Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

13 – 19 April 2015

The zloty has appreciated sharply in the last two weeks, with EURPLN sliding to 4.0, its lowest since July 2011. We agree with the finance minister Mateusz Szczurek that current level of the zloty is not yet a big threat to Poland's economic growth, and in fact we have just raised our GDP growth forecast for 2015 from 3.2% to 3.6% (with 4Q15 at 4.0%YoY). However, if sharp appreciation continues, it may start having a negative effect on growth outlook and may complicate the central bank's job.

The MPC is unlikely to change monetary policy parameters this week, but the market will be looking for any central banker comment on the zloty's recent appreciation. This means that the MPC's press conference will be watched closely, especially since it will be the first time when it will take place just after the ECB's conference and after the CPI data release. We expect a bit stronger rebound of CPI in March than is predicted by the market and this could be slightly negative for the FI market (unless it gets neutralised by some dovish signals from the central bank). Other data to be released this month are also likely to be unsupportive of the bonds, showing strong labour market and accelerating economic activity. Greece is expected to have enough cash for its €420m payment for the maturing T-bills on April 14, but it may run out of money at the end of the month, which is still a risk factor for the markets.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 April)					
14:00	**PL**	**Current account**	**Feb**	**€m**	**60**	**142**	**56**
14:00	**PL**	**Exports**	**Feb**	**€m**	**13470**	**13480**	**13 472**
14:00	**PL**	**Imports**	**Feb**	**€m**	**12836**	**12980**	**12 451**
		TUESDAY (14 April)					
11:00	EZ	Industrial output	Feb	%MoM	0.3	-	-0.1
14:00	**PL**	**Money supply**	**Mar**	**%YoY**	**8.6**	**8.5**	**8.8**
14:30	US	Retail sales	Mar	%MoM	1.0	-	-0.6
		WEDNESDAY (15 April)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
13:45	EZ	ECB decision		%	0.05	-	0.05
14:00	**PL**	**CPI**	**Mar**	**%YoY**	**-1.4**	**-1.3**	**-1.6**
15:15	US	Industrial output	Mar	%MoM	-0.3	-	0.1
20:00	US	Fed Beige Book					
		THURSDAY (16 April)					
14:00	**PL**	**Core inflation**	**Mar**	**%YoY**	**0.4**	**0.4**	**0.4**
14:30	US	Initial jobless claims	week	k		-	281
14:30	US	House starts	Mar	k	1040	-	897
14:30	US	Building permits	Mar	k	1080	-	1092
16:00	US	Philly Fed index	Apr	pts	5.0	-	5.0
		FRIDAY (17 April)					
10:00	**PL**	**Fiscal notification: general government balance**	**2014**	**% GDP**		**3.2**	**4.3**
11:00	EZ	HICP	Mar	%YoY	-0.1	-	-0.3
14:00	**PL**	**Wages in corporate sector**	**Mar**	**%YoY**	**3.3**	**3.4**	**3.2**
14:00	**PL**	**Employment in corporate sector**	**Mar**	**%YoY**	**1.2**	**1.2**	**1.2**
14:30	US	CPI	Mar	%MoM	0.3	-	0.2
16:00	US	Flash Michigan	Apr	pts	93.7	-	93.0

Source: BZ WBK, Reuters, Bloomberg

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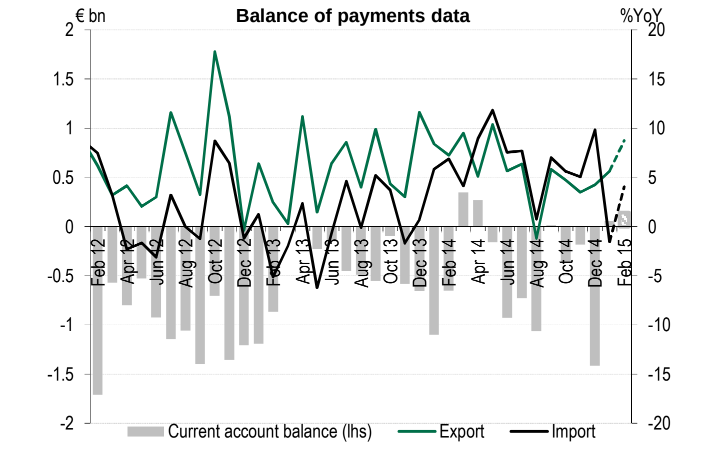
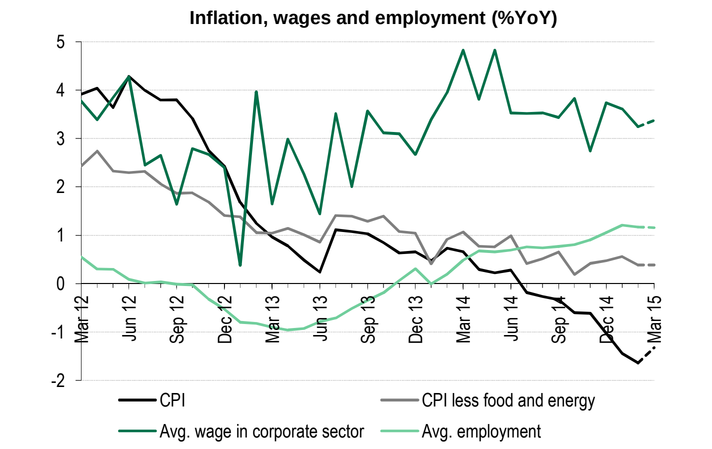
What's hot in this week – MPC meeting, current account, inflation and labour market statistics





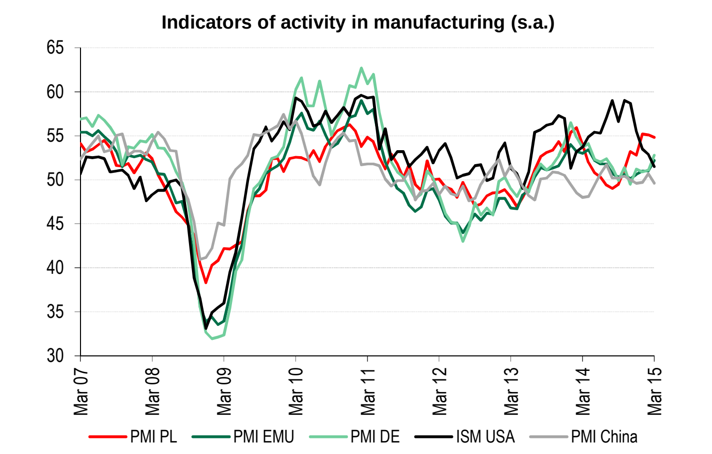
▪ April's meeting of the Monetary Policy Council will most likely bring no changes in the monetary policy parameters. However, since minutes from the Council's previous meeting showed that the end of the easing cycle was conditional, it will be interesting to see if the MPC will try to list factors, which could encourage it to resume cuts, especially given the recently considerable appreciation of the PLN. The current exchange rate levels are, in our view, still safe for economic growth but further strong and persistent appreciation could affect the growth outlook negatively.

▪ We expect a rebound in both export and import growth in February. Exports drew support from the accelerating industrial output. Moreover, German export data came out strong and so the Polish statistics may follow suit. On the other hand, imports were supported by strong domestic demand. We expect a surplus in both trade and the current account balance. In our view, the 12M current account balance is likely to shrink to -1.0% of GDP in February, the lowest level since mid-90s.

▪ In our view, CPI inflation reached its trough level in February at -1.6%YoY and March should show a rebound to -1.3%YoY, mainly thanks to higher food and fuel prices, with core inflation excluding food and energy flat at 0.4%YoY. According to our forecast, CPI growth will be gradually accelerating throughout the year to reach +0.7%YoY in December.

▪ We expect wage growth to rebound to 3.4%YoY in March from 3.2%YoY in February. It should be remembered that February's reading was undermined by shifts in the timing of bonus payments in mining, so a rebound in March is very likely. Growth of employment most probably remained in March at February's 1.2%YoY and these two numbers, combined with the negative CPI, will again yield high growth of the real wage bill, which we expect at 6.0%YoY, providing strong support for private consumption at the start of 2015.

Last two weeks in the economy – PMI lower, but still confirms recovery



▪ PMI for the Polish manufacturing sector fell in March to 54.8pts from 55.1pts, below market expectations. However, the index remains at a relatively high level, showing that positive trends in the Polish economy continue. The main drag on the March release came from weaker – although still solid – growth of new orders. The survey showed that export orders rose at a faster rate (mainly thanks to the zloty's depreciation vs. the dollar), indicating that domestic orders had underperformed last month. At the same time, employment continued to grow at an accelerating rate. All in all, although the headline number was a bit of a disappointment, the data's details confirmed that recovery in the Polish economy was on track.

▪ The LFS unemployment rate slid in February to 7.8% and was by 2.0 percentage points lower than one year earlier. If the current labour market trends continue, the jobless rate is likely to reach 6.8% by the end of the year, the lowest level in history.

Quote of the week – GG deficit above 3% in 2014 but below 3% in 2015

Mateusz Szczurek, finance minister, 1 April, Reuters

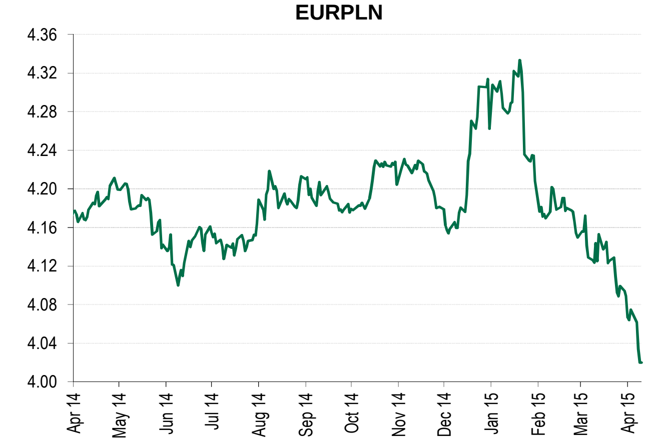
Fresh data that the Finance Ministry has at its disposal shows that the general government deficit was lower than the expected 3.6% in 2014 and that it could have amounted to 3.3%. The GG deficit will certainly be lower than 3% of GDP in 2015.

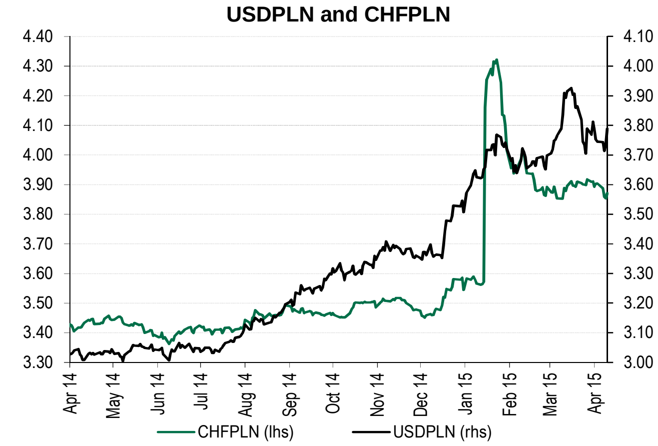
9 April, PAP

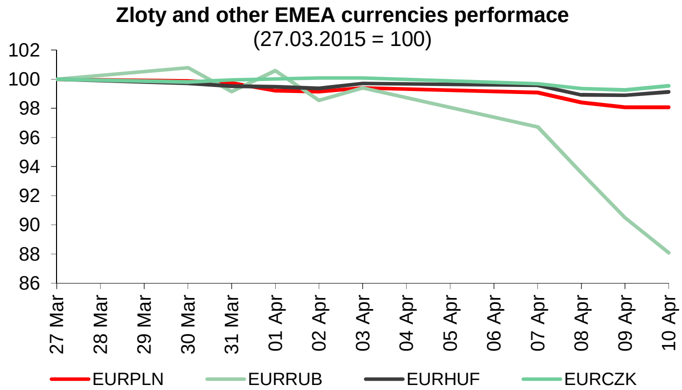
Given the main GDP growth drivers, i.e. investment and private consumption, the current zloty strengthening is not a direct threat to economic growth forecasts for 2015.

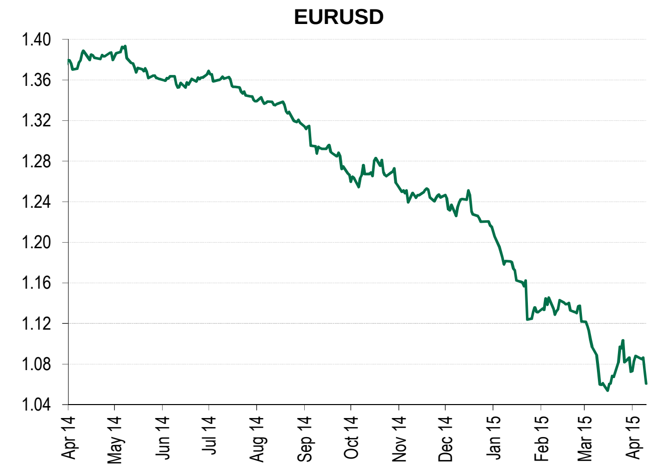
Data on the general government deficit in 2014 are due for release on April 17. In mid-March, Szczurek suggested that the deficit may have been closer to 3.6% than to 3.3% of GDP. He later said just the opposite: that 3.3% is more likely than 3.6%. What is more, media had recently speculated that the deficit likely stood at 3.2% last year. As far as the deficit in 2015 is concerned, we expect it to fall to 2.9% of GDP, which should allow Poland to exit the Excessive Deficit Procedure (EDP) in 2016. We agree with Szczurek that the current level of PLN poses no threat to economic growth, so this forecast is still secure. We see some downward risk for this year's tax revenues given that inflation will be lower than had been assumed in the budget act. But we think that the deficit should not be higher than planned at the end of this year.

Foreign exchange market – Correction is probable after strong rally









The zloty hits a four-year low against the euro …

- Over the past two weeks, emerging market currencies, including the Polish zloty, drew support from the global risk appetite, the ECB's QE programme and expectations that the Fed would delay its first rate hike later into 2015. As a result, EURPLN tested its psychological support level of 4.00, but failed to break through it for good. The exchange rate temporarily reached 3.998, the lowest level since July 2011. In the second part of the week, there was profit taking (EURPLN retreated from 4.00 towards 4.03), but the zloty firmed again on Friday.
- The zloty gained about 2% against the euro in the last two weeks. The currency also appreciated against the Swiss franc (by 1.2%) and the British pound (by 1.5%), while its strengthening against the U.S. dollar was only temporary, due to further decline of EURUSD. USDPLN, after dropping to 3.675, climbed towards 3.80.
- In our opinion, the zloty should remain quite strong, helped by: (1) an improving macro outlook; (2) the potentially positive impact from the ECB's QE; (3) and the Polish central bank's declaration about the end of the easing cycle. However, we believe that EUR/PLN may persistently fall below 4.0 only at the year-end (which does not rule out temporary moves). For the moment, any potential for further appreciation may be limited by the continuously unresolved issues of Greece, worries over possible intensification of the Russia-Ukraine conflict, as well as uncertainty about the timing of the first rate hike in the U.S.
- From a technical point of view, the risk of a correction on EURPLN has risen after its sharp appreciation. In our view, even a rise towards 4.10 would not deny the downward trend.

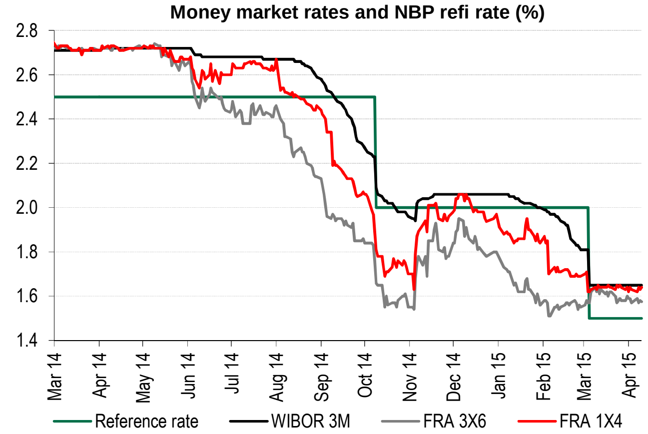
… as appetite for EM currencies grows

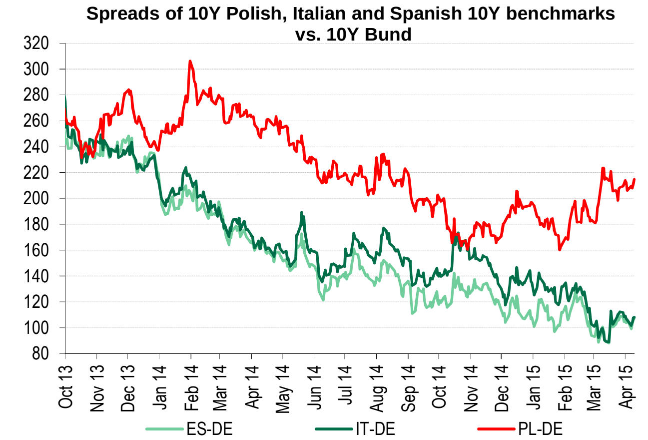
- Improvement in the global sentiment supported demand for EM currencies, with the Russian ruble benefiting the most. Also the Hungarian forint and the Czech koruna gained quite visibly in the last two weeks. Contrary to our view, EURHUF fell below 300 and temporarily reached 296, the lowest level since November 2013. At the same time, EURCZK dropped to 27.3. Slightly higher readings of CPI inflation for both Hungary and the Czech Republic caused rates to rise somewhat, but the move was short lived. Notwithstanding, the end of the week brought some strengthening, similar to PLN.
- This week's data calendar for Hungary and the Czech Republic is very light. The ECB meeting and macro data releases from both the euro zone and the U.S. should be crucial for the CEE currencies. In our view, it is very probable that a correction will follow the strong gains of the last two weeks.

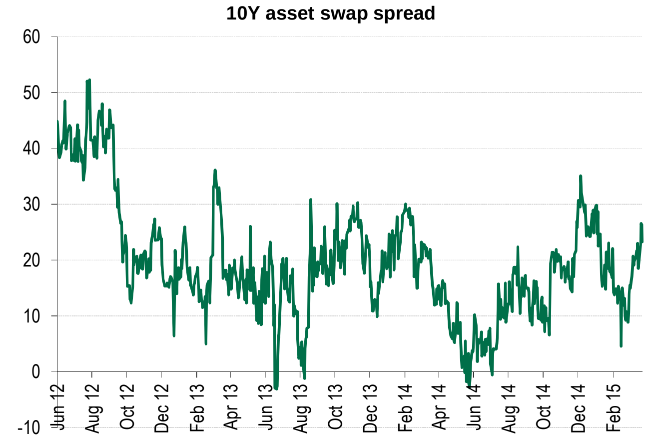
EURUSD lower despite weak U.S. data

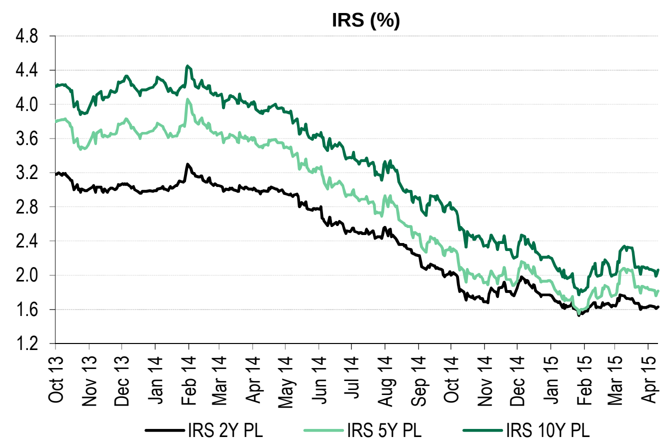
- The U.S. dollar continued to gain against the euro over the past two weeks despite the weaker-than-expected monthly non-farm payrolls. The EURUSD's sharp rise slightly above 1.10 (after the disappointing payrolls data) was only short-lived and the exchange rate quickly fell below 1.07. The FOMC minutes seemed to show divided opinions in terms of when to hike rates, but USD appeared happy to take in the prospect of a 2015 hike as a positive. All in all, EURUSD tested 1.06 at the end of the week.
- We think that the euro will stay under pressure from the ECB's outcome, which should confirm the QE programme as it stands now. Signals of a moderate pickup in the euro economy's outlook have fuelled speculation that the ECB may consider to shorten the period of tapering sovereign asset purchases. EURUSD is currently moving sideways between 1.045 and 1.10. This fluctuation range remains intact, though weaker U.S. macro data might push the rate towards the top of the boundary.

Interest rate market – Asset swaps may rise further









IRS and bond yields lower…

▪ During the past two weeks, the 1-12M WIBOR stayed flat and the FRA rates were also quite stable. At the same time, the IRS and bond yields eased 1-6bp, mostly in the belly and the long end. The decline's scale was bigger in the case of the IRS, particularly for the 10Y tenor. The down move in the IRS/yields was fuelled by the strengthening of the European debt market (thanks to the ECB's QE) and the not too hawkish signals from the FOMC.

▪ The bond auction was not a successful one. The Polish Ministry of Finance sold debt for PLN3.8bn, less than the upper limit of the planned supply band set at PLN4.5. Total demand reached PLN4.2bn. PLN2.1bn was raised from the sale of DS0725, while the remaining PLN1.7bn from WZ0124. Still, we estimate that after the auction, the Ministry has already covered 59% of this year's gross borrowing needs, which is quite good.

… but debt may still lag the European market

▪ As mentioned above, the 10Y IRS has recently dropped more than bond yields and the asset swap spread for this tenor reached 27bp, the highest level since the end of January. The 10Y asset swap spread has been rising gradually since early March and is currently approaching the 30-35bp zone, which has been a strong resistance since February 2013. We think there is room for the asset swap spread to continue its upward march towards this area.

▪ Polish bonds have been clearly underperforming the euro zone bonds of late and even the strong appreciation of the zloty of the last two weeks was not accompanied by a significant decrease of yields, with the 10Y spread vs. Bunds widening by c3bp. At the same time, the corresponding spreads for the euro zone's peripheral countries narrowed by 3-5bp, with even the Hungarian 10Y debt performing better than the Polish debt as the HU-DE spread dropped by 14bp.

▪ Three weeks ago we suggested that Polish bonds might lag the European debt market as European investors would be buying euro zone's treasuries in the first place and only when yields of the European bonds dropped sufficiently low, foreign capital would start looking for alternative assets to buy. This has not happened yet. We still cannot rule out that the continuing money expansion in Europe could trigger some stronger portfolio flows to Polish bonds, but room for yield falls does not seem to be very big given the: (1) improving economic outlook (in Poland and abroad); (2) expected bottoming out of domestic inflation; (3) geopolitical risks (Russia, Greece); and (4) looming Fed's rate hike (probably in September). The latter seems particularly important, which means that the market may be sensitive to any new U.S. data releases or FOMC members' comments.

▪ Poland's FI market may be sensitive to signals from central banks this week. The MPC is expected to leave rates on hold, but any comment on the recent zloty appreciation and its implications for the monetary policy outlook will be closely followed. Any sign that the central bank could be concerned with the pace of the currency's strengthening might support the interest rate market. The ECB meets on the same day and should it restate that the QE programme will continue at least until September 2016 – despite the recent series of positive economic activity releases – the Polish market could get another boost, though still a weaker one than the peripheral bonds, in our view.

▪ In contrast, the Polish macro data releases may be negative for bonds as we expect to see above-consensus CPI inflation, wages and employment. However, we think their impact should not be very strong.

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.