Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

11 – 17 May 2015

Bond market developments were surely last week's main event. The sharp rise of the German yields caused a massive sell-off on the whole bond market, sending the Polish 10Y yields temporarily above 3%, their highest level in 6 months, and making the Polish Finance Ministry call off a bond auction. While the end of the week brought some respite, it may take time before the market stabilises as investors remain wary after the recent volatility surge. The Polish MPC meeting was a non-event, with rates on hold and almost a copy-paste statement.

We think that domestic data to be released this week may be positive for the zloty, but they are unlikely to support bonds as they are likely to show accelerating GDP growth, bottoming out inflation and improving current account. The money market has already started pricing-in rising odds for an interest rate hike in one year's time and incoming strong data releases may reinforce this trend. However, external factors will be key for the market sentiment again. Monday's Eurogroup meeting is quite unlikely to bring an agreement between Greece and its creditors. In Europe, the focus will be on the 1Q15 flash GDP data, while in the U.S. the key releases will include retail sales and industrial production, which should help assess the strength of economic growth in 2Q15 after the surprisingly weak first quarter.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (11 May)					
	EZ	Eurogroup meeting					
		TUESDAY (12 May)					
9:00	CZ	CPI	Apr	%YoY	0.4	-	0.2
		WEDNESDAY (13 May)					
8:00	DE	Advance GDP	Q1	%YoY	1.3	-	1.4
9:00	HU	Advance GDP	Q1	%YoY	3.4	-	3.4
11:00	EZ	Advance GDP	Q1	%YoY	1.0	-	0.9
11:00	EZ	Industrial output	Apr	%MoM	1.5	-	1.6
14:30	US	Retail sales	Apr	%MoM	0.2	-	0.9
		THURSDAY (14 May)					
14:00	**PL**	**CPI**	**Apr**	**%YoY**	**-1.3**	**-1.1**	**-1.5**
14:00	**PL**	**Money supply**	**Apr**	**%YoY**	**8.4**	**8.6**	**8.8**
14:30	US	Initial jobless claims	week	k	-	-	265
		FRIDAY (15 May)					
9:00	CZ	Advance GDP	Q1	%YoY	2.0	-	1.4
10:00	**PL**	**Advance GDP**	**Q1**	**%YoY**	**3.5**	**3.4**	**3.3**
14:00	**PL**	**Current account**	**Mar**	**€m**	**962**	**1445**	**116**
14:00	**PL**	**Exports**	**Mar**	**€m**	**15 364**	**15 309**	**13 720**
14:00	**PL**	**Imports**	**Mar**	**€m**	**14 300**	**14 740**	**12 937**
14:00	**PL**	**Core inflation**	**Apr**	**%YoY**	**0.2**	**0.3**	**0.2**
15:15	US	Industrial output	Apr	%MoM	0.0	-	-0.6
16:00	US	Flash Michigan	May	pts	96.5	-	95.9

Source: BZ WBK, Reuters, Bloomberg

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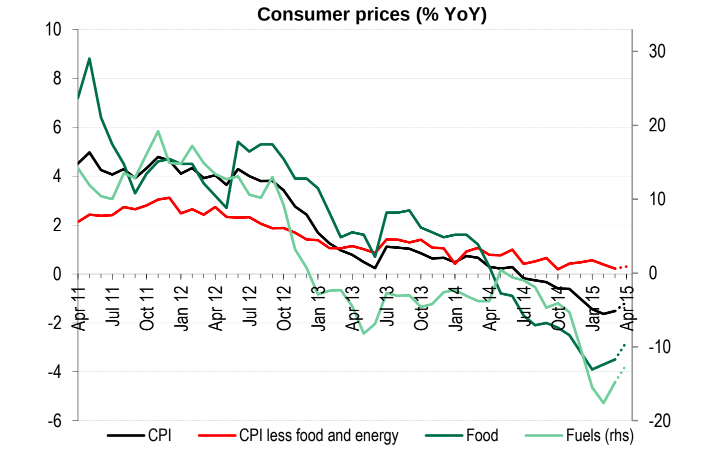
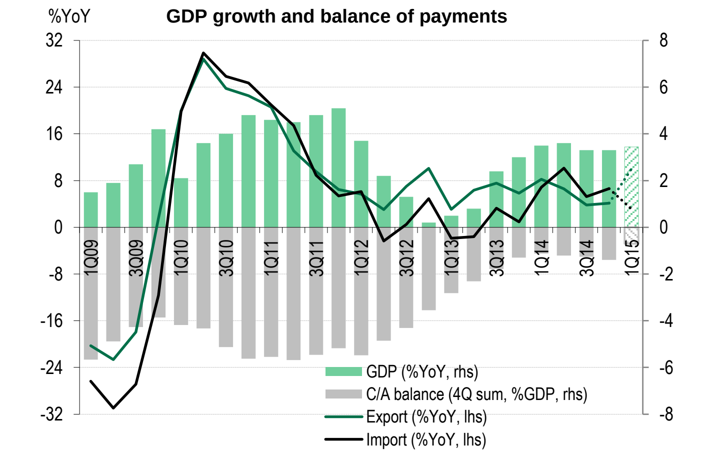
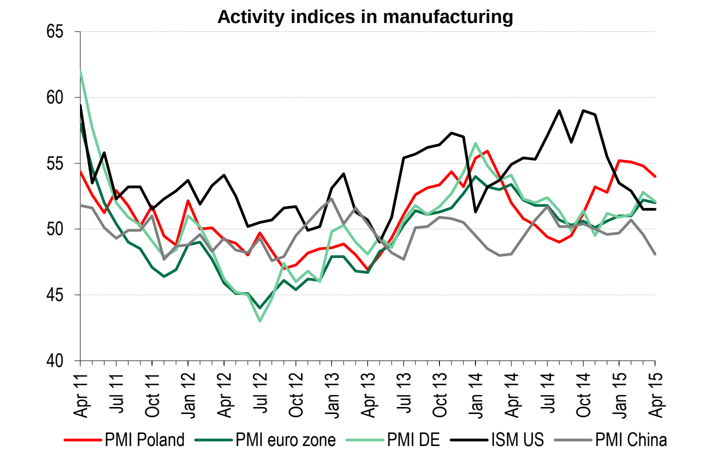
What's hot this week – Inflation bottoming out, GDP and export growth accelerating





- We expect CPI growth to rebound to -1.1%YoY in April from -1.5% in March, mainly on the back of slightly higher prices of food, more expensive fuel and a very low statistical base. Core inflation excluding prices of food and energy should rebound only slightly in April, though we expect the gradual upward trend to continue in the coming months, supported by strong private consumption and low base effects.
- GDP growth accelerated in 1Q15 to 3.4%YoY, according to our estimates, and we even see an asymmetric upward risk to our forecast despite the relatively high statistical base. The flash release will not show the structure of economic growth, but we think that it was fuelled by persistently solid investments, acceleration of private consumption (amid higher personal income) and much stronger exports (with neutral or even slightly positive net exports' contribution to GDP).
- Balance of payments data for the first two first months of the year surprised positively, showing a significant acceleration of export growth (due to the European Union's economic revival) and a sizeable foreign trade surplus. We expect data for March to confirm these positive trends in foreign trade: export growth was probably the fastest since late 2012 and outpaced imports. As a result, the trade balance remained positive in March, while the current account balance recorded an unprecedented surplus of nearly €1.5bn, according to our forecast, drawing additional support by solid inflows of EU funds.
- Money supply data should confirm that loan growth remained solid in April. A recent NBP survey showed that banks eased credit requirements for companies in 1Q, mainly thanks to the rising competition in the banking sector. Banks said they had recorded higher demand for long-term loans, mainly from large companies. According to the survey, banks intend to ease their requirements for companies further in 2Q.

Last week in the economy – Greece weighs on business climate



- Poland's manufacturing PMI fell for the third month in a row to 54.0 in April, mainly due to lower growth in new orders and employment. However, both these sub-indexes remained comfortably above the 50-pt neutral mark. Interestingly, growth in export orders expanded at the fastest pace since February 2014 despite the zloty's appreciation. The pace of output growth did not change much vs. March as the sub-index stayed above 55 pts. The recent slowdown in economic activity measured by the manufacturing PMI index is consistent with developments seen in Germany and in the euro zone as a whole. The less positive sentiment despite the weak single currency and additional monetary policy easing implemented by the ECB suggests, in our view, that the Greek deadlock is weighing on business sentiment in the region.

Quote of the week – Growth will stay relatively low in the long run

Marek Belka, NBP president, 6 May, MPC press conference

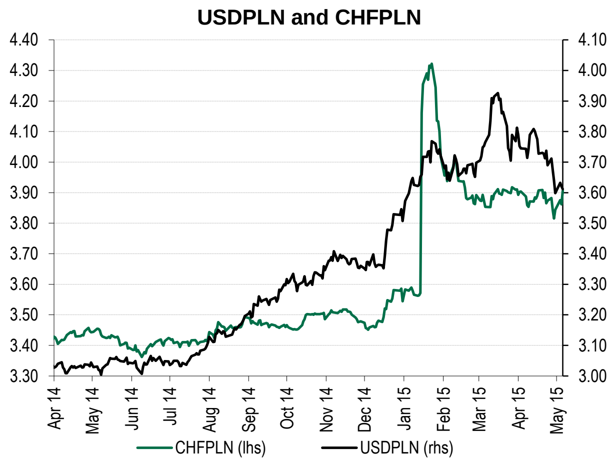
We are observing the exchange rate, the zloty is fluctuating, we are satisfied. (…) If growth will stay at a relatively low level in the longer run, the population will age and propensity to save will be high, then it will be possible for interest rates to stay relatively low. (…) We should be optimistic about economic growth (in the short run) – the economy is accelerating.

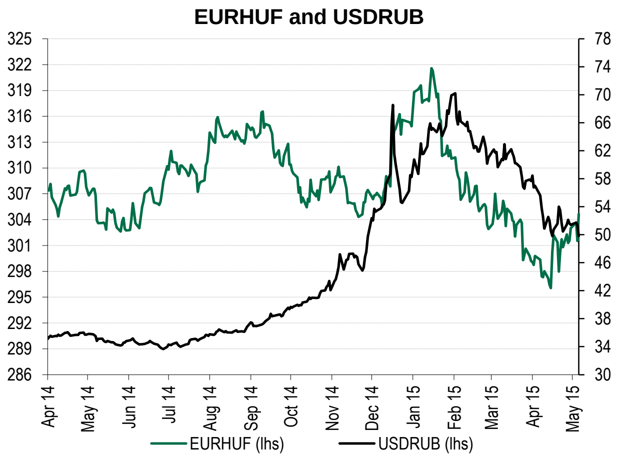
Jan Winiecki, MPC member, 6 May, MPC press conference

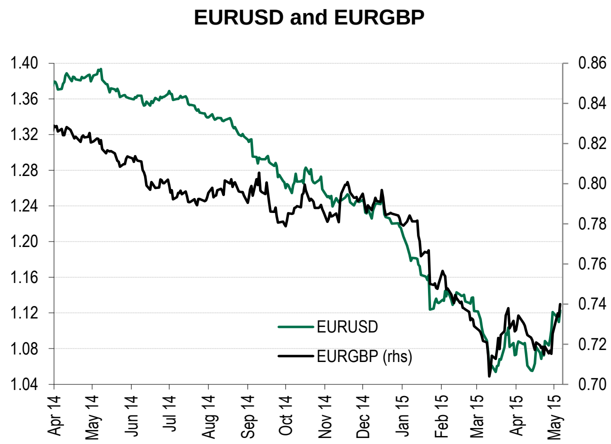
The economic environment points to exceptionally low economic growth and inflation pressure (in the long run). Given this context, expectations that an average-size economy is able to generate policy, which can create higher inflation, are unfounded.

The Monetary Policy Council did not surprise in May and kept interest rates on hold. It only made slight changes in the official post-meeting communique. This should be of no surprise in light of the fact that the recent macro data confirmed economic growth was accelerating, the labour market improving and inflation was bottoming out. At the same time, the zloty's appreciation trend has stalled since the MPC's previous meeting. Thus, there were no reasons to change the monetary policy bias. We expect Poland's interest rates to remain stable for more than a year – with the first rate hikes only possible at the end of 2016 and in reaction to the gradual inflation rise towards the central bank's official target.

Foreign exchange market – Stuck between strong 1Q15 GDP and Greece







Mixed situation on the zloty …

▪ Most emerging market currencies (including the Polish zloty) weakened considerably against the euro last week, which was mainly caused by the uncertain situation in Greece, worries over global economic growth and the significant weakening on the European debt market. Consequently, EURPLN lost ground and reached temporarily 4.085, the highest level since the end of March. However, EURPLN recovered quite fast and oscillated between 4.05-4.07 ahead of April's U.S. labour market data. Outcome of non-farm payrolls was close to market consensus, therefore market reaction was muted. The EURPLN ended the week near 4.05.

▪ At the same time, the zloty gained versus the U.S. dollar due to the rise of EURUSD. USDPLN temporarily fell to 3.55 (the lowest level since the end of December 2014) and, after a quick upward move, stabilised at slightly above 3.62 (trimming all earlier gains). Zloty was weaker against all main currencies as compared with the end of April, but lost the most against the Swiss franc (by 1.9%).

▪ This week is filled with macroeconomic data releases (including data on Poland's economy) and important events, including the Eurogroup summit. Domestic macro data should support the zloty in our view, showing a significant current account surplus and acceleration of GDP growth in 1Q15. On the other hand, the persisting uncertainty about Greece may limit the scope for the zloty to appreciate.

… and other CEE currencies

▪ In the CEE region, the forint and the Czech koruna also lost vs. the euro, while USDRUB dropped again due to the continued rebound in oil prices. Investors on the Czech FX market did not react to the Czech central bank's decision to keep its monetary policy unchanged since this decision was widely expected.

This week investors should mainly focus on the external factors, in particular the Eurogroup meeting, at which financial help for Greece will be discussed. Currencies could suffer and pressure could rise if the deadlock in talks between Greece and its creditors continues. However, depreciation could be limited by strong 1Q15 GDP growth data for both the Czech Republic and Hungary.

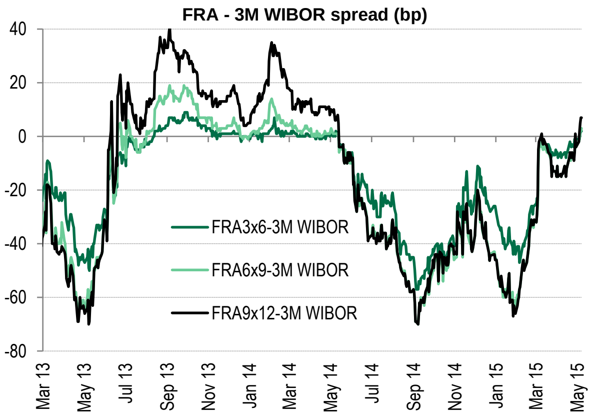
EUR and GBP stronger over the past week

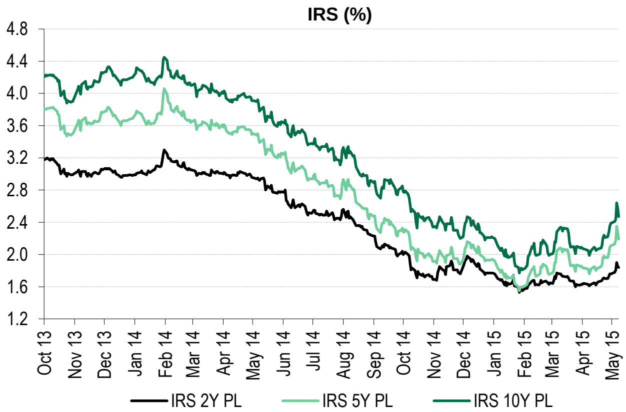
▪ Last week the euro gained visibly against the U.S. dollar, with EURUSD going up to nearly 1.14 (the highest level since February). The euro gained mainly on the back of weak data from the U.S. as investors started to pay more attention to signals from the U.S. than the prolonged negotiations with Greece. However, the exchange rate returned towards 1.12 at the end of the week as oil prices saw some correction and the European debt market rebounded ahead of the U.S. monthly labour market report. Non-farm payrolls data was close to market consensus and their impact on the market was only short-lived.

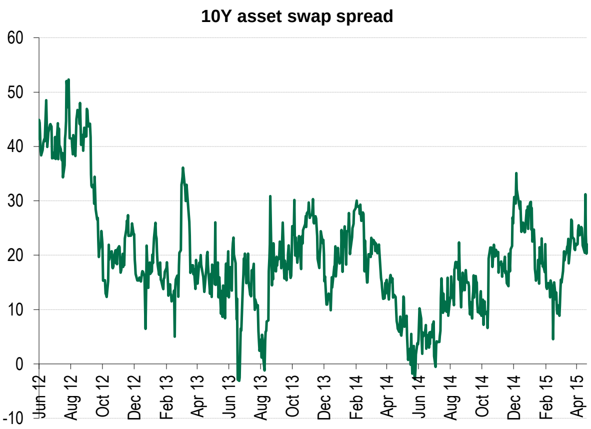
▪ The GBP rallied against the main currencies on the news that the conservatives had won the election in the UK. Consequently, EURGBP fell towards 0.72 from c0.74 at the beginning of the week.

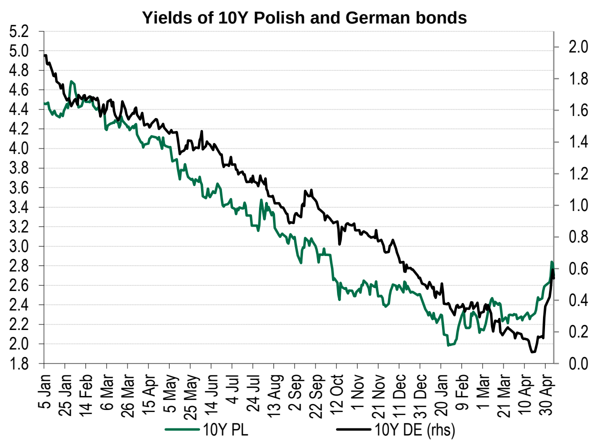
▪ This week's key events include the Eurogroup meeting, Greece's payment to the IMF, flash 1Q15 GDP data for the EU countries and some macro data from the U.S. Strong economic growth in Europe in 1Q 2015 may overshadow the uncertain situation in Greece and help the euro to continue its strengthening.

Interest rate market – Little scope for a recovery









10Y yield temporarily above 3% after sharp weakening

- The upward impulse in the Polish yields and IRS, which started at the end of the previous week, accelerated sharply during the recent sessions. The significant weakening seen in the core and peripheral euro zone bonds pushed the domestic bond and IRS curves 15-30 pb up, with the 10Y yield rising temporarily above 3%. Bond selling on the core and peripheral markets was fuelled by rising concerns over Greece, but we think that it was simply the activation of stop-loss orders that was its main driver.
- On a weekly basis, the 2Y, 5Y and 10Y IRS rose 8bp, to 1.70% (the highest since December), 2.19% (the highest since September 2014) and 2.47% (the highest since October), respectively. The significant IRS move pushed the WIBOR rates up – from 1bp for the 1M rate up to 6bp for the 12M rate. FRAs rose 4-20bp in the 1x4-21x24 segment.
- The significant weakening of the Polish debt caused the Finance Ministry to call off the bond auction. Deputy finance minister Artur Radziwiłł said that the government's borrowing needs have been covered in 66% and the ministry held over PLN63bn PLN- and FX-denominated funds, so it could "limit bond supply or even suspend it for a few months".
- We wrote in mid-April that the 10Y asset swap spread may rise to the 30-35 resistance area. Last week saw an increase to the lower end of this range but it was soon corrected to 20bp.

Little scope for a recover

- We believe the recent surge in yields/IRS to have been too fast and too furious to be sustained for longer, particularly as the market pulled back significantly in the second part of the week. Recent signals from China, Europe and the U.S. are weakening optimism about the performance of the global economy and should warrant no immediate changes in the monetary policy run by the biggest central banks and thus do not justify such sudden retreat from the debt assets.
- At the same time, we think that at least as far as the domestic market is concerned, there could be little potential for a sustained recovery in the short term. Our inflation forecast assumes a stronger rebound than the market expects. We also expect GDP growth to accelerate in 1Q15 and exports to post strong growth in March. If these forecasts prove correct, they should reduce expectations for interest rate cuts in Poland of anybody who still anticipates further monetary easing this year. The bottoming out inflation and strong economic growth could weigh on the Polish bonds and limit the potential for the IRS drop this week.
- The Greek financial problems also remain unsolved and the Eurogroup meeting scheduled for Monday is expected to offer no reasonable solution once again. Greece is running out of cash and the longer the negotiations last without reaching a solution, the more seriously worried investors could become.
- We expect the domestic IRS and bond yields to rise in the course of 2015 amid strengthening economic growth and rising inflation as the ECB's QE programme proves successful and reaches its objective.

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.