Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

25 – 31 August 2014

New macro data from the Polish economy confirms that GDP growth can weaken further and in the second half of the year will be probably lower than 3% YoY. Together with worse outlook for exports, we see more doubts about persistence of the domestic demand growth, among others because of surprising weakening of construction output and a clear decline in consumer moods. In general, the number of arguments supporting the interest rate cut is growing. In our opinion, after recent set of information a decisive move in monetary policy would be justified already in September, but recent comments of MPC members suggested there could be no majority to support such decision at the nearest meeting. Nevertheless, we assume that until the end of the year NBP's rates will be lowered by 75bp.

In the last week of summer holidays markets will be watching upcoming publications which can shed some light on economic perspectives, and on developments in Ukraine. If retail sales data (in line with our forecast) are lower than market expectations, it can fuel further strengthening on Polish debt market. Detailed data on GDP growth in 2Q will be also important, but data from core markets, potentially giving more hints about monetary policy outlook in the US and in the Eurozone, may be even more significant.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (25 August)					
10:00	DE	Ifo index	Aug	pts	107	-	108
16:00	US	New home sales	Jul	k	425	-	406
		TUESDAY (26 August)					
10:00	**PL**	**Retail sales**	**Jul**	**%YoY**	**2.1**	**1.6**	**1.2**
10:00	**PL**	**Unemployment rate**	**Jul**	**%**	**11.8**	**11.9**	**12.0**
14:00	HU	Central bank decision		%	2.1	-	2.1
14:30	US	Durable goods orders	Jul	%MoM	7.5	-	0.7
16:00	US	Consumer confidence	Aug	pts	89.0	-	90.9
		WEDNESDAY (27 August)					
		No important data releases					
		THURSDAY (28 August)					
14:30	US	Preliminary GDP	Q2	%QoQ	3.9	-	-2.1
14:30	US	Initial jobless claims	week	k	-	-	298
16:00	US	Pending home sales	Jul	%MoM	0.5	-	-1.1
		FRIDAY (29 August)					
9:00	CZ	Flash GDP	Q2	%YoY	2.6	-	2.9
10:00	**PL**	**GDP**	**Q2**	**%YoY**	**3.2**	**3.2**	**3.4**
10:00	**PL**	**Private consumption**	**Q2**	**%YoY**	**2.7**	**2.8**	**2.6**
10:00	**PL**	**Fixed investments**	**Q2**	**%YoY**	**5.5**	**3.0**	**10.7**
11:00	EZ	Flash HICP	Aug	%YoY	0.3	-	0.4
14:00	**PL**	**Inflation expectations**	**Aug**	**%YoY**	**-**	**-**	**0.1**
14:30	US	Personal income	Jul	%MoM	0.3	-	0.4
14:30	US	Consumer spending	Jul	%MoM	0.2	-	0.4
15:55	US	Michigan index	Aug	pts	80.1	-	79.2

Source: BZ WBK, Reuters, Bloomberg

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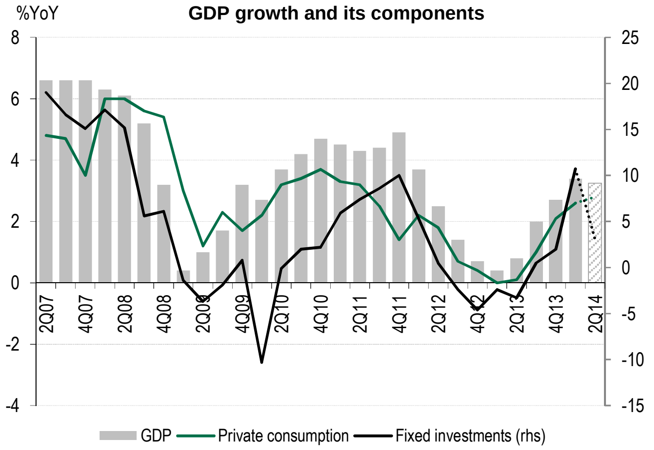
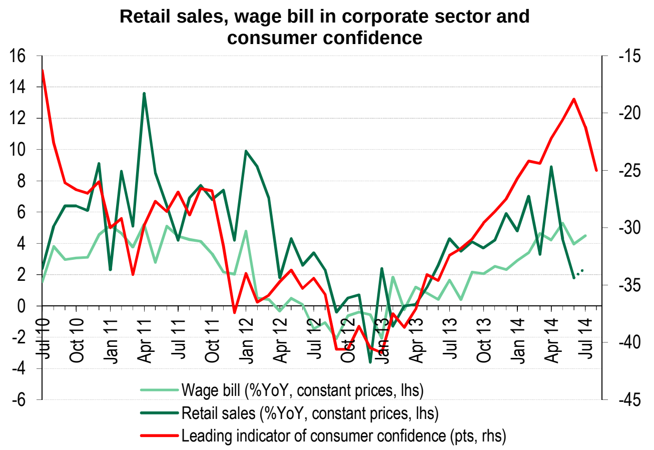
What's hot this week – Important data about retail sales and GDP

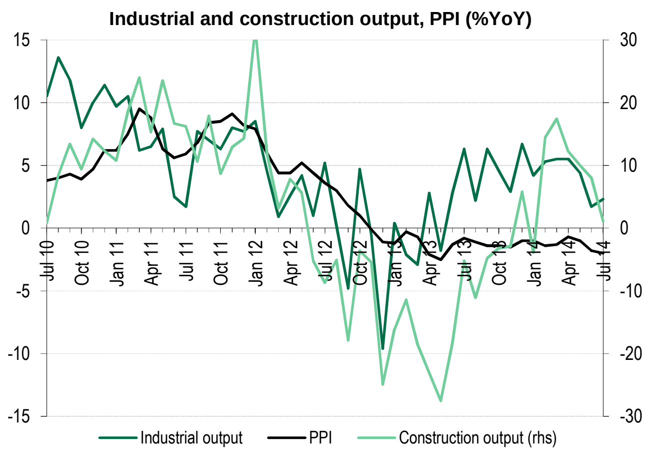


- Our forecast of July's retail sales is below market consensus, but we see upward risk for the figure, among others due to good weather, supportive for spending holiday in Poland, not abroad (higher sales of fuels, food).
- Unemployment rate probably fell in July to 11.9%, in line with Labour Ministry's estimate, confirming that the improvement of situation versus last year is gradually losing steam.
- Flash data about GDP showed only a small slowdown in 2Q, to 3.2%YoY. However, the structure of the growth will be important. We assume slight acceleration of private consumption growth and a clear slowdown of fixed investments as one-off effects seen in 1Q disappeared (extraordinary weather and car purchases during temporary tax allowances).

Last week in the economy – Monthly data herald weaker third quarter



- Pace of employment growth accelerated in July to 0.8%YoY, in line with expectations, while pace of wage growth stabilised at 3.5%YoY, slightly below consensus. Situation in the labour market continues to improve gradually, strengthening the purchasing power of households amid very low inflation.
- On the other hand, rising uncertainty about future may be limiting consumption demand. In August the consumer confidence deteriorated quite significantly for the second straight month, mainly due to worse assessment of economic situation. Although propensity to spend increased but it may drop later on if improvement in the labour market does not gain pace. We think private consumption may grow by nearly 3%YoY in 3Q, being a stabilizer for growth. However, it is unlikely to prevent a GDP slowdown below 3% in 2H14.



- After two months of disappointments, industrial output for July was roughly in line with median market forecast, showing growth of slightly above 2%YoY. It confirms weaker growth of industrial sector at the turn of Q2 and Q3 and the outlook for the following months is not bright given external factors. What is more, output in construction sector in July was a very negative surprise. Our forecast and market consensus pointed to increase by above 5%, while it was at merely 1.1%YoY.
- It looks like GDP growth slowdown to c3% was not only temporary phenomenon observed in Q2, but is continued also in Q3 and may persist in the next few quarters. Together with the environment of no inflation (CPI below zero for months, July's PPI below expectations again at -2% r/r), this gives room for manoeuvre for the MPC.

Quote of the week – Probability of interest rate cuts increased

Jerzy Osiatyński, MPC member, 22.08, Reuters
There is no macroeconomic reasoning for current very high interest rates in Poland, but it does not mean they should be reduced automatically.

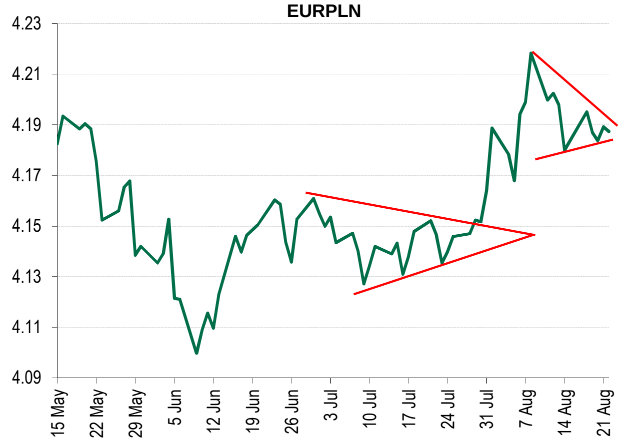
Andrzej Bratkowski, MPC member, 21.08, Reuters
In the last two months the probability of interest rate cuts has increased. (...) In my view the total scale of rate cuts could amount to 50-100bps.

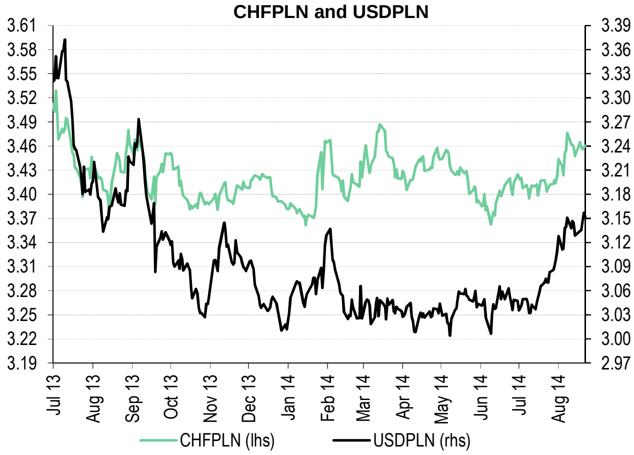
Anna Zielińska-Głębocka, MPC member, 18.08, PAP
In my opinion last events and macro data are getting us closer to decision about rate cut.

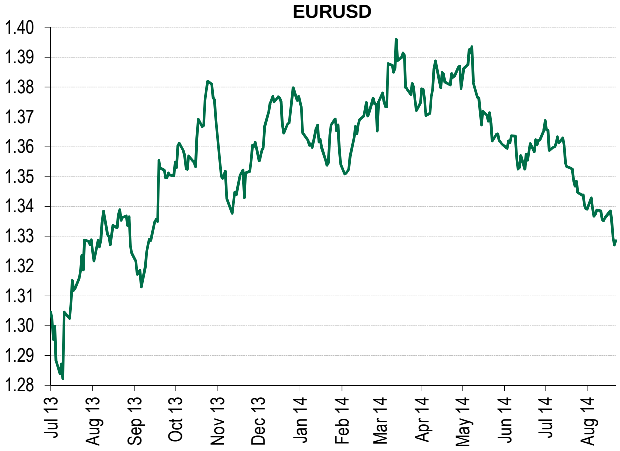
Andrzej Kaźmierczak, MPC member, 18.08, PAP
The superior goal is not to destabilise markets, not to destabilise exchange rate, to maintain stability of the entire financial system. This is the most important priority. And this is what interest rates policy is used for.

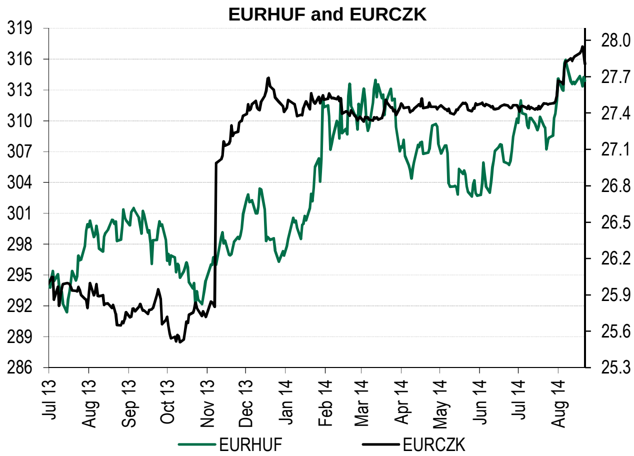
In our view, the information on the Polish economy available after the recent flow of data (no growth acceleration and no inflation) and news (sanctions, lower demand for Polish exports) is enough to take action by the MPC already in September (and then wait till November's meeting with new projections to see if more is needed). However, the recent comments of MPC members are suggesting that although the number of persons mentioning possibility of rate cut is rising, it might be difficult to form a majority to support the motion to cut rates already at the nearest meeting. In any event, until year-end we may see 75bps cumulative monetary easing

Foreign exchange market – EURPLN more stable before a significant move?









Data from the US can influence EURPLN

- Zloty has been appreciating versus the euro for the last five sessions. Decline to 4.177 from 4.205 began just at the beginning of the week and in following days the rate was fluctuating in very narrow range 4.18-4.195. The appreciation took place despite persisting high geopolitical risk. Polish currency was also supported by strengthening of domestic bonds.
- Zloty remained stable versus British pound and Swiss franc, while versus the dollar it was temporarily the weakest since September 2013 (USDPLN broke the peak from the last week and reached 3.166 for a moment).
- In the last three weeks we have seen gradually narrowing range of EURPLN fluctuations. Meanwhile, in nearest days we will get to know many important data from the US. It is worth to remind that one of the factors which triggered big market fluctuations was (apart from situation in Ukraine) the first estimate of US GDP for 2Q. The data was highly above the consensus and, according to investors, moved closer the perspective of Fed interest rate hike, pushing EURPLN above resistance at 4.17. This was followed by increase to almost 4.23 in following days. Set of important data releases from the US, plus the approaching MPC's decision and narrowing range of fluctuations suggest that a strong directional move may occur very soon. Scenario of larger currency fluctuations is also supported by recent events in Ukraine – the country considered entrance of Russian trucks with humanitarian aid as an act of aggression, which definitely does not bode well for situation behind our eastern border. 4.16 and 4.225 are important levels for the EURPLN.

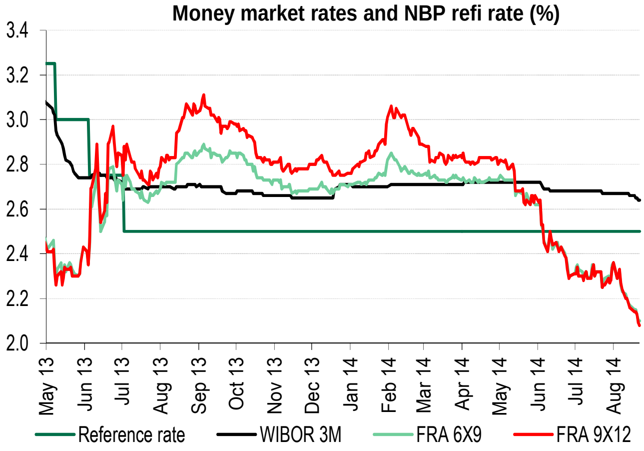
Fed's rhetoric and data from the US support the dollar

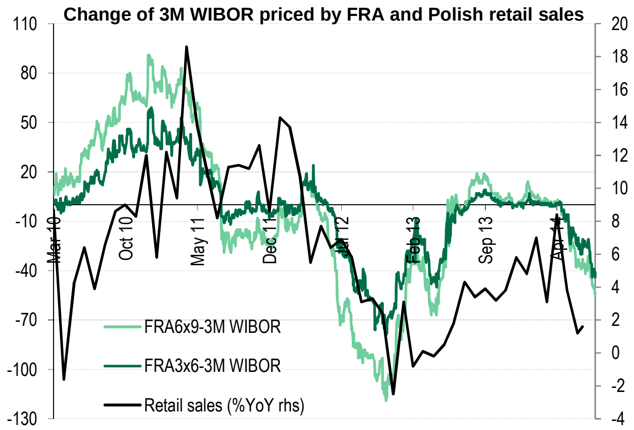
- Last week brought next publications of better than forecast, important data from the US and, therefore, continuation of dollar's strengthening versus euro. Decline of EURUSD to 1.322 (the lowest level since September 2013) was also supported by hawkish tone of FOMC minutes.
- Last days of the week passed in expectations for speeches of central banks' presidents at the economic symposium in Jackson Hole. Speech of Fed's president Janet Yellen, just before the close of European session, was perceived as hawkish, which may increase investors' sensitivity to new data from the USA, especially those from the labour market.
- The speech by the ECB Governor Mario Draghi, scheduled for Friday evening might be equally important as investors will try to find any suggestions of QE in Europe. Apart from that, data from the US and Germany will have significant influence on EURUSD, which will be interpreted in terms of their influence of Fed's and ECB's monetary policy.

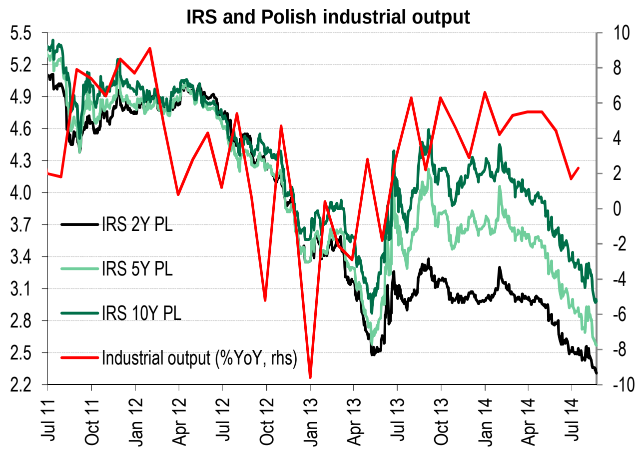
Hungary's central bank may support the forint

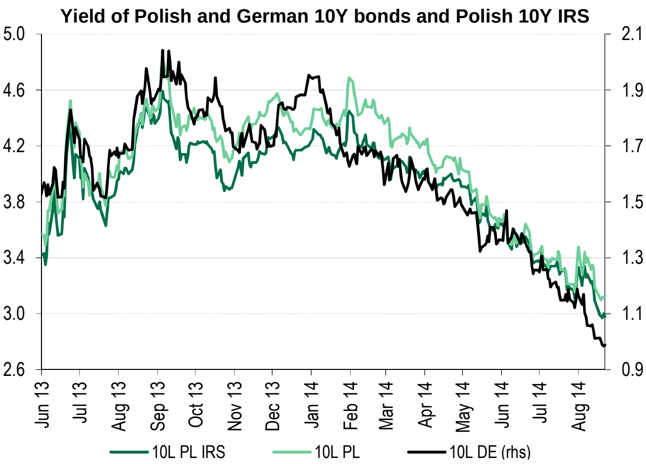
- Similarly as in case of zloty, quotations of CZK and HUF have stabilised. EURCZK was fluctuating near 28 and EURHUF was in a narrow range of close to 313-314.
- This week Hungary's central bank will make the decision concerning interest rates. On month ago the bank decided to cut the rates, which was regarded as concluding the rates reduction cycle. Since then we saw the publication of data concerning GDP in 2Q, after which the Hungarian Ministry of Economy revised their growth forecast upwards for this year. Also, CPI in July ended 3-month deflation period. Therefore, the bank's communique will probably not be more dovish than the last one. It can potentially influence HUF positively.

Interest rate market – Data locally and abroad will be the key









Expectations for rate cut still strong

- Comments of MPC's members and another bunch of economic Polish data for July have strengthen markets' expectations for NBP to cut the rates this year. Last week WIBOR rates from 3 to 12 months fell by 2-3bp (the shortest rate lowered the slightest). Conviction about the upcoming cuts has intensified pricing in the FRA market, though still the scale of reduction of interest rates does not exceed 50bp in 6 months horizon.
- IRS and bond yields in 2-10 year segment fell this week by 4-11bp with the most significant decline in the middle and at the end of the curves. As a result 5Y IRS fell to c2.55% (a new historical minimum) and 10Y IRS is only 10bp above the record minimum from May 2013. The short-ends of IRS and bond curves had already priced the cut of rates earlier (reaching new record levels) so the recent changes were relatively smaller there. The turnover on the market was quite limited this week.
- The NBP published minutes of the MPC meeting held in July. The document said that the rationale for the decision to keep rates on hold was the ongoing economic recovery, which should contribute to inflation rising close to the NBP inflation target over the projection horizon. After two months, it looks like this argument is much weaker, as a continuation of the recovery is questionable and thus the return of inflation toward the target may be longer (with a longer period of negative CPI in upcoming months). A few members stressed such risks back in July and said that an "interest rate decrease could be necessary in the near future". There is no doubt they will have more arguments during September's meeting.

The data and Ukraine in focus

- After recent publication of hawkish FOMC minutes and better than forecasted flash PMI for Germany, the Polish market weakened (IRS and bond yields grew by 10bp). The move was used as an opportunity to accumulate bonds again and the correction proved very short-lived. Expectations concerning NBP cutting rates are very strong so it seems that IRS and bond yields will stay near this (or even lower) level until the MPC's September meeting. This week's data concerning retail sales can be a prompt to deepen the move. Our forecast of sales is significantly below the market consensus and though we see the upside risk to this figure, in the case of a weak reading of below 2% YoY we see a potential for IRS and bond yields to decline.
- Apart from the Polish data, changes on core markets will be crucial, especially for 5-10Y curve segment. The upcoming days will bring many important data releases, especially in the US and Germany. In recent weeks hopes for further monetary easing in the Eurozone were growing (under influence of very weak data and uncertainty of influence of Russian sanctions). At the same time, the probability of rates being raised in the US has become more probable amid positive surprises in the macro data. These two contradictory tendencies had a significant impact on core debt markets (hope for more expansive ECB's monetary policy was more important though), which are highly correlated with the Polish debt market.
- The unstable situation in Ukraine still creates an important risk factor. At the end of the week Ukraine's state security chief treated entrance of Russian trucks with humanitarian aid without permission of local authorities as an invasion. Possible exacerbation of the conflict would make a strong pressure on the Polish debt. Similarly as with the zloty exchange rate, the domestic interest rate market can experience higher volatility in nearest days.

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