Bank Zachodni WBK
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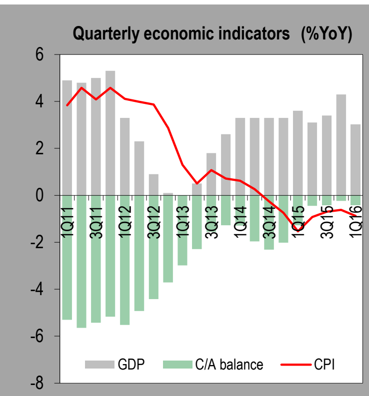
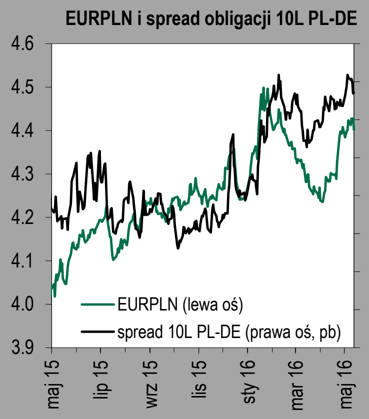
MACROscope

Polish Economy and Financial Markets

May 2016

Warning signals





■ Flash GDP for the first quarter was well below our and market expectations. The slowdown from 4.3% in 4Q15 to just 3% YoY was most likely the result of weak investment activity, particularly in the public sector. While poor construction data in 1Q16 were already a negative indicator, confirmation of an above-one-percentage-point **GDP slowdown is certainly a warning signal**.

■ The Polish Monetary Council emphasised in the statement after May's meeting that "the weakening in GDP growth in early 2016 was probably temporary, although the continuing uncertainty about economic conditions abroad is a risk factor for domestic economic activity". We also think that the most important risks for Polish economic growth are external, though if investments continue a downward trend, private consumption might not be able to offset this. This is particularly important in the light of the relatively weak performance of exports in 1Q16. **For now, we maintain our forecast of GDP growth above 3% for the remainder of the year**. This is supported by a strong labour market, improving consumer sentiment, and relatively high credit growth.

■ The market has resumed pricing in monetary easing later during the year. The next decision in June (the last meeting of Governor Marek Belka) is relatively easy to predict. The following in July is more complicated, as the Council will have the new inflation projection available, which might be even more dovish than the previous one. However, we do not think that the new Governor, Adam Glapiński, will opt for additional easing at his first meeting as the MPC Chairman, especially given his recent comments on the need for the continuation and stabilisation of monetary policy. Therefore, we think the meetings after the holiday period (the MPC will not meet in August) will be more interesting. However, we would only expect **a cut in interest rates if GDP growth falls (well) below 3% YoY**.

■ Moody's rating agency decided to keep Poland's rating unchanged. However, at the same time, **the rating outlook was changed to negative from stable, which is undoubtedly a warning signal** for the Polish government. As one could have expected, given Moody's methodology, the key drivers of the decision were fiscal risks (possible substantial increase in spending and lowering of retirement age), as well as "unpredictable policies and legislations" (issue of CHF-loans, conflict concerning the constitutional court). The next calendar day for rating action by Moody's is not far off and is scheduled for September 9th. By then, we should have more clarity on several of the above mentioned steps in the government's policy. That is why it made sense, in our opinion, to only cut the outlook and wait for government actions, while the risk of a possible negative impact was reflected in the outlook change.

■ The Polish market reacted positively to Moody's decision, as some market participants expected a more (or much more) negative message and therefore the Polish zloty and bonds also gained (EURPLN below 4.37 and 10Y bond yield close to 2.90%). We think, however, that **a further strengthening of Polish assets will be limited by many local risk factors**. The three key bills to watch out for in the next few months include: 1. any new proposal on CHF-loans; 2. retirement age (not only the lowering itself, but also additional conditions such as minimum years of paying contributions and/or minimum pension needed to be allowed to retire); and 3. The budget for 2017 (which pre-election promises will be honoured and how these will be financed).

In this issue:

Financial market on May 16 2016:

NBP deposit rate	0.50	WIBOR 3M	1.67	EURPLN	4.3727
NBP reference rate	1.50	Yield on 2-year T-bond	1.49	USDPLN	3.8625
NBP lombard rate	2.50	Yield on 5-year T-bond	2.11	CHFPLN	3.9577

This report is based on information available until 16.05.2016.

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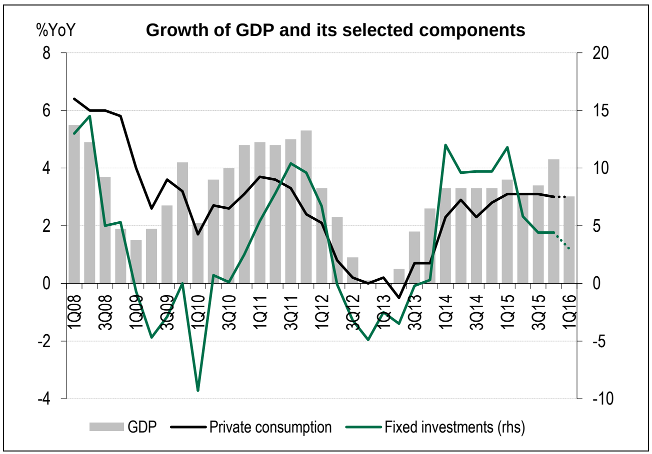
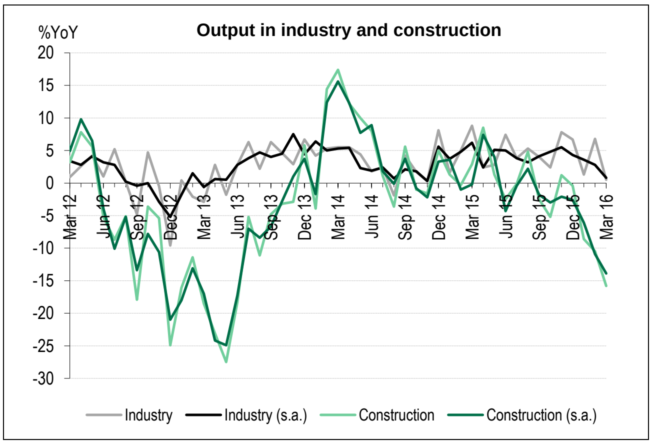
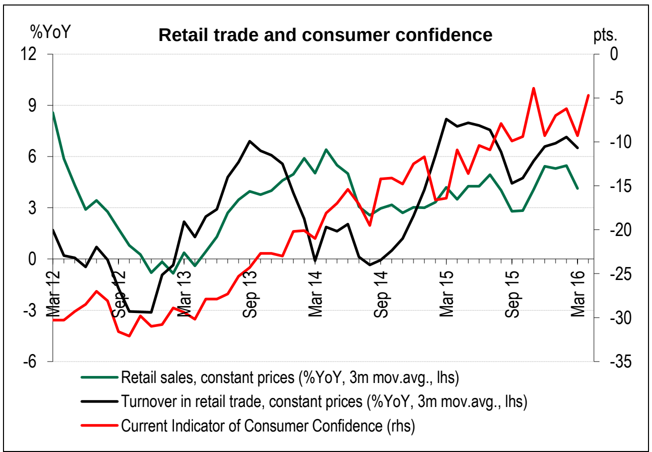
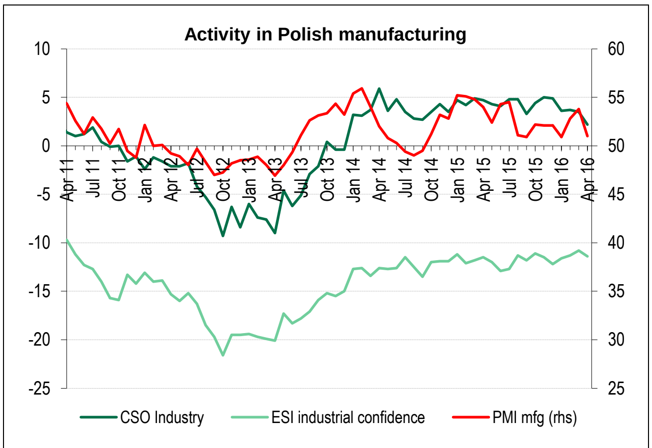
Economic update









Source: Markit, European Commission, CSO, NBP, BZ WBK.

GDP growth slowdown in 1Q16

- Economic growth reached 3.0% y/y in 1Q16, considerably below market expectations (3.5% y/y). Seasonally adjusted data showed a decline of 0.1% q/q, the weakest reading since the end of 2012. Even though the negative reading in q/q terms is primarily due to the high base from 4Q15, the reading was definitely disappointing. We were expecting a slowdown in GDP growth, mostly due to weaker public investment, which was temporarily undermined by the shift in two EU funds' frameworks (weak results in construction are a strong argument confirming this view). We do not yet know the breakdown of GDP growth, but such a low figure suggests that the slowdown was also visible in private investment – there were signs that this might be the case (e.g. NBP quick monitoring). On the other hand, there are no signs of deceleration in private consumption, which we estimate increased by c3% y/y in the first quarter.

- We forecast a rebound in GDP growth to c3.5% y/y in the coming quarters. Private consumption is likely to accelerate under the impact of the strong labour market and the 500+ Child Benefit Programme. The biggest risk factor for Polish growth seems to be the current situation abroad and worries that it may result in a deceleration of economic growth in the Euro zone.

Industry and construction suggest weaker 1Q

- Weak (though not that weak) GDP growth in 1Q was suggested by industry and construction data: industrial output rose 3.0% y/y vs 6.0% in 4Q15, while construction output declined 12.2% y/y vs -1.5% in 4Q15. The growth rate of exports (in euros) was just above zero in annual terms (close to 10%YoY in 4Q15).

- As regards the numbers for March alone, industrial output grew only 0.5% y/y. Industry results were somewhat distorted by the high base effect in mining (miners from one of the big companies were on strike in February 2015 and then made up for it in March 2015), but still, manufacturing output rose by a paltry 1.8% y/y. An even bigger disappointment was recorded in the construction sector, where output contracted 15.8% y/y. Civil engineering declined by as much as 21.9% y/y. This sector is probably still burdened by the slowdown in public investments and infrastructure projects co-financed with EU funds. We expect construction output to improve later in the year as EU spending should gain steam and given the impact of the boom in dwelling construction (see details on page 4).

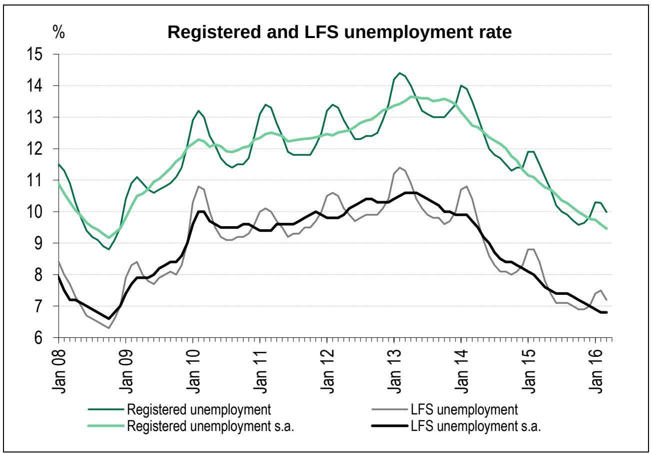
Sales data suggest stable consumption growth

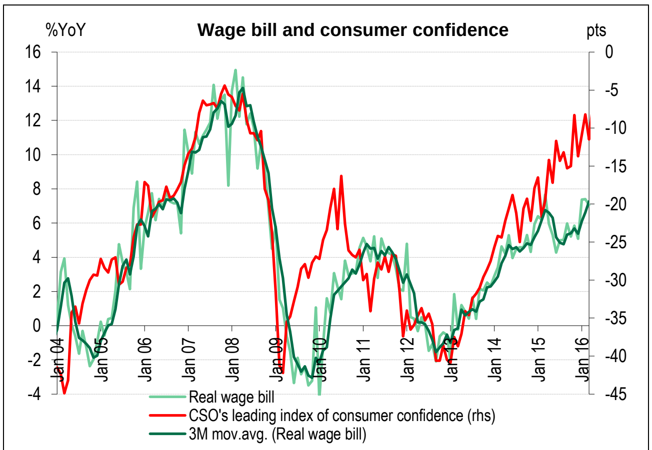
- The situation in retail trade did not change much: real retail sales expanded 4.4% y/y (the same as in 4Q15), and real retail trade turnover rose by 6.4% y/y (vs 6.6% in 4Q15), suggesting that private consumption growth remained close to that observed in previous quarters. In March, real retail sales rose 3.0% y/y (vs 6.2% y/y in February). The growth breakdown was quite interesting, as the Easter effect supported sales of food and sales in non-specialised stores, but undermined sales of clothing and household appliances.

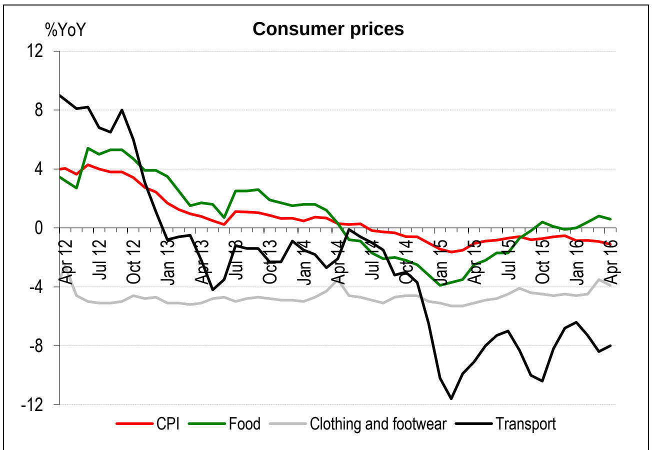
What about 2Q?

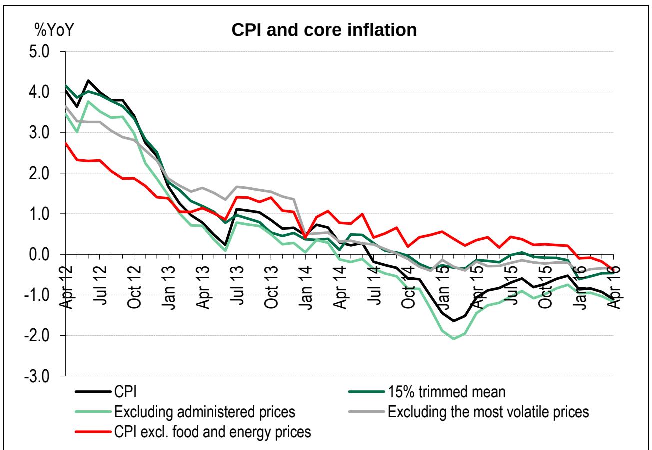
- We are quite positive about the prospects for consumption and construction in the coming quarters. But there is more uncertainty regarding industry, especially after the Polish manufacturing PMI fell sharply in April (to 51.0), returning to January's level after a strong performance in February-March. It is hard to draw conclusions from one-month data only, but the report sounded rather gloomy, given the sharp slowdown in output, new orders and employment growth. New orders inflow was the slowest in 19 months. The slowdown in Polish industry was also evidenced recently in other leading indicators (ESI, GUS). Indeed, the start of the year was quite poor for Polish industry, and the recurrent signs of weakness raise uncertainties about the rest of the year.

Economic update









Source: CSO, NBP, Eurostat, BZ WBK.

No signs of weakness in the demand for labour

- In March employment in the enterprise sector increased 2.7% y/y, more than expected. On a monthly basis, the number of workplaces increased by as much as 15.5k, and it was the best March since 2007. These data show that demand for labour remains strong and even strengthened in 1Q16. Wages in the enterprise sector grew by 3.3% y/y. We think the slowdown in wage growth compared to February (3.9% y/y) stemmed mainly from a weaker working-day effect.

- The Labour Ministry announced that the registered unemployment rate fell to 9.6% in April. This was the lowest reading for that month since 1991. However, these estimates are not fully accurate, as the Labour Ministry bases its estimates on employment figures for the previous month. In our view, in April the Ministry even used employment figures for February instead of March (we do not know why). Taking into account the fast growth rate of employment in the corporate sector recently, we estimate that the actual registered unemployment rate, to be released by the Statistics Office on May 25, could reach 9.5%. Our estimate of seasonally adjusted unemployment showed a fall to 9.3% from 9.4% in March. We are very close to the pre-crisis levels of October 2008 (9.2%).

- The real wage bill in the corporate sector rose 7.0% y/y in March. The decent pace of growth in households' incomes supported private consumption in 1Q16. We think that the Polish economy's sound fundamentals should continue to fuel demand for labour, although the pace of employment growth could decelerate as the stock of qualified labour is drying up (which should put upside pressure on wages). However, this effect could be partly neutralised by intensified immigration, which we have already begun to see. At the same time, the pace of wage growth could rise to 4%-5% y/y.

Deflation spreading

- April's CPI declined 1.1% y/y, in line with the flash estimate and vs -0.9% y/y in March. On a monthly basis, prices rose 0.3%. Prices of consumer goods fell 1.6% y/y, while services prices rose 0.3% y/y.

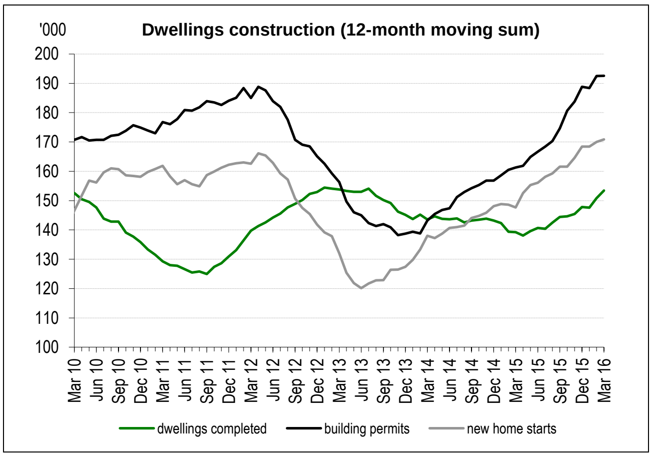
- Prices of food and non-alcoholic beverages rose 0.3% m/m, mainly on the seasonal rise in vegetable prices and higher sugar prices (although in general April's rise in food prices was lower than in past years). Prices of clothing and footwear rose 2.7% m/m due to the introduction of new collections. Transport prices rose 1.5% m/m, mainly due to the effect of higher fuel prices (2.3% m/m). Meanwhile, a decline in prices was recorded in culture and recreation (-0.8% m/m, thanks to discounts in cable TV), in communication (-0.6% m/m) and in routine household maintenance and energy (-0.3% m/m) owing to lower gas prices for households.

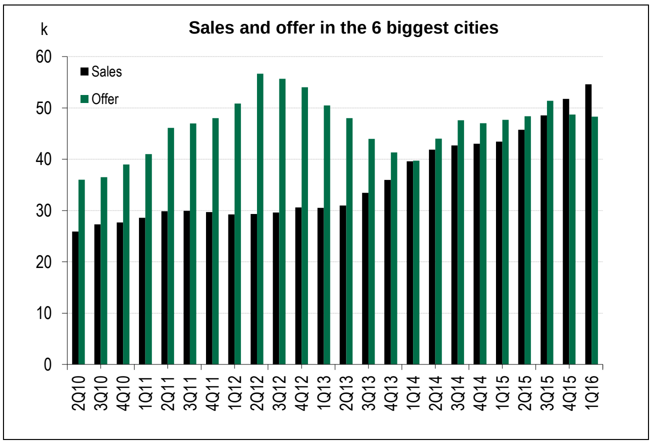
- Core CPI, excluding food and energy prices, fell to -0.4% y/y in April, the lowest level since comparable data are available (2001). All other core inflation measures are below zero.

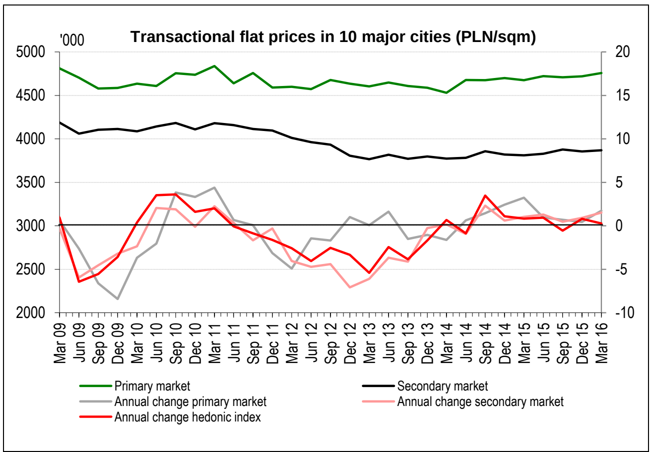
- Producer prices declined 1.7% y/y in March by (after falling 1.5% y/y in February – data after revision). On a monthly basis, producer prices fell 0.1%. Interestingly, in previous months the decline in PPI inflation was mainly due to the fall in prices of oil and other commodities. This time (March), commodity manufacturing prices rose, while prices declined in other categories: manufacture of chemical products (-1.3%); paper (-1.2%); computers (-0.9%); and cars (-0.8%).

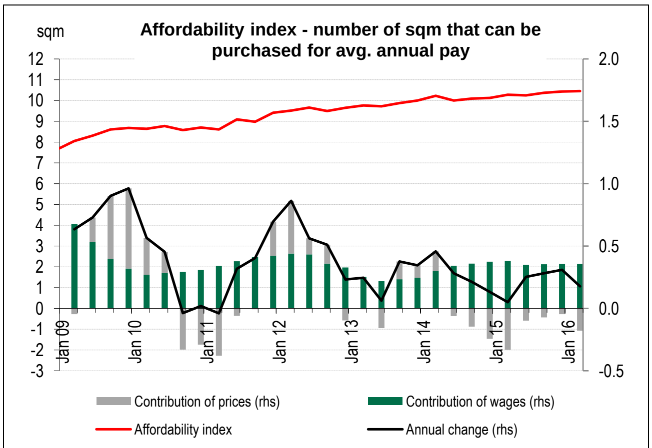
- It seems that the deflationary trends are intensifying in sectors that have so far remained weak or moderate. No upward pressure on prices is visible.

Housing market update









Source: Markit, European Commission, CSO, NBP, BZ WBK.

Supply booms . . .

▪ New dwelling supply is booming: the number of completed dwellings (12-month sum) hit 153k in March 2016, the highest level in three years. This number is likely to grow further, given the high level of new home starts (171k, the highest since 2008) and of building permits (192k, the highest since 2009). In our view, the upward trend in completed dwellings may last at least 1-2 years, given the lag between permits, starts and completions. Recent data on building permits suggest some levelling-off, but we cannot yet say whether this is a harbinger of a trend reversal. Booming supply is especially visible in the biggest cities (Warsaw, Krakow, Wroclaw, Tri-city, Poznan, Lodz), with 54.4k new flats finished between March 2015 and March 2016 (the highest level since 2007) and 13.7k in 1Q16 alone (+21.7% y/y).

. . . and so does demand . . .

▪ Demand for flats also seems to be strong. Data from the six biggest cities show that 14.3k new flats were sold in 1Q16 (24.8% y/y) and 54.7k in 2Q15-1Q16 (all-time high). Demand is partially driven by the MdM programme (the government's financial support for young families), and as many as 25% of transactions in 1Q16 were supported by this scheme. MdM-related buying was especially strong in cities where the maximum allowed price per square metre under the scheme were recently raised; these were: Wroclaw, Krakow and Warsaw. It may also be the case that some buyers decided to accelerate their purchasing decisions prior to the cut in the maximum allowed price for April 1. The MdM programme was expanded on September 1, 2015, to also allow purchases on the secondary market (earlier only the primary market was eligible), boosting total financing under this scheme to PLN391mn in 4Q15 from PLN111bn in 2Q15. The general macroeconomic situation is favourable for buyers, as rising wages and falling unemployment support their incomes and creditworthiness. Thus, we expect demand to remain high, although it could weaken somewhat given the cut in MdM transaction limits and the actual depletion of the financial means earmarked for this programme for 2016.

. . . so prices are quite stable and affordability is rising

▪ As explained above, there is rising supply, coupled with rising demand. In the six biggest cities, the volume of dwellings on offer has been stable at c50k for a couple of quarters. This stability between demand and supply held pricing pressure in check. Transactional prices on the primary and secondary markets are in a weak upward trend, but the correction for the quality of dwellings (hedonic index) shows that the actual trend is weaker, and prices rose by a mere 0.3% y/y in 1Q16. Flat prices are still below the peak recorded at the end of 2008. We think a possible slight weakening of demand amidst ongoing high supply will exert some negative pressure on prices.

▪ Affordability of flats is still on the rise, mainly thanks to robust wage growth, which offsets the negative effect of the rise in flat prices. We expect this tendency to hold. However, financing conditions may be tightening somewhat, given the lower maximum LtV ratio for new mortgage loans (85% in 2016 vs 90% in 2015) and rising margins. The upward move in margins was suggested by the latest NBP Survey of chief credit officers. However, this is not yet visible in the data: average mortgage loan margins stood at 274bp in March 2016 vs 263bp in November 2015 (local low). As we stated earlier, transfers from the MdM programme for 2016 are already depleted. The continuation of this programme is also questionable, as recent comments by government officials suggested that the government would like to abandon its financial support of flat purchases and switch into supporting rentals. However, no details are known yet.

Monetary policy watch

Excerpts from the MPC's official statement after its May meeting

Global economic activity growth remains moderate, amid continuing uncertainty about its outlook. In the euro area, economic recovery continues, although weak economic conditions in emerging economies have a negative impact on the activity in this economy. In the United States, economic growth slowed down in 2016 Q1, but this was accompanied by ongoing improvement in labour market conditions. In China, GDP growth continues to decelerate gradually, while Russia and Brazil remain in recession.

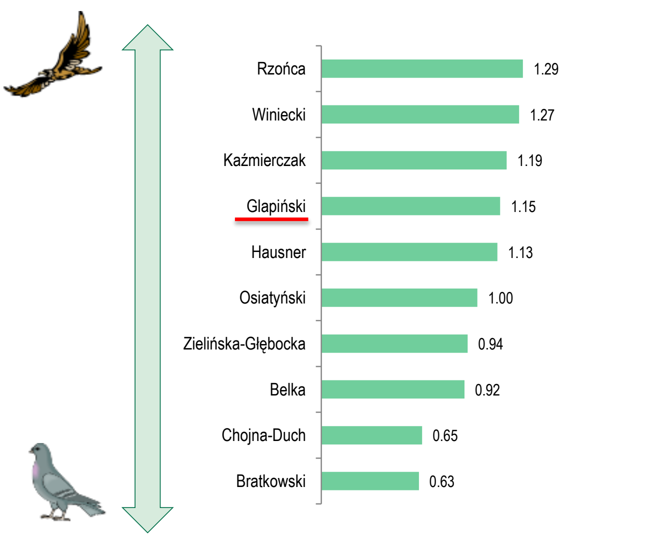
In Poland, the revised data on national accounts indicate that GDP growth in 2015 Q4 was higher than previously estimated. In 2016 Q1, GDP growth might have slowed down slightly. The rise in economic activity is still supported by growing employment, improving consumer sentiment, sound financial standing of enterprises, their high capacity utilization and stable lending growth. Hence, the weakening in GDP growth in early 2016 was probably temporary, although the continuing uncertainty about economic conditions abroad is a risk factor for domestic economic activity.

With negative output gap and moderate growth of average nominal wages, currently there is no inflationary pressure in the economy. Annual consumer price growth and producer price growth stay negative. External factors – particularly the earlier sharp fall in global commodity prices and low price growth in the environment of the Polish economy – continue to be the main sources of deflation. This is accompanied by very low inflation expectations. The persisting deflation has not adversely affected decisions of economic agents so far.

In the Council's assessment, price growth will stay negative in the coming quarters due to the earlier substantial decline in global commodity prices. At the same time, GDP growth is expected to remain stable, following a temporary deceleration earlier this year. Consumer demand will continue to be the main driver of economic growth, supported by rising employment, forecasted acceleration of wage growth and an increase in social benefits. This notwithstanding, the downside risks to the global economic conditions and the volatility of commodity prices remain the sources of uncertainty for domestic economy and price developments.

The Council maintains its assessment that – given the available data and forecasts – the current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance.

Index of MPC members' restrictiveness based on their votes



Index is between 0 and 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Average of points for all votes in the entire MPC member's term of office is the value of the index for a given MPC member.

Sources: NBP, BZ WBK.

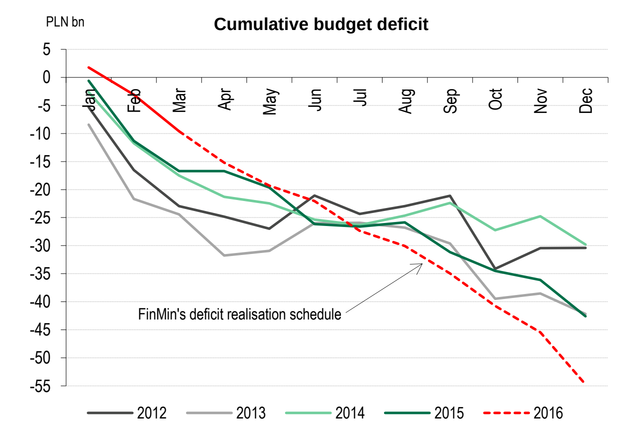
Interest rates still on hold

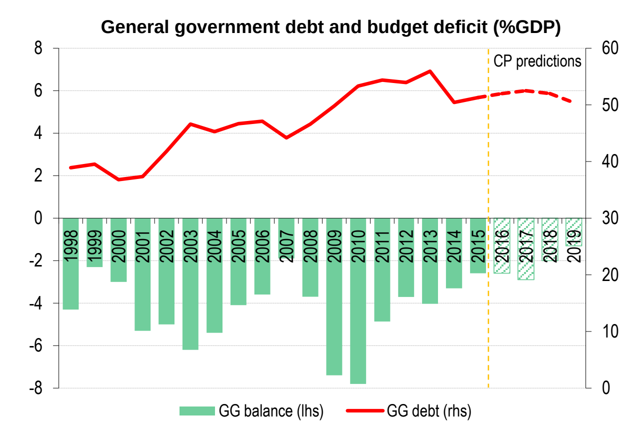
- The Monetary Policy Council's (MPC) decision to keep interest rates stable in May came as no surprise. Also, the official post-meeting statement did not change too much.
- The Council expects a slowdown in 1Q16, after the surprisingly strong GDP growth recorded in Poland in 4Q15 (4.3% y/y), although it will "probably" only be temporary. In the following quarters, the Central Bank expects economic growth to be stable and solid, supported mainly by private consumption.
- NBP head Marek Belka said during the press conference that recent weaker-than-expected monthly data did not change the MPC's views on the policy outlook and did not increase their willingness to cut interest rates. Moreover, MPC member Eryk Łon, who earlier was among those suggesting that interest rate cuts cannot be ruled out if the economy slows, said at the press conference that he did not currently see any threats that would warrant monetary easing.
- Our expectations on the monetary policy outlook remain unchanged: we think rate cuts would only take place if economic growth were to slow significantly (2Q below 3% YoY) or if the zloty were to appreciate sharply, which is not our base-case scenario. Thus, we believe that rates will remain on hold in the coming months.

Adam Glapiński – New NBP Governor, old policy

- In early May, the President's chancellery announced that ex-MPC member Adam Glapiński was the candidate to replace Marek Belka as the NBP's Governor. Belka's term of office ends on June 10. The President's nomination has to be approved by the Sejm, but it should be a mere formality. The hearing of Adam Glapiński in the Sejm's Public Finance Committee will take place on May 18.
- Glapiński received a positive recommendation from Marek Belka, who appointed him to the NBP Board in March, just after his MPC term ended. At the last MPC press conference, Belka repeated that Glapiński was a good candidate and suggested that "in such a situation, a continuation [of the monetary policy line] is quite a natural thing". In one of his recent interviews, Glapiński also said that the NBP Board has been stabilised for a number of years.
- Glapiński underscored the importance of maintaining central bank independence and asserted that he will not bend under political pressure as the NBP Governor. He was also advocating a "conservative, traditional and classic" monetary policy that would be stabilising for the economy and would avoid any imbalances. He further suggested that the current level of interest rates is adequate and the central bank should leave them stable for as long as possible. In fact, he mentioned that the next step might be a hike, though it was very hard to specify when it might take place.
- Glapiński's conservatism was also seen in his voting pattern when he was a member of the Monetary Policy Council. He did not support any motion to cut interest rates in 2014-15 and only voted to lower interest rates three times during his entire term in office, making him one of the most hawkish members on the panel. Our synthetic measure of MPC members' restrictiveness confirms that his votes were, on average, more hawkish than the majority view of the Council (see chart on left).
- Glapiński is an advocate of keeping the floating FX regime unchanged, as he perceives it as an effective tool. As regards the issue of FX loans, Glapiński said that for the central bank it is important that the final proposal meets the criterion of ensuring the financial system's stability. Also, he said that there is currently no issue of any NBP involvement in this operation, and there is no point discussing whether and to what extent the NBP might participate.
- On fiscal policy, he sees a possibility of higher spending only if the government reaches its target of higher revenues (through improved tax collection), in order to keep the fiscal deficit below 3% of GDP.

Fiscal policy watch





Main assumptions of the 2016 Convergence Programme (%YoY)

	2016	2017	2018	2019
Nominal GDP	4.1	5.6	6.0	6.5
Spending	4.4	6.4	4.7	4.7
Revenues	4.4	5.6	7.1	6.5
Revenues ex one-offs in 2016*	1.9	8.1	7.1	6.5
Revenues ex one-offs in 2016, ex VAT cut and ex better tax collection*	1.6	8.1	6.1	5.7

* BZ WBK estimate; One-offs include: NBP profit (PLN7.9bn) and inflows from LTE auction (PLN9.2bn)

Finance Ministry estimates of new budget proposals (effect on GG balance in PLNbn, cum. change vs 2016)

			2017	2018	2019
Included in baseline CP scenario	VAT cut		-7.2	-7.6	-8.1
	Better tax collection	Min	6.5	11.9	21.7
		Assumed**	10.0	18.0	26.0
		Max	16.7	27.0	33.4
Not in baseline CP scenario	Higher tax-free allowance		-4.0	-8.0	-12.0
	Lower retirement age		-8.6	-10.2	-11.9

** BZ WBK estimate of inflows assumed in the CP based on available partial information.

Source: Ministry of Finance, Reuters, Eurostat, CSO, BZ WBK.

No significant threat for 2016 budget

- According to the Finance Ministry's data, the state budget deficit amounted to PLN9.6bn after March, slightly above the initial plan for that month (PLN9.3bn). Revenues reached PLN76.8bn (95% of the 1Q plan), while expenditures amounted to PLN86.4bn (96% of the plan). VAT revenues were down 4% y/y in March and reached cPLN6bn – the second straight month with a poor performance, after a surprisingly strong January. Income from the bank tax reached PLN364mn, and if a similar level is maintained in the coming months, budget revenues from the bank tax could be some PLN1.5bn short of plan at the end of this year. Revenues from retail tax and the LTE auction could be also lower than planned, by at least PLN1bn each. At this stage, this does not seem to be a big threat to the budget as one-off income from the NBP's profit should be almost PLN5bn higher than planned. However, if VAT revenues do not pick up significantly in the coming months, the finance ministry's comfort zone will shrink. For the time being, we still do not see significant risks to this year's budget.

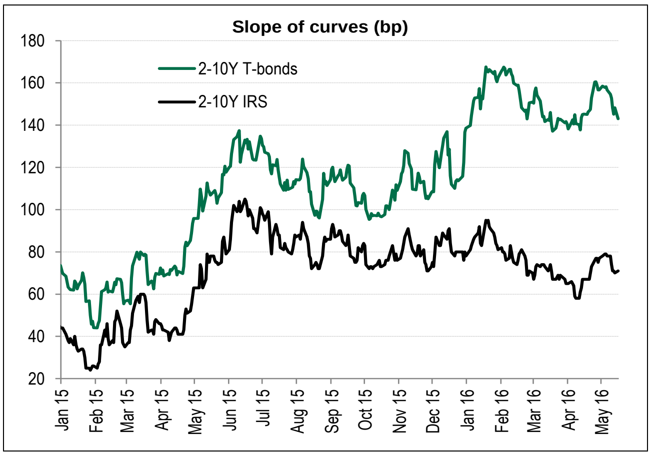
Fiscal deficit to rise in 2017, before it starts falling

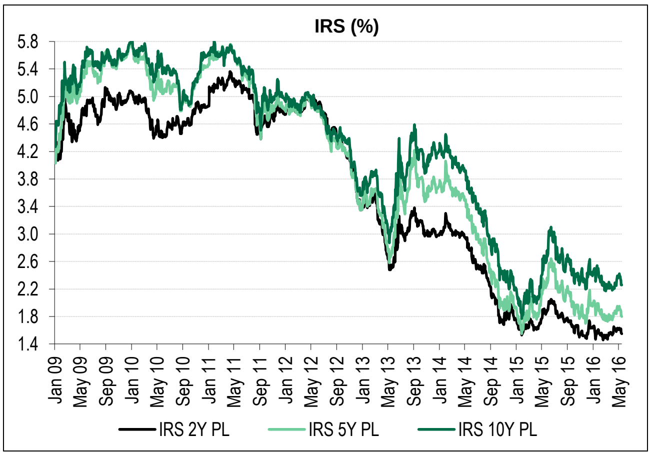
- According to the 2016 Convergence Programme (CP) approved by the government, real GDP growth should accelerate from 3.8% this year to 4.1% in 2019 (forecasts up to 2018 are the same as assumed by the previous government in its 2015 CP). In our view, these forecasts are quite optimistic.
- The General Government (GG) deficit is expected to fall to 1.3% of GDP in 2019 (last year this target was assumed for 2018), which is a more ambitious plan than we had anticipated. But before the fiscal gap starts decreasing, it is likely to rise in 2017E to 2.9% of GDP, mainly due to higher spending that will only be partly covered by higher tax collection. Public debt to GDP should also be higher than the path expected in 2015 – above 50% on the forecast horizon.
- Assumptions for 2017 seem risky, in our view, as the programme implies a very ambitious rise in revenues: according to our estimates, after excluding one-offs and discretionary changes (a VAT cut and higher tax collection), planned revenue growth in 2017 amounts to 8.1% (vs a 5.6% rise in nominal GDP). However, this may be partly due to higher expected inflows of EU funds in 2017 (as assumed by the European Commission in its Spring Economic Forecasts).
- The programme is based on the assumption of a VAT cut in 2017 and improved tax collection. However, the finance minister said he would like to cancel the planned VAT cut. We think that such a decision is highly probable, though it will depend on tax revenues in 1H16.
- On the other hand, the government's baseline scenario does not envisage the realisation of upcoming election promises: an increase in tax-free income or the lowering of retirement age (although the document showed the estimated cost of these measures). As regards the former, its cost could be reduced if implemented slowly, step-by-step, or even neutralised if the government opts for a large overhaul of the personal tax system (as recently suggested by PM Beata Szydło).

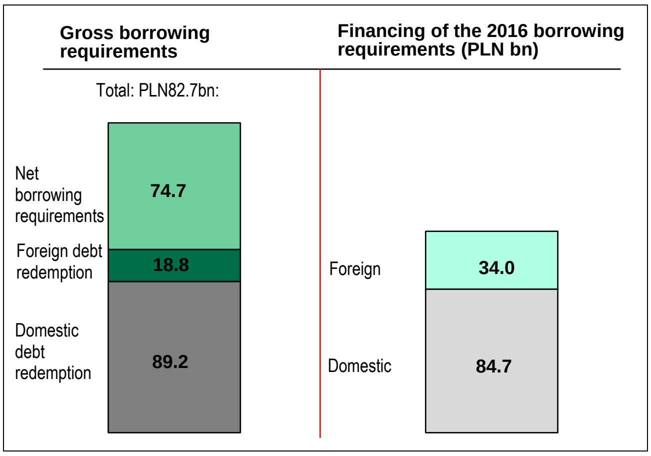
Still no details on plans to lower retirement age

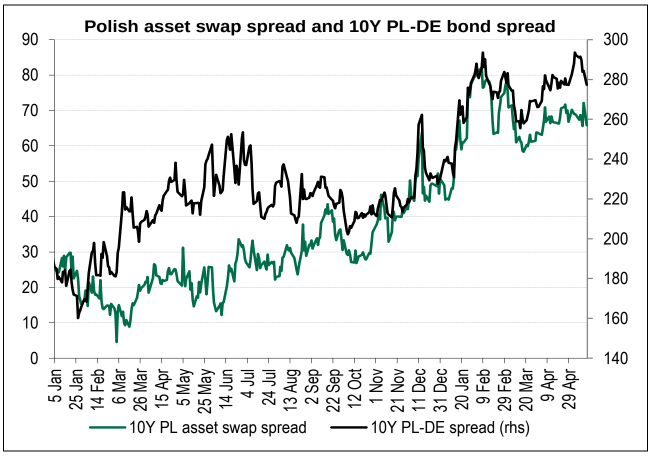
- Lowering the retirement age is potentially a much more dangerous idea, not only due to its fiscal costs, but also because it could undermine Poland's growth potential, amplifying labour shortages that could become a major drag on economic growth in the coming years. Top PiS officials continue to say that the lowering of retirement age should come into force in 2017.
- However, the economic and fiscal consequences of the proposal will depend on additional conditions for retirement included in the bill (minimum work experience, minimum level of accumulated pension benefit, etc). The so-called Social Dialogue Council (bringing together trade unions, employers and the government) discussed the issue recently but failed to come up with a joint stance. The debate will now be moved to the parliament and should be closely watched.

Interest rate market









Source: Finance Ministry, Reuters, Bloomberg, BZ WBK.

Bond market driven by Moody's and core yields

▪ Early May T-bond yields and IRS rates remained at elevated levels after significant increase in April (by 20bp on average at the long end of the curves). This resulted from investors' worries over Moody's decision on Poland's rating. However, just before the decision Polish assets strengthened visibly, reflecting downward movement in yields on core markets. As a result, the 10Y benchmark yield fell below 3% again (after reaching 3.14% at the beginning of May), for the first time in three weeks.

▪ At the same time, both the IRS and bond yield curves flattened slightly as a consequence of visible 2-5Y spread tightening. Moreover, the risk premium declined moderately as the Polish 10Y benchmark spread over the Bund narrowed to c285 ahead of Moody's decision (down from nearly 295bp, the highest level since early February, reached in early May).

▪ Moody's decision to affirm Poland's rating at A2 and to change the outlook to negative from stable was in line with our expectations. This provides support for the bond market as a downgrade by one notch seemed to be priced in, pushing the 10Y benchmark yield down towards 2.90%. However, in general, we see limited room for yields to decline in the coming weeks taking into account upcoming domestic and external events, in particular a new proposal for FX loans conversion at the end of May/beginning of June, a bill on the retirement age or the approaching EU referendum in the UK. As a consequence, the risk premium might remain quite high.

▪ In our view, the Polish IRS and bond curves might continue to flatten in the very short term, though more as a result of weakening on the short end rather than more gains on the long end. We remain less optimistic about the FI market in the months to come and expect the yields and IRS to rise later in the year driven mainly by the Fed's rate hikes and stable economic growth in the euro zone.

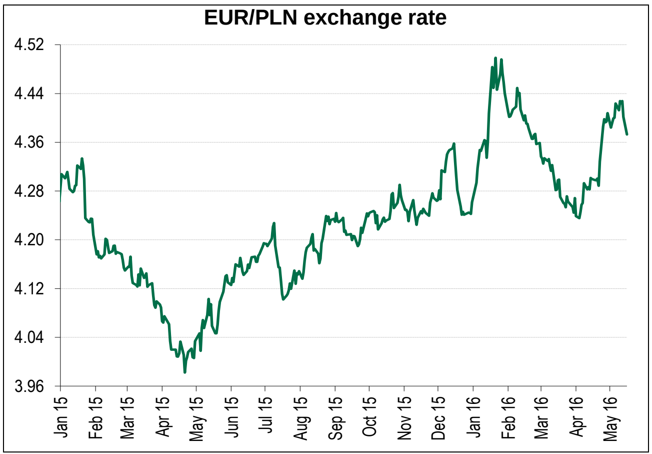
▪ Poland's bond market has attracted healthy demand from investors (both domestic and non-residents) on the primary market. At the first auction in May, Poland's Ministry of Finance successfully placed short- and long-term bonds, selling 2Y OK1018 and 10Y DS0726 worth PLN4.7bn in total, slightly above the upper band of the planned supply at PLN4.5bn. Nearly PLN3bn from the issue came from the 10Y DS0726 benchmark. Demand was solid at PLN7.1bn. We estimate that this year's borrowing needs are now covered by nearly 65%.

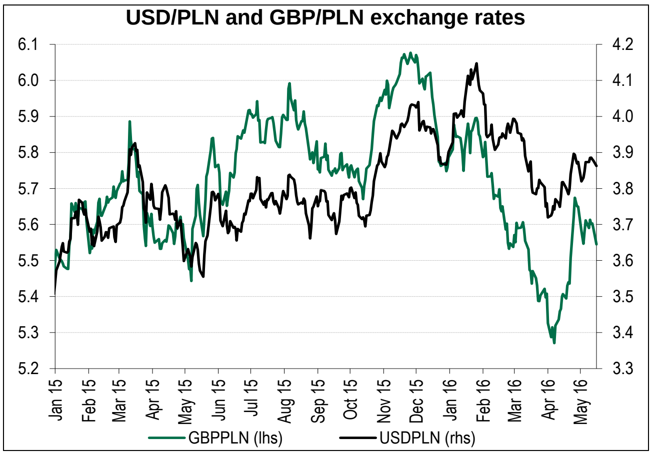
No disappointment in data release can push FRAs higher

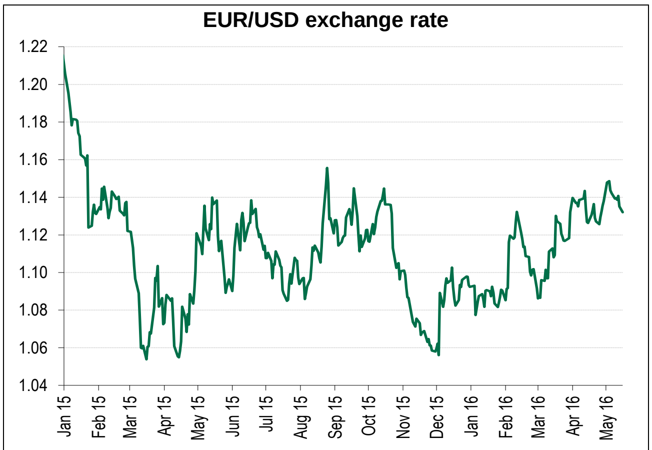
▪ On the money market, in the first half of May, WIBORs were roughly stable (the 1M rate grew just 1bp), while FRA rates were 1-11bp down across the board, with long-term rates dropping the most. This mainly resulted from much weaker flash GDP data, which strengthened market expectations on monetary easing in the coming months. Currently, the FRA market is seeing a c90% chance that rates will fall by 25bp in the next nine months (up from c70% at the end of April).

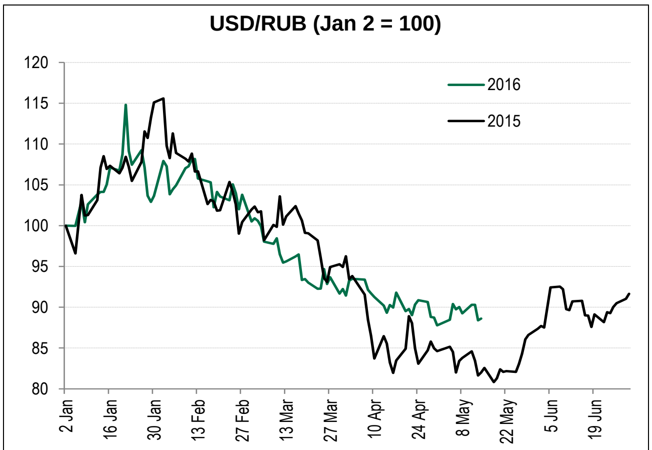
▪ As mentioned above, the FRA market is pricing in quite a high probability of rate cuts later this year/ early 2017, but so far this is not our base case scenario. Data for 1Q16 confirmed that economic growth was weaker when compared with the strong end of 2015, but, in our view, 2Q will be key for monetary policy. We think that upcoming monthly data should confirm quite decent economic activity at the start of the second quarter (our industrial output and retail sales forecasts are above market consensus). These data could neutralise (at least partly) the dovish GDP numbers and bring some profit-taking on the short end of the curves and FRAs. As regards WIBOR rates, we uphold our base case scenario assuming WIBOR rates remain roughly stable in upcoming weeks.

Foreign exchange market









Sources: Reuters, Bloomberg, Markit, BZ WBK.

Gains on Moody's seem limited

- The weeks following the release of our April MACROscope have seen a sharp weakening of the zloty. The Polish currency suffered mainly from internal factors, like rising concerns about a rating downgrade by Moody's and the resurfacing of worries about Poland's banking sector. As a result, the EUR/PLN jumped to 4.43, with the zloty losing much more than 50% of the gains recorded during the recovery following S&P's decision in mid-January.
- In line with our expectations, ratings agency Moody's reaffirmed Poland's credit rating at A2 and only downgraded the outlook to 'negative' from 'stable'. This decision supported the zloty, and in our view, EUR/PLN could fall slightly further in the coming days.
- However, we think the zloty's gains could be limited. It is worth noting that the zloty firmed against the euro in May only twice in the last 10 years: in 2008 (when risky assets were rallying worldwide a few months before the US financial crisis) and in 2014 (on expected monetary policy easing in the euro zone). The average monthly percentage EUR/PLN rise in May for the last 10 years was c2.3%. We do not think sentiment in the equity market is strong enough to provide sufficient support for the zloty and the ECB is likely to refrain from taking more action in the short term. At the beginning of the month, EUR/PLN was close to 4.37 and so we think there is limited room for the zloty to gain in the immediate future.
- At the same time, we remain cautious also for the summer months and do not expect the Polish currency to appreciate due to: (1) uncertainty about the Polish government's proposals on the FX-loan conversion bill, and the lowering of the retirement age; (2) generally weak sentiment towards EM currencies; (3) the approaching EU referendum in the UK; (4) and concerns about the Polish 2017 budget that could emerge quite soon.

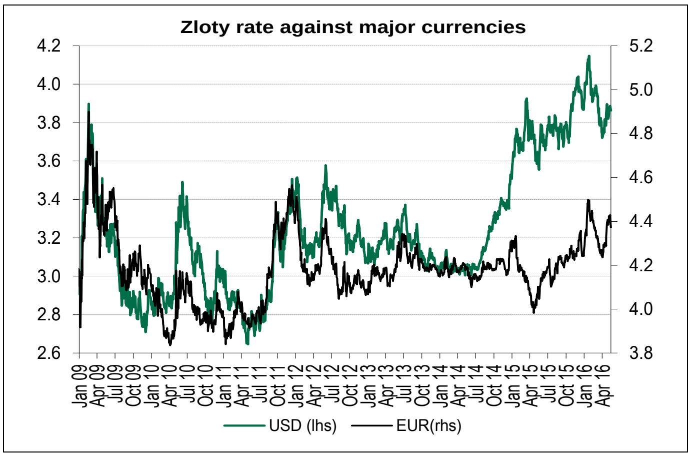
Range trading expected for EUR/USD in short term

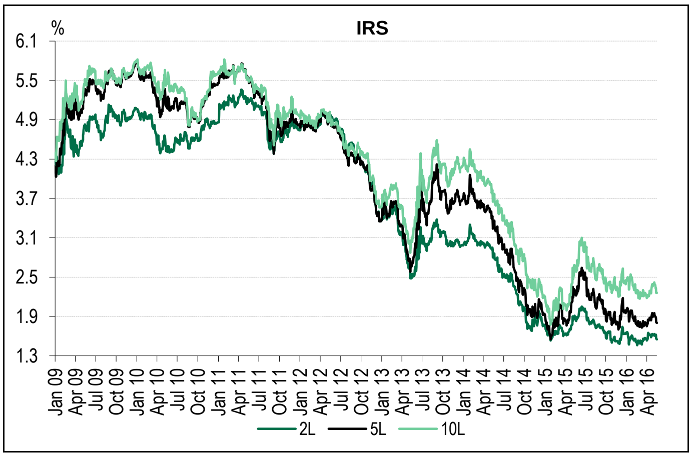
- Last month we wrote that EUR/USD could fall, but instead the exchange rate moved sideways with a slight upward bias. In early May, EUR/USD reached 1.16, but at mid-month it is back to close to 1.13.
- EUR/USD is currently well above the 1.10 level seen in March, when the ECB decided to extend its asset purchase programme. This suggests that central bankers might try to talk the exchange rate down. At the same time, however, recent US labour market data was rather sluggish, with April nonfarm payrolls running well below 200k. The market is now pricing in no Fed rate hike until December 2016/February 2017, which could boost the dollar. As a result, we think EUR/USD could stay at close to or slightly below recent levels in the coming weeks, as the market will be waiting to see the outcome of the EU Referendum vote and the June FOMC decision on rates. We still expect the euro to resume its appreciation trend later in the year.

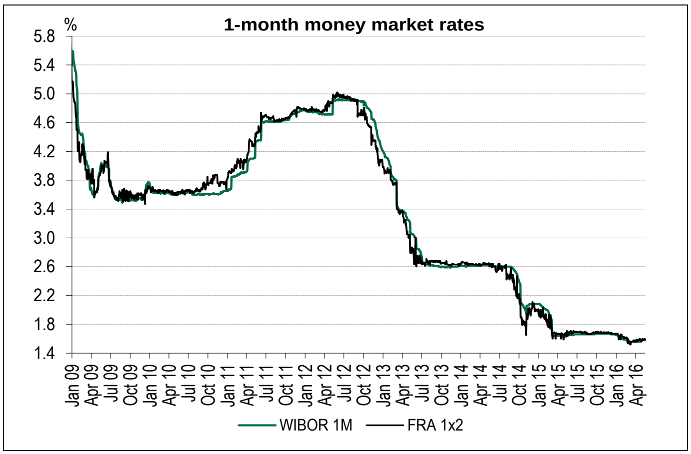
Oil key for the rouble

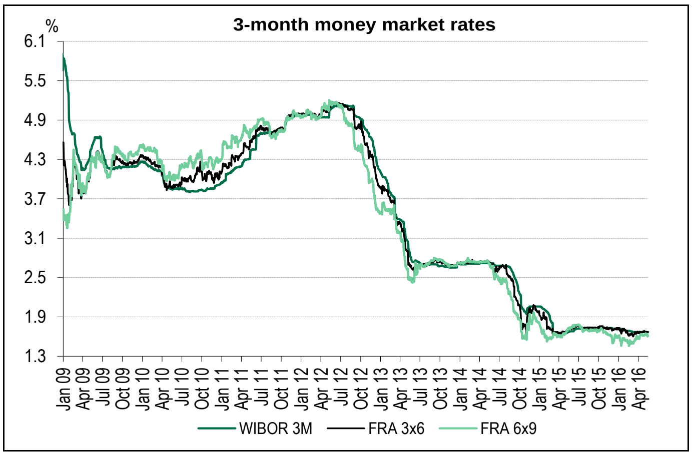
- The rouble remained strong as the Brent price continued its upward trek. USD/RUB fell to its lowest level since November 2015, but in our view the downward trend seems to be losing strength. We still think that some profit-taking could take place soon. Note also that the Brent price (and USD/RUB) is following the pattern seen in 2015, and this is another statistical factor that raises the possibility of a correction in the short term in this commodity market, which, in turn, could trigger profit-taking after the rouble's recent appreciation.

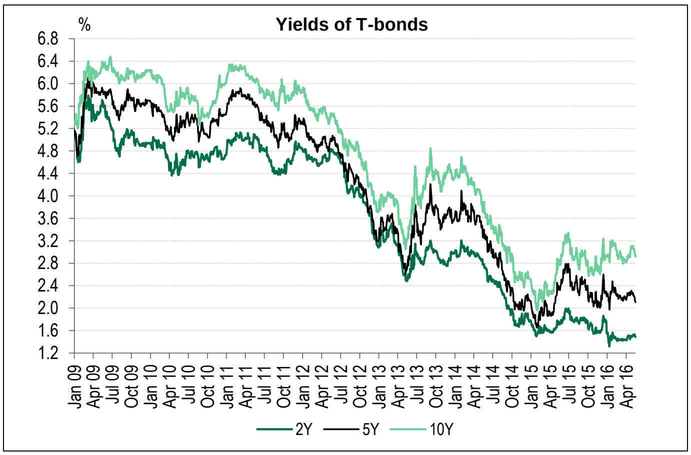
Market monitor

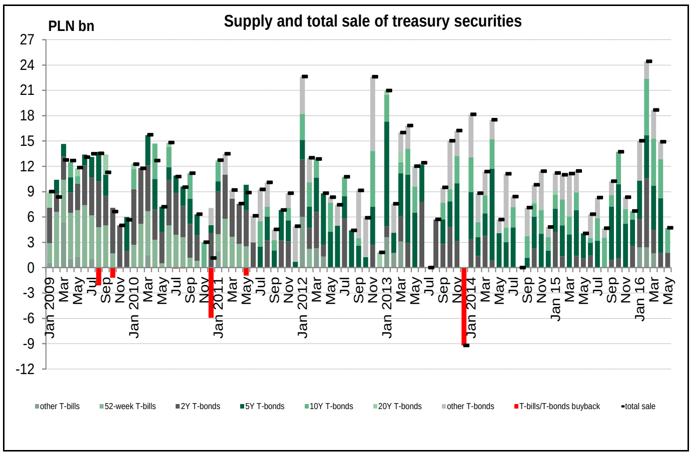












Treasury bond auctions in 2015/2016 (PLN mn)

Month	First Auction				Second Auction				Switch Auction		
	Date	T-bonds	Offer		Date	T-bonds	Offer		Date	T-bonds	Offer
May ‘15	7.05	OK/WZ	3000-5000	Call off	21.05	OK0717/PS0420	2000-4000	4056.0			
June	11.06	OK0717/WZ0120	2000-4000	4236.5					25.06	OK0715/DS1015	PS0420/DS0725
July	9.07	WZ0120/WZ0124	1000-2000	2430.3	23.07	PS0420/DS0725	3000-6000	5852.7			
August	6.08	DS0725/WZ0126	1000-4000	4655.9							
September	10.09	WZ0126/DS0726	2000-4000	3019.0	24.09	OK0717/PS0420	4000-6000	7214.0			
October	29.10	OK/PS/DS	5000-8000	8082.0					8.10	DS1015/OK0116	PS0421/DS0726
November	26.11	EUR20160201**	Up to €1bn	€730m					19.11	OK0116/PS0416	WZ0120/PS0421/DS0726
December									10.12	OK0116/PS0416	OK0717/PS0421/DS0726
January ‘16	7.01	PS0421	2500-4500	4555.0	28.01	OK1018/WZ0120/WZ0126	5000-8000	8074.0			
February	4.02	OK1018/DS0726	4500-7500	9011.2	18.02	WZ0120/PS0421	4000-6000	7210.0			
March	3.03	OK1018/DS0726	4000-7000	8387.5					24.03	PS0416/OK0716/PS1016	WZ0120/PS0721/WZ0126
April	7.04	OK1018/DS0726	3000-6000	6356.6	28.04	WZ0120/PS0721/WZ0126	5000-8000	8534.7			
May	5.05	OK1018/DS0726	2500-4500	4703.9	25.05	To be announced	2000-6000				

** with supplementary auction, ** buy-back auction, *** demand/sale.*

Source: Finance Ministry, Reuters, BZ WBK.

Bank Zachodni WBK
Grupa Santander

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
16 May	**17** CZ: Flash GDP (Q1) US: House starts (Apr) US: Building permits (Apr) US: CPI (Apr) US: Industrial output (Apr)	**18** ***PL: Wages and employment (Apr)*** EZ: HICP (Apr) US: FOMC minutes	**19** ***PL: Industrial output (Apr)*** ***PL: PPI (Apr)*** ***PL: Retail sales (Apr)*** US: Philly Fed index (May)	**20** US: Home sales (Apr)
23 DE: Flash PMI – manufacturing (May) EZ: Flash PMI – manufacturing (May)	**24** DE: ZEW index (May) DE: GDP (Q1) US: New home sales (Apr) HU: Central bank decision	**25** DE: Ifo index (May)	**26** US: Durable goods orders (Apr) US: Pending home sales (Apr)	**27** ***PL: MPC minutes*** US: Preliminary GDP (Q1) US: Michigan index (May)
30	**31** ***PL: GDP (Q1)*** ***PL: Inflation expectations (May)*** EZ: Flash HICP (May) US: Personal income (Apr) US: Consumer spending (Apr) US: Consumer confidence index (May)	**1 June** ***PL: PMI – manufacturing (May)*** CN: PMI – manufacturing (May) DE: PMI – manufacturing (May) EZ: PMI – manufacturing (May) US: ISM – manufacturing (May) US: Fed Beige Book	**2** EZ: ECB decision US: ADP report (May)	**3** DE: PMI – services (May) EZ: PMI – services (May) CZ: GDP (Q1) US: Non-farm payrolls (May) US: Unemployment rate (May) US: ISM – services (May) US: Industrial orders (Apr)
6 DE: Industrial orders (Apr)	**7** DE: Industrial output (Apr) CZ: Industrial output (Apr) EZ: GDP (Q1) HU: GDP (Q1)	**8** ***PL: MPC decision*** HU: CPI (May)	**9** DE: Exports (Apr) CZ: CPI (May)	**10** US: Flash Michigan (Jun)
13 ***PL: CPI (May)*** ***PL: Balance of payments (Apr)***	**14** ***PL: Money supply (May)*** ***PL: Core inflation (May)*** EZ: Industrial output (Apr) US: Retail sales (May)	**15** US: FOMC decision US: Industrial output (May)	**16** ***PL: Wages and employment (May)*** EZ: HICP (May) US: Philly Fed index (Jun) US: CPI (May)	**17** ***PL: Industrial output (May)*** ***PL: PPI (May)*** ***PL: Retail sales (May)*** US: House starts (May) US: Building permits (May)

Source: CSO, NBP, Bloomberg.

Calendar of MPC meetings and data releases for 2016

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
ECB meeting	21	-	10	21	-	2	21	-	8	20	-	8
MPC meeting	13-14	2-3	10-11	5-6	12-13	7-8	5-6	-	6-7	4-5	8-9	6-7
MPC minutes	28	18	17	21	27	23	-	25	22	20	24	22
Flash GDP*		12			13			12			15	
GDP*	-	29	-	-	31	-	-	30	-	-	30	-
CPI	15	12[a]	15[b]	11	12	13	11	12	12	11	14	12
Core inflation	18		16	12	13	14	12	16	13	12	15	13
PPI	21	17	17	19	19	17	19	18	19	19	21	19
Industrial output	21	17	17	19	19	17	19	18	19	19	21	19
Retail sales	21	17	17	19	19	17	19	18	19	19	21	19
Gross wages,employment	20	16	16	18	18	16	18	17	16	18	18	16
Foreign trade	about 50 working days after reported period											
Balance of payments*			31									
Balance of payments	13	15	15	13								
Money supply	14	12	14	14								

** Quarterly data. a preliminary data for January. b January and February.*
Source: CSO, NBP.

Economic data and forecasts for Poland

Monthly economic indicators

		Apr 15	May 15E	Jun 15	Jul 15	Aug 15	Sep 15	Oct 15	Nov 15	Dec 15	Jan 16	Feb 16	Mar 16	Apr 16E	May 16E
PMI	pts	54.0	52.4	54.3	54.5	51.1	50.9	52.2	52.1	52.1	50.9	52.8	53.8	51.0	51.4
Industrial production	% YoY	2.4	2.8	7.4	3.8	5.3	4.0	2.4	7.8	6.7	1.3	6.8	0.5	3.8	5.0
Construction production	% YoY	8.5	1.3	-2.5	-0.1	4.8	-2.5	-5.2	1.2	-0.4	-8.6	-10.5	-15.8	-14.1	-14.1
Retail sales [a]	% YoY	-1.5	1.8	3.8	1.2	-0.3	0.1	0.8	3.3	4.9	0.9	3.9	0.8	3.4	3.1
Unemployment rate	%	11.1	10.7	10.2	10.0	9.9	9.7	9.6	9.6	9.8	10.3	10.3	10.0	9.6	9.2
Gross wages in corporate sector	% YoY	3.7	3.2	2.5	3.3	3.4	4.1	3.3	4.0	3.1	4.0	3.9	3.3	3.7	4.2
Employment in corporate sector	% YoY	1.1	1.1	0.9	0.9	1.0	1.0	1.1	1.2	1.4	2.3	2.5	2.7	2.8	2.9
Exports (€)	% YoY	8.6	7.8	10.6	5.2	8.1	3.0	4.5	12.6	11.5	-0.4	4.7	-0.1	2.4	6.8
Imports (€)	% YoY	7.7	0.5	10.3	7.3	6.7	5.2	0.2	6.7	3.8	0.3	7.3	1.7	-0.8	7.5
Trade balance	EUR mn	-117	500	-165	-727	-150	19	252	574	294	548	216	204	348	437
Current account balance	EUR mn	929	928	-963	-1,174	-574	-608	-216	395	-603	805	-552	-103	1,047	1,496
Current account balance	% GDP	-0.9	-0.7	-0.4	-0.5	-0.3	-0.4	-0.4	-0.3	-0.2	0.0	-0.1	-0.4	-0.4	-0.2
Budget deficit (cumulative)	PLN bn	-16.7	-19.6	-26.1	-26.6	-25.9	-31.1	-34.5	-36.1	-42.6	1.8	-3.1	-9.6	-15.2	-19.3
Budget deficit (cumulative)	% of FY plan	36.2	42.6	56.7	57.7	56.1	67.6	74.8	78.4	92.5	-3.2	5.7	17.5	27.7	35.2
CPI	% YoY	-1.1	-0.9	-0.8	-0.7	-0.6	-0.8	-0.7	-0.6	-0.5	-0.9	-0.8	-0.9	-1.1	-0.7
CPI excluding food and energy	% YoY	0.4	0.4	0.2	0.4	0.4	0.2	0.3	0.2	0.2	-0.1	-0.1	-0.2	-0.4	-0.1
PPI	% YoY	-2.7	-2.1	-1.4	-1.8	-2.7	-2.8	-2.3	-1.8	-0.8	-1.2	-1.5	-1.7	-1.3	-1.1
Broad money (M3)	% YoY	7.1	7.5	8.2	8.5	7.2	8.3	8.9	9.3	9.1	10.2	10.1	9.1	11.5	11.3
Deposits	%YoY	7.8	7.8	8.7	8.8	7.7	8.9	9.2	9.7	9.1	9.9	10.4	9.4	11.5	11.4
Loans	%YoY	6.4	7.7	7.9	7.9	7.6	7.9	7.7	7.0	6.9	6.2	5.8	4.4	6.6	5.9
EUR/PLN	PLN	4.02	4.08	4.16	4.15	4.19	4.22	4.25	4.25	4.29	4.41	4.40	4.29	4.31	4.41
USD/PLN	PLN	3.73	3.66	3.71	3.78	3.77	3.75	3.78	3.96	3.95	4.06	3.96	3.87	3.80	3.88
CHF/PLN	PLN	3.88	3.93	3.98	3.96	3.89	3.86	3.91	3.92	3.96	4.03	3.99	3.93	3.94	3.99
Reference rate [b]	%	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	1.65	1.67	1.70	1.72	1.72	1.72	1.73	1.73	1.72	1.71	1.69	1.67	1.67	1.67
Yield on 2-year T-bonds	%	1.60	1.74	1.91	1.82	1.79	1.79	1.65	1.58	1.71	1.46	1.46	1.44	1.48	1.46
Yield on 5-year T-bonds	%	1.98	2.38	2.68	2.45	2.40	2.43	2.18	2.10	2.28	2.24	2.26	2.18	2.25	2.27
Yield on 10-year T-bonds	%	2.36	2.83	3.20	3.00	2.88	2.91	2.66	2.73	2.93	3.04	3.03	2.88	2.95	3.03

Note: [a] in nominal terms, [b] at the end of the period.
Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

Quarterly and annual economic indicators

		2013	2014	2015	2016E	1Q15	2Q15	3Q15	4Q15	1Q16E	2Q16E	3Q16E	4Q16E
GDP	PLN bn	1,656.3	1,719.1	1,790.1	1,846.8	413.1	431.0	437.1	508.4	421.3	442.2	450.4	532.9
GDP	% YoY	1.3	3.3	3.6	3.4	3.6	3.1	3.4	4.3	3.0	3.4	3.6	3.5
Domestic demand	% YoY	-0.7	4.9	3.3	3.1	2.9	3.0	3.0	4.5	3.1	1.7	2.9	4.5
Private consumption	% YoY	0.2	2.6	3.1	4.0	3.1	3.1	3.1	3.0	3.0	3.5	4.6	4.8
Fixed investments	% YoY	-1.1	9.8	6.1	3.7	11.8	5.8	4.4	4.4	3.0	3.5	4.0	4.0
Industrial production	% YoY	2.3	3.4	4.8	4.7	5.3	3.9	4.3	6.0	3.0	5.1	6.3	4.5
Construction production	% YoY	-10.3	4.3	0.3	-12.0	1.4	1.9	0.5	-1.5	-12.2	-12.3	-12.4	-11.2
Retail sales [a]	% YoY	2.6	3.1	1.5	4.9	0.7	1.4	0.4	3.2	1.9	3.3	6.9	6.9
Unemployment rate [b]	%	13.4	11.4	9.8	8.7	11.5	10.2	9.7	9.8	10.0	8.9	8.5	8.7
Gross wages in the national economy [a]	% YoY	3.4	3.6	3.3	4.2	4.1	3.1	3.0	3.2	3.7	4.3	4.2	4.7
Employment in the national economy	% YoY	-1.1	0.2	0.9	1.9	0.8	0.8	0.9	1.0	1.8	2.1	2.0	1.8
Exports (€)	% YoY	5.7	6.4	8.3	6.8	9.8	9.0	5.3	9.3	1.5	6.5	9.0	10.0
Imports (€)	% YoY	0.2	8.3	4.9	6.3	3.5	6.2	6.4	3.4	3.2	3.8	8.0	10.0
Trade balance	EUR mn	-335	-3,255	2,135	3,090	1,651	216	-852	1,120	968	1,392	-502	1,232
Current account balance	EUR mn	-5,031	-8,303	-1,011	1,326	900	864	-2,348	-427	150	2,427	-1,764	513
Current account balance	% GDP	-1.3	-2.0	-0.2	0.3	-1.3	-0.4	-0.4	-0.2	-0.4	0.0	0.1	0.3
General government balance	% GDP	-4.0	-3.3	-2.6	-3.0	-	-	-	-	-	-	-	-
CPI	% YoY	0.9	0.0	-0.9	-0.5	-1.5	-0.9	-0.7	-0.6	-0.9	-0.8	-0.6	0.3
CPI [b]	% YoY	0.7	-1.0	-0.5	0.6	-1.5	-0.8	-0.8	-0.5	-1.1	-0.6	-0.2	0.6
CPI excluding food and energy	% YoY	1.2	0.6	0.3	0.0	0.4	0.3	0.3	0.2	-0.1	-0.1	-0.1	0.4
PPI	% YoY	-1.3	-1.5	-2.2	-1.2	-2.7	-2.1	-2.4	-1.6	-1.5	-1.6	-0.9	-0.9
Broad money (M3) [b]	% oY	6.2	8.2	9.1	4.7	8.7	8.2	8.3	9.1	8.0	6.9	5.8	4.7
Deposits [b]	%YoY	6.6	9.0	9.1	5.0	9.2	8.7	8.9	9.1	8.1	7.0	6.0	5.0
Loans [b]	%YoY	3.5	7.2	6.9	5.4	7.8	7.9	7.9	6.9	6.6	6.2	5.8	5.4
EUR/PLN	PLN	4.20	4.18	4.18	4.37	4.20	4.09	4.19	4.26	4.37	4.36	4.41	4.33
USD/PLN	PLN	3.16	3.15	3.77	3.87	3.72	3.70	3.77	3.90	3.96	3.85	3.90	3.77
CHF/PLN	PLN	3.41	3.45	3.92	3.83	3.93	3.93	3.90	3.93	3.98	3.93	3.77	3.63
Reference rate [b]	%	2.50	2.00	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3M WIBOR	%	3.02	2.52	1.75	1.68	1.87	1.67	1.72	1.73	1.69	1.67	1.67	1.69
Yield on 2-year T-bonds	%	2.98	2.46	1.70	1.49	1.61	1.75	1.80	1.65	1.45	1.48	1.50	1.53
Yield on 5-year T-bonds	%	3.46	2.96	2.21	2.27	1.90	2.35	2.43	2.19	2.23	2.26	2.25	2.35
Yield on 10-year T-bonds	%	4.04	3.49	2.69	3.11	2.24	2.79	2.93	2.77	2.98	3.03	3.10	3.33

Note: [a] in nominal terms, [b] at the end of period. Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

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