Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

18 – 24 May 2015

Global sentiment was calmer from session to session, supported by the U.S. macro data and the ECB governor's speech, in which Mario Draghi assured that the QE programme would be implemented in full despite some pickup in growth and inflation in the euro area. The unexpected win of Andrzej Duda in the first round of the presidential election weighted on Poland's assets, but strong domestic macro data helped the zloty recover at the end of the week. Meanwhile, domestic debt remained under pressure due to the continued sell-off on the core and peripheral debt markets and cooling expectations on further monetary easing by the MPC. The market's reaction to the news that the EC was recommending to lift the Excessive Deficit Procedure for Poland was muted.

This week is heavy with macro data releases and events. We think that data from Europe will confirm the current fundamental picture for the euro zone, while dovish FOMC minutes from its April meeting might support the debt markets as was the case in the previous months. In our view, PLN should remain strong, supported by strong domestic macro data, but nervousness may return ahead of the 2nd round of the election. At the same time, we forecast sideway moves in the yields/IRS rates, not so far from the YTD highs.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 May)					
		No important data releases					
		TUESDAY (19 May)					
11:00	DE	ZEW index	May	pts	69.0	-	70.2
11:00	EZ	HICP	Apr	%YoY	0.0	-	-0.1
14:00	**PL**	**Wages in corporate sector**	**Apr**	**%YoY**	**3.9**	**5.0**	**4.9**
14:00	**PL**	**Employment in corporate sector**	**Apr**	**%YoY**	**1.1**	**1.2**	**1.1**
14:30	US	House starts	Apr	k	1020	-	926
14:30	US	Building permits	Apr	k	1070	-	1042
		WEDNESDAY (20 May)					
14:00	**PL**	**Industrial output**	**Apr**	**%YoY**	**5.5**	**5.6**	**8.8**
14:00	**PL**	**Retail sales**	**Apr**	**%YoY**	**1.0**	**1.0**	**3.0**
14:00	**PL**	**Construction and assembly output**	**Apr**	**%YoY**	**5.8**	**9.9**	**2.9**
14:00	**PL**	**PPI**	**Apr**	**%YoY**	**-2.2**	**-2.7**	**-2.4**
20:00	US	FOMC minutes					
		THURSDAY (21 May)					
3:45	CN	Flash PMI – manufacturing	May	pts	49.4	-	48.9
9:30	DE	Flash PMI – manufacturing	May	pts	51.9	-	52.1
10:00	EZ	Flash PMI – manufacturing	May	pts	51.7	-	52.0
11:00	**PL**	**Bond auction**					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	-	-	264
16:00	US	Philly Fed index	May	pts	8.2	-	7.5
16:00	US	Home sales	Apr	m	5.2	-	5.19
		FRIDAY (22 May)					
8:00	DE	GDP	Q1	%YoY	1.1	-	1.4
10:00	DE	Ifo index	May	pts	108.0	-	108.6
14:30	US	CPI	Apr	%MoM	0.1	-	0.2

Source: BZ WBK, Reuters, Bloomberg

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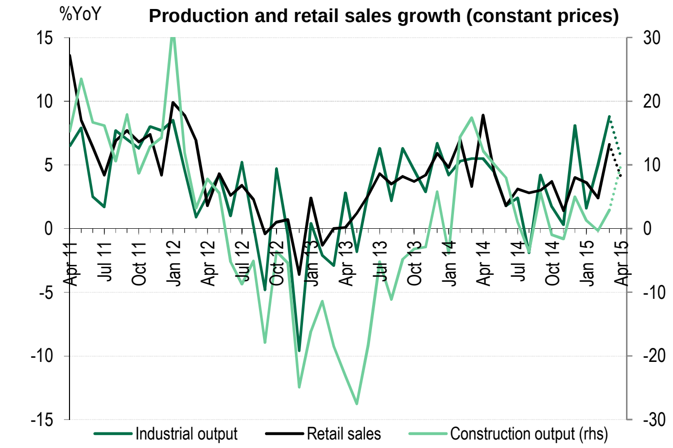
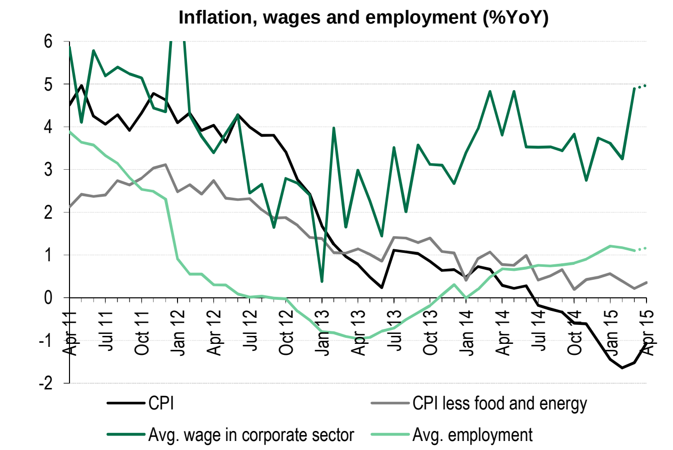
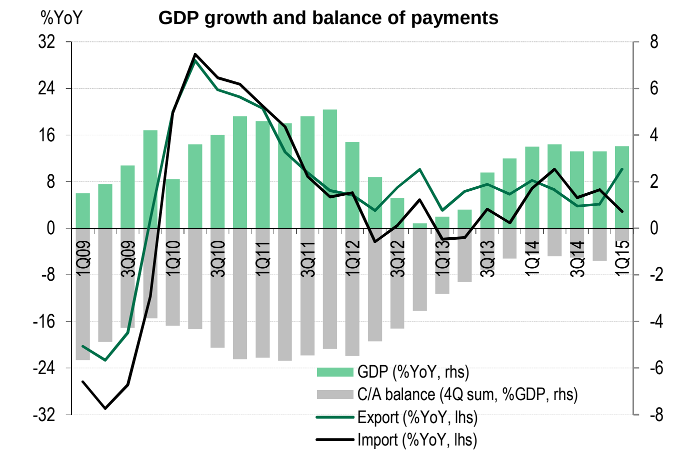
What's hot this week – Strong labour market, but statistical effects weigh on industry and sales



- We expect another strong reading from the labour market in April. Employment growth is likely to tick up, while wage growth is likely to stay close to 5.0%YoY, mainly due to earlier bonus payments in one of the major mining companies (KGHM). Thus, real wage bill growth is likely to stay above 7%YoY.
- Industrial output slowed down in April, but mainly on the back of a working-day effect. The underlying trend remained strong, in our view. We expect construction output to accelerate.
- April's real retail sales also decelerated versus March thanks to a base effect: Easter was in early April, which caused most of the Easter-related shopping to be done in March. This effect will be mostly visible in food sales, with other categories strong, in our view.

Last week in the economy – Growth accelerating, inflation bottoming out





- CPI rebounded in April to -1.1% YoY from -1.5% YoY in March. In monthly terms, prices rose 0.4%, the strongest increase since April 2013. The rise in the annual CPI was driven mainly by higher fuel and food prices. Prices of fruit and vegetables rose considerably and this apparently was the fading effect of the Russian embargo. Core inflation also rose to 0.4%YoY, from 0.2% in March. We expect inflation to rise further in the coming months. However, deflation will persist until 3Q and only in late 2015 we will see +0.6-0.7% YoY, still well below the MPC's inflation target. Upside pressure on CPI will be generated by the revival in economic growth and low base effect.
- GDP growth accelerated faster than expected to 3.5%YoY in 1Q15, according to flash data. The seasonally adjusted GDP rose 1%QoQ, accelerating from 0.9% in 3Q14 and 0.8% in 4Q14. We do not know the structure of the growth yet, but according to our estimates based on high-frequency data, it was driven by every possible factor: (1) accelerating private consumption; (2) strong fixed investments; (3) re-acceleration of exports due to the reviving demand from the EU. We think that the positive trend will continue in the coming quarters and GDP growth may accelerate to 4% before the end of the year.
- Polish exports surged in March by 13.7%YoY, driven by reviving demand from the EU, and the current account reached a record-high surplus (€1.9bn). We think that rapid export growth should continue, pushing economic growth up in the coming quarters.
- Surpluses in goods and services in 1Q15 were higher than expected and we think that this may imply that the flash 1Q GDP estimate could be revised up in the next release on May 29 once the statistics office takes into account the very positive foreign trade data.

Quote of the week – EDP exit reflected in the rating

Arnaud Louis, Fitch agency analyst, 13.05.2015, PAP

The falling deficit is credit-positive. But its influence on public debt to GDP is more important for us. Currently, debt is above 50%. According to my estimates, deficits at c2.5-3.0% of GDP are sufficient to stabilise the debt-to-GDP ratio or to lower it a bit, but this is not enough [to upgrade rating].

Felix Winnekens, S&P agency analyst, 13.05.2015, PAP

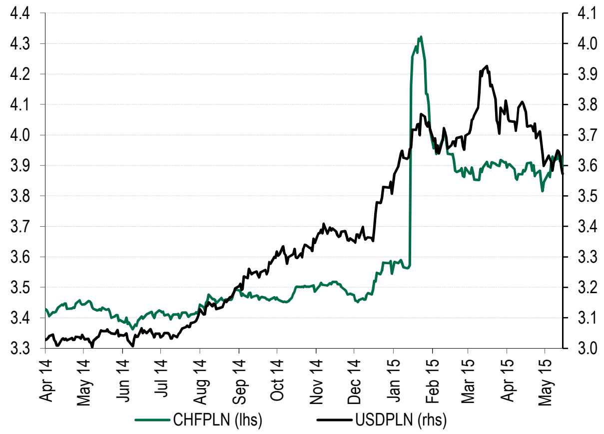
We are observing the election. The campaign is becoming fiercer, raising the risk of a pre-election spending spree. We had expected that Poland will exit the EDP in 2015 or 2016. Both the exit from the EDP and pre-election fiscal easing have already been accounted for in the rating.

The European Commission confirmed it was satisfied with Poland's progress in fiscal austerity and recommended the Excessive Deficit Procedure to be lifted. The Council of the EU is likely to confirm this decision in June. Lifting of the EDP gives the Polish government a bit more manoeuvre in budget management, e.g. tax cuts are possible right now after they were frozen for a long time. This may be tempting in the election year, even though it would be more reasonable, in our view, to maintain fiscal consolidation in times of an accelerating GDP growth. Although, in our view, a change of Poland's rating does not seem likely in the foreseeable future, we would not exclude a change of its rating outlook to positive once the EDP is lifted, especially if economic growth keeps surprising to the upside.

Foreign exchange market – Little odds for EUR/PLN to drop below 4.0

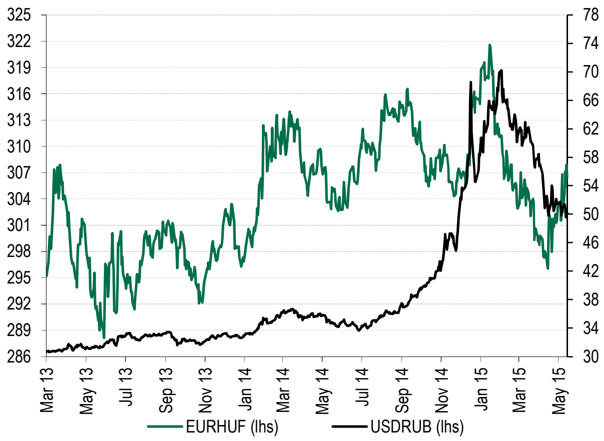
EURPLN

USDPLN and CHFPLN



EURUSD

EURHUF and USDRUB



Significant zloty swings

- EUR/PLN had quite a volatile week as it initially surged to 4.11 on the back of the global risk aversion and later dropped to 4.05 as Polish inflation, GDP, and C/A balance all beat market expectations. The global market also stabilised and this also helped the domestic currency to regain confidence. The zloty's recovery vs. the euro and the higher EUR/USD pushed USD/PLN down to the local low at 3.55, its lowest since early January. GBP/PLN was also quite volatile recently as EUR/GBP was reacting to the news from the UK. In the previous week, the zloty lost vs. the pound as GBP gained on the back of the British parliamentary elections. This week, however, the zloty pared part of its losses as the pound lost after the BoE lowered its GDP forecasts.
- The recent bunch of Polish macro data was supportive for the zloty as it showed the economic recovery was on track and that odds for more monetary policy easing were rather low. This week will offer another set of domestic, but our forecast is clearly above the consensus only in the case of corporate wages. However, the data should be positive in general, confirming that economic growth keeps accelerating in early Q2, which may slightly support the zloty.
- The global market sentiment stabilised at the end of the week, but the Greek issue remains unsolved. Greek officials suggest that some extra Eurogroup meeting could be arranged to discuss the country's huge repayments mounting on the horizon (in July) but prolonging of the talks is likely to weigh on the risky assets, in our view. Global investors are also likely to be sensitive to the U.S. macro releases that have been recently failing to convince them that the economy accelerated in 2Q after making a poor start to the year. We think that uncertainty over Greece and performance of the U.S. economy will limit the room for EUR/PLN's drop back below 4.0 in the nearest future. Additionally, a strong technical signal emerged in early May that rather shows upside potential for EUR/PLN.

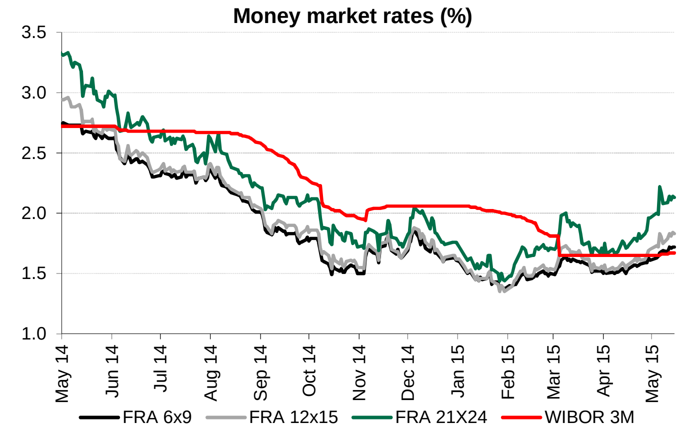
EUR/USD trends higher

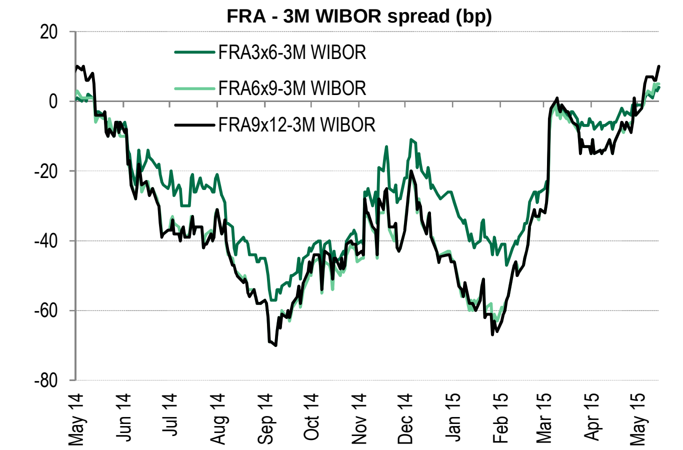
- The rebound in EUR/USD continued last week as most U.S. data disappointed and the euro zone's rising yields made the single currency more attractive. The exchange rate reached 1.145, the highest level since February.
- Plenty of U.S. data is due this week and they are likely to have the biggest impact on EUR/USD. The recently released indicators were rather on the weaker side and fuelled worries that the slowdown seen in 1Q also extended into 2Q. Should this be confirmed by the upcoming numbers, market expectations for the first Fed rate hike could be postponed and the dollar could suffer more losses vs. the euro.
- February's peak at 1.153 is EUR/USD's next resistance after 1.145.

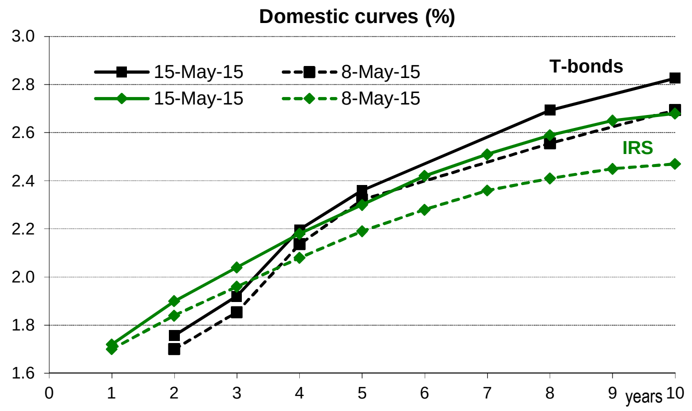
Will the USD/RUB downtrend stop?

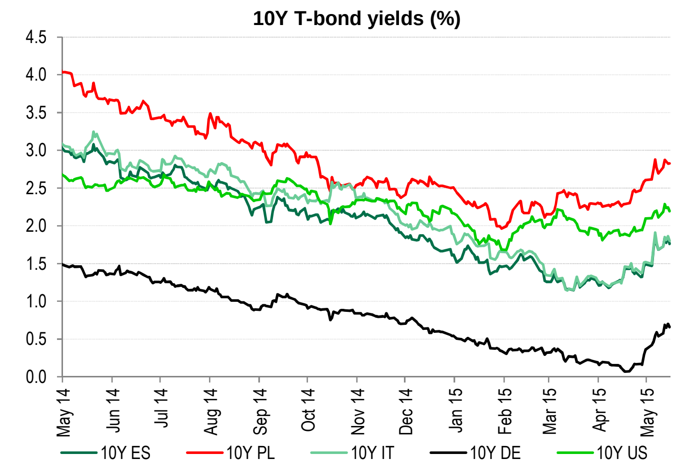
- The ruble continued to appreciate vs. the dollar, but the pace of the USD/RUB drop is clearly fading. Last week the Russian central bank announced it would be buying USD100-200mn daily to rebuilt its currency reserves, which it used at the turn of 2014/2015 to stop the ruble's depreciation. This could be a trigger for some profit-taking in the RUB market, particularly if the oil price falls when U.S. data due this week proves rather disappointing.
- The Czech koruna gained last week mainly on the back of the biggest ever quarterly GDP growth reported in the flash 1Q data. EUR/CZK dropped to 27.33 from 27.46 in response to this release.

Interest rate market – Debt market still volatile and illiquid









Debt market continues to experience upwards pressure

- Money market rates, bond yields and IRS rates remained under upside pressure last week. WIBOR rates between 3M and 12M rose by 1-4bps, while FRAs grew by 2-8bps across the curve over the past week. Investors still expect that the MPC might start monetary tightening in 12 months' time.
- Volatility on both the IRS and T-bond markets stayed high. The continuing sell-off on the core and peripheral debt pushed the domestic bond yields/IRS rates up. Comments of some MPC members suggesting that NBP's rates should remain on hold until the end of the Council's term, coupled with strong domestic macro data (higher GDP and CPI) did not help the market either. Yields and IRS rates, therefore, stayed at elevated levels, not too far from this year's maximums.
- Poland's curves steepened noticeably over the past week, with the long-end performing the worst. The 2-10Y spread widened to more than 100bps for the T-bonds and temporarily reached nearly 115bps, its highest since May 2014. At the same time, the 2-10Y spread for the IRS widened temporarily to 80bps and then stabilised slightly below this level. However, it is worth noting that the bear steepener strategy is intact on all the major CEE sovereign bond markets.

Relief depends on sentiment on the core market

- External factors will continue to be a major driver for Poland's assets. Sell-off pressure continues on longer maturity German bonds as so far every sign of stabilisation has been followed by more selling. What is more, volatility remains high. This week's macro data releases from Europe (mainly leading indicators, detailed GDP growth in Germany) could bring some new information about economic growth in the euro zone at the beginning of 2Q15. However, we do not think that the fundamental picture for Europe will change significantly. Investors might pay more attention to Fed's minutes. We do not exclude that a dovish outcome could bring some support for the core market as was the case in the previous months. Consequently, domestic assets could also rebound in the short run. However, uncertainty about Greece remains the main risk factor.
- This week Poland's Ministry of Finance plans to tap T-bonds on the domestic primary market. However, conduct of the auction was conditioned on the market situation. In our view, there is a possibility that the ministry will call off the tender as rising yields make the cost of financing debt less favourable. Such a decision would not be a surprise and should not become a problem since Poland has already covered 66% of this year's gross borrowing requirements and hold cPLN63bn of funds in PLN and in foreign currencies, which ensure liquidity in financing of its borrowing needs. This should be a supportive factor for the domestic T-bonds.
- On the domestic side, another set of important domestic macro data from the real economy is due for release this week. We expect strong growth in the corporate sector wages and a decent rise in industrial output and retail sales, which are likely to weigh on Polish debt and limit the potential for a recovery.
- Given all the factors mentioned above, we forecast a sideways move in the yields/IRS rates, not so far from the YTD highs.

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.