still a distant future. Apart from that, many members have already redirected market attention to July, when the next Inflation Report will be available. What we are likely going to get from this meeting is the MPC's take on the 1Q GDP (with no growth in investments, but a surprisingly strong reading overall) and the further decline of inflation. We doubt the latter will calm down the minority inside the Council that fears the effect on CPI of a possibly increasing wage pressure (as the labour market gets tighter). On the other hand the latest data did not give them arguments to become more vocal.

- The ECB meeting on Thursday is definitely a more market-relevant event - more on this on our interest rate market page.

Last two weeks in economy – CPI and PMI down, GDP breakdown disappointed

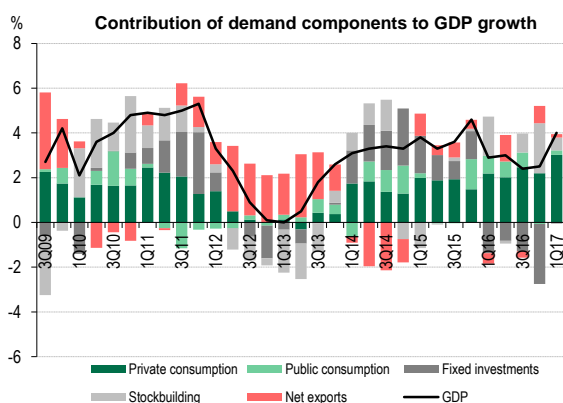
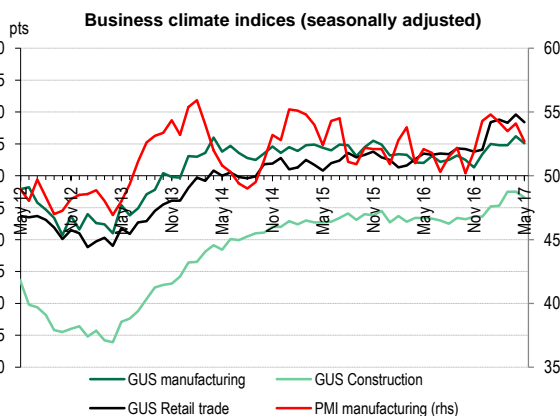


- Flash CPI for May showed a deceleration from 2.0% y/y to 1.9% as we expected. The forecasts of other analysts were focused on 2.0% and 2.1%. We have not seen a positive surprise in inflation since February. We are expecting CPI to oscillate around 2.0% y/y in the months to come and end the year at 1.7%. There is some upward risk due to cold weather, which might have weighed on fruit crops. However, in our view, the risk is not pronounced.

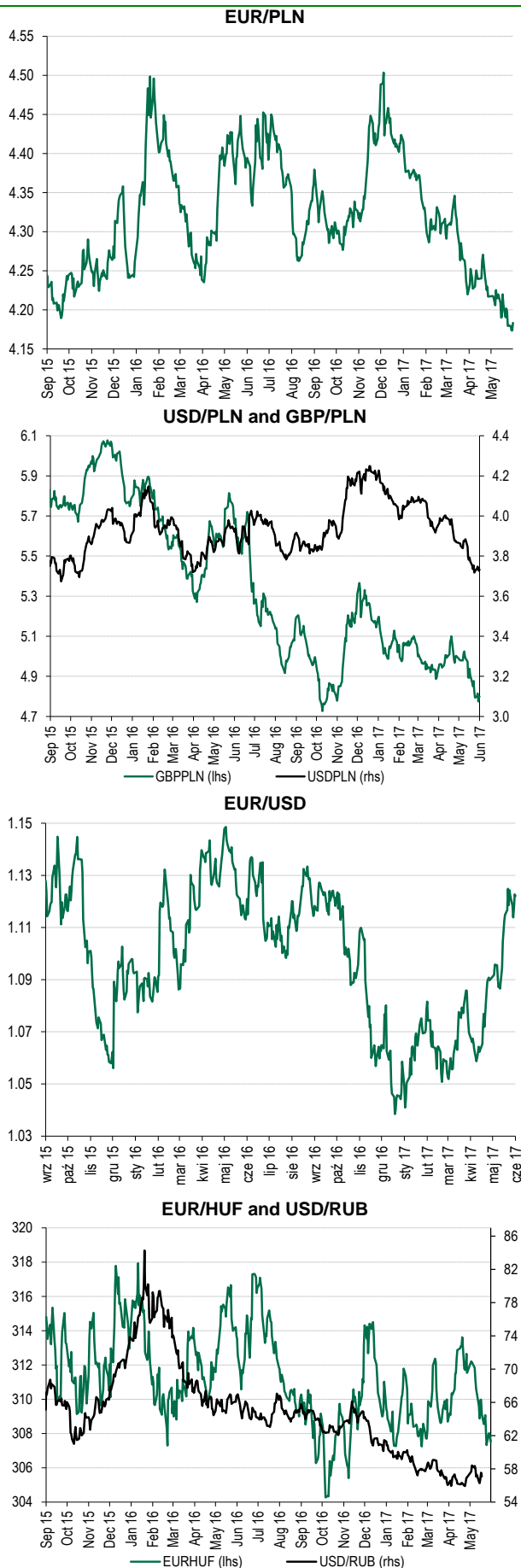
- PMI index for Polish manufacturing in May fell to 52.7pts (the lowest level in 6 months) from 54.1pts due to a decline in subindices for output, new orders and employment. This move was in line with the development of Statistics Office's business climate indices for May reported earlier. PMI reading does not make it impossible to reach 4% economic growth this year, but suggests taking some caution in forecasting. Moreover, the PMI suggested a strong rise of price pressure on Polish producers. On the other hand, improvement in new export orders, shown in the PMI report, is good news.

- GDP growth rate in 1Q17 was 4.0% y/y, in line with the flash reading. Seasonally-adjusted GDP increased by 1.1% q/q. The structure of growth was rather disappointing, especially with regard to investments, which fell by 0.4% y/y, despite a very low base last year. Inventories added 0.7pp, which is relatively high, especially given the fact that they also grew last year. Private consumption rose 4.7% y/y, the fastest pace since 2008, and remained the main driver of economic growth. We expect private consumption to remain robust later in 2017 while some slowdown could be recorded only in 2H due to the high base effect from the end of 2016. The gross value added rose 3.7% y/y contributing 3.3pp to the headline figure. This means that 0.7pp in the 4% GDP growth was added by "taxes less subsidies". We think that the relatively weak structure of growth in 1Q17, especially when it comes to investments, high input from inventory changes and taxes, is an argument for a critical look at the forecasts for the quarters to come. While we do not see a need for downward revisions, we find it hard to assume that the 2017 growth could beat 4%. The GDP data provide reasons for the MPC to stick to its 'wait-and-see' approach.

- The registered unemployment rate decreased in April to 7.7%, in line with our expectations and flash estimate of the Labour Ministry. LFS seasonally adjusted unemployment rate fell in April to 4.8%, setting a new (but probably not the last one this year) all-time low. These data confirm that the demand for labour remains stable. We expect further drop in unemployment in the months to come.



Foreign exchange market – ECB will give a signal



Limited potential for zloty appreciation

▪ May saw the continuation of the zloty's appreciation, but the pace of the EURPLN decline was slower than earlier in the year. We expect the Polish currency's rally to pause in the coming weeks amid looming Fed rate hikes and no further acceleration of the pace of economic growth in Poland. As regards USDPLN, the rate will mirror EURUSD moves. Now USDPLN is close to the resistance level of 3.70; breaking of this level will open the room for further decrease towards 3.62.

▪ We see a risk of rising volatility in the nearest future as two crucial events will take place on Thursday. The United Kingdom will hold snap parliamentary elections and so far Theresa May's lead has fallen to a fresh low of 3pp just a week before voting begins. We think that the uncertainty regarding British politics may encourage investors to take profit after the recent rally which could be negative for the zloty. Secondly, the ECB meeting may also be important. According to the EBC, the risks to growth in the Euro zone persist, albeit they are now lower. Moreover, there were no plans to change the forward guidance soon. Dovish rhetoric of the ECB on Thursday should support the zloty.

Rally on EURUSD ahead of ECB meeting

▪ Euro gained significantly against the dollar last week and EURUSD broke 1.12, the highest level since September 2016. The rise in EURUSD was the strongest since March 2016 and the exchange rate is now significantly higher than before the March Fed interest rate hike.

▪ This week investors will focus on the ECB meeting and macro data releases in Europe and in the US. In our view, the ECB will confirm current loose monetary policy stance, keeping rates unchanged. Although the market has recently expected possible earlier tapering in light of improvement in the Euro zone economy, we think that after the last inflation data and Mario Draghi's comments, chances for a change in the ECB rhetoric at the June meeting have decreased.

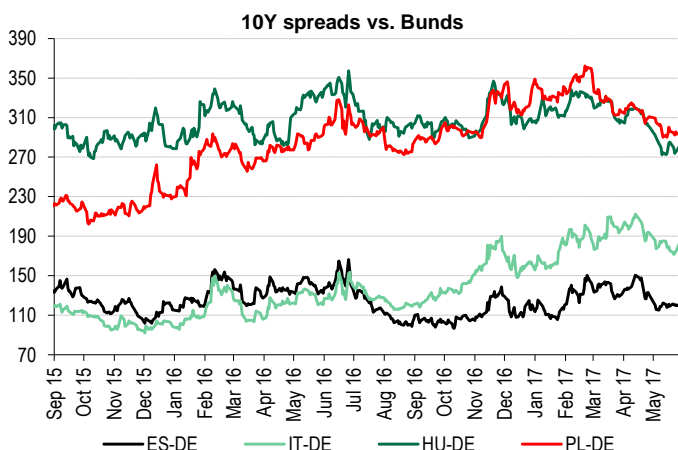
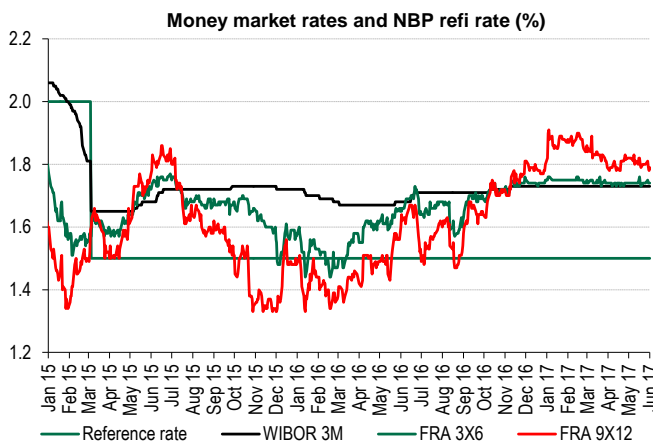
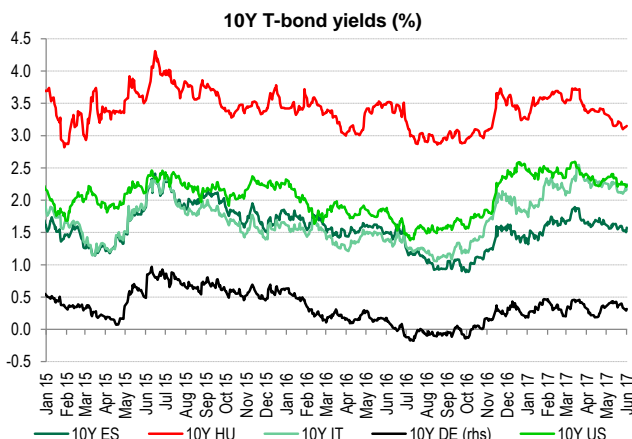
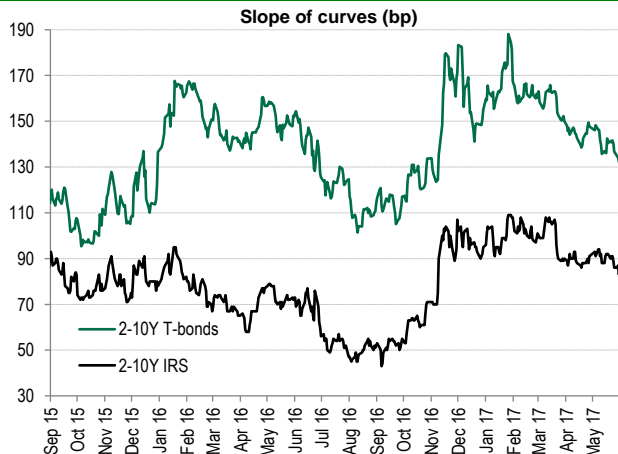
Strong fundamentals support CEE currencies

▪ The Czech koruna continued to gain in May after a temporary correction seen after the central bank dropped EURCZK peg. We think that the koruna should remain strong thanks to solid economic growth and looming rate hikes.

▪ Over the past month, the Hungarian forint has appreciated against the euro below 308. We think EURHUF should remain in a horizontal trend in the weeks to come. In our view, the internal risks are balanced for the time being, and improving economic fundamentals are supportive for the HUF in the medium-to-long run. On the other hand, triggers from global central banks and dovish rhetoric from the MNB could put more pressure on the forint in the coming weeks.

▪ The oil price has continued to drop sharply after OPEC's decision to extend oil output cut till March 2018 and abandonment the global climate pact by the US, but USDRUB remained fairly stable. We see a growing risk of the ruble giving up part of its recent gains because of a still weak rebound in the Russian economy and possible FX repurchases to rebuild the Reserve Fund.

Interest rate market – The calm before the storm?



Flattening curves

- Last week, Polish bond yield curve flattened with the strongest decrease in the belly (-11bp) and at the long end (-10bp). In May Polish 10Y bond strengthened for the fourth consecutive month and June started with further bond yields drop. Currently, 10Y yield is close to 3.20% and respective PL-DE spread fell below 300bp, the lowest level since November 2016.

- Both 2-10Y and 2-5Y spreads of IRS curve were last week at the lowest levels since US elections in November 2016 reaching 83bp and 73bp, respectively. Asset swap spread remained stable and amounts now to 50bp.

- 1-12M WIBORs did not move on a weekly basis. 15x18 FRA fell by 1bp and 21x24 by 5bp, which is pretty in line with our scenario.

Non-residents' bond holdings at all-time high

- According to the Ministry of Finance data, in April foreign investors bought Polish PLN marketable bonds for nearly PLN7bn, taking the nominal value of their holdings to the fresh all-time high at cPLN210bn. This was the fifth month of buying in a row.

- Foreign commercial banks sold bonds for PLN1bn and the nominal value of their holdings fell to PLN7.3bn, the lowest level since comparable data has been made available (April 2004). The central bank cut their exposure by PLN607mn. Mutual funds purchased debt for PLN1.4bn and the nominal value of their portfolio reached the highest level since September 2016. "Others" added PLN2.8bn.

- Under the geographical criteria, non-residents from the EU but outside the Euro zone bought bonds for PLN1.3bn and those from Asia (excluding Middle East) increased their portfolio by PLN1.2bn. Meanwhile, Polish banks sold bonds for PLN2.1bn.

ECB to keep its dovish rhetoric

- In May Polish inflation eased to 1.9% from 2.0% in April. In our view, inflation is likely to remain close to the current level in the nearest months as the base effects fade. As inflation is within the range of the target rate, Polish MPC does not seem to hurry with the interest rate hikes. As a result, Wednesday's MPC meeting should be rather neutral for both domestic currency and the bond market.

- The recent performance recovery in the Euro zone combined with the diminishing European geopolitical uncertainty could raise the market hopes for more hawkish tone at the June ECB meeting. In our view, market expectations that the ECB will dare to change forward guidance to signal that QE tapering is coming, have been reduced after a soft Mario Draghi speech and a surprise drop in Euro zone inflation in May. The Thursday meeting can, however, have a big impact on the Polish currency and assets. The probability of a hawkish move is small but non-negligible. The ECB will update its macroeconomic forecasts with upward revisions possible so it seems to be an opportunity to upgrade the macro assessment part of the statement. That said we think the ECB will prefer to stay very cautious.

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