Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

25 – 31 May 2015

Global sentiment deteriorated last week due to worries about Greece's possible default and the worse outlook for the European economy after weak data from Germany. However, this was partly offset by comments of an ECB member, who pointed out that the ECB could front-load its QE in the May-June period. In Poland, macroeconomic data releases were weaker-than-expected (especially industrial output, retail sales). We think this was caused by the Easter effect, which we had underestimated in our forecasts. We, therefore, do not treat April's disappointment as a trend reversal, but rather a one-off temporary disturbance in the data. The Statistical Bulletin, to be released on Tuesday, should help us explain this puzzle in more detail. The zloty suffered quite visibly against the main currencies over the past week due to the disappointing data and uncertainty ahead of the presidential election. At the same time, Polish T-bonds slightly rebounded, following core market relief.

The presidential election results will be the key theme for the Polish market at the start of this week, especially since the important foreign markets are closed on Monday (USA, UK, Germany). Recent opinion polls showed mixed results, which means that the outcome will likely be a close call. If Andrzej Duda wins, it may imply higher market volatility since some of his proposals are controversial or costly, and his victory would probably increase uncertainty about the outcome of the autumn's parliamentary election. However, we do not expect a large scale correction for this reason. A much more significant risk comes from Greece, in our view, as the time for its bailout agreement is running out and the German finance minister warned on Friday about the growing risk of introducing a parallel currency in Greece. Polish GDP data, to be released on Friday, should confirm that faster growth was fuelled by every possible component and we even don't exclude the possibility of an upward revision after the surprisingly strong foreign trade data for March. Trends in the global financial markets will be determined by U.S. data releases as they may affect expectations on the timing of the Fed's next rate hike.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (25 May)					
		No important data releases					
		TUESDAY (26 May)					
10:00	**PL**	**Unemployment rate**	**Apr**	**%**	**11.3**	**11.3**	**11.7**
14:00	HU	Central bank decision		%	1.65	-	1.8
14:30	US	Durable goods orders	Apr	%MoM	-0.5	-	4.0
16:00	US	Consumer confidence index	May	pts	95.2	-	95.2
16:00	US	New home sales	Apr	k	500	-	481
		WEDNESDAY (27 May)					
		No important data releases					
		THURSDAY (28 May)					
14:30	US	Initial jobless claims	week	k	-	-	274
16:00	US	Pending home sales	Apr	%MoM	0.7	-	1.1
		FRIDAY (29 May)					
10:00	**PL**	**GDP**	**Q1**	**%YoY**	**3.5**	**3.5**	**3.3**
10:00	**PL**	**Private consumption**	**Q1**	**%YoY**	**3.2**	**3.4**	**3.0**
10:00	**PL**	**Investment**	**Q1**	**%YoY**	**6.4**	**8.5**	**8.6**
14:00	**PL**	**Inflation expectations**	**May**	**%YoY**	**-**	**-**	**0.2**
14:30	US	Preliminary GDP	Q1	%QoQ	0.2	-	2.2
16:00	US	Michigan index	May	pts	90.0	-	95.9

Source: BZ WBK, Reuters, Bloomberg

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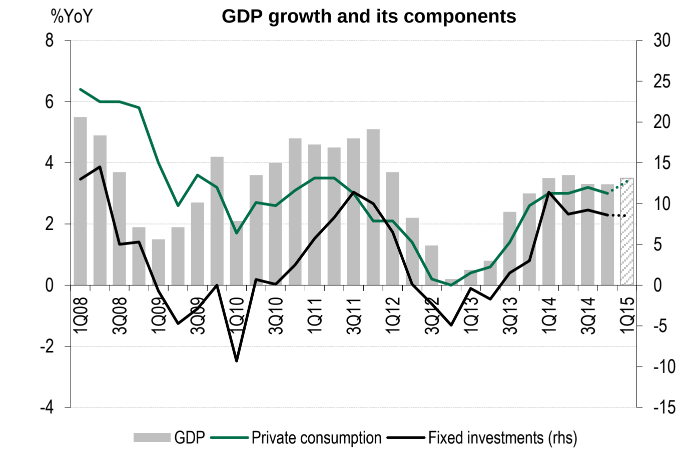
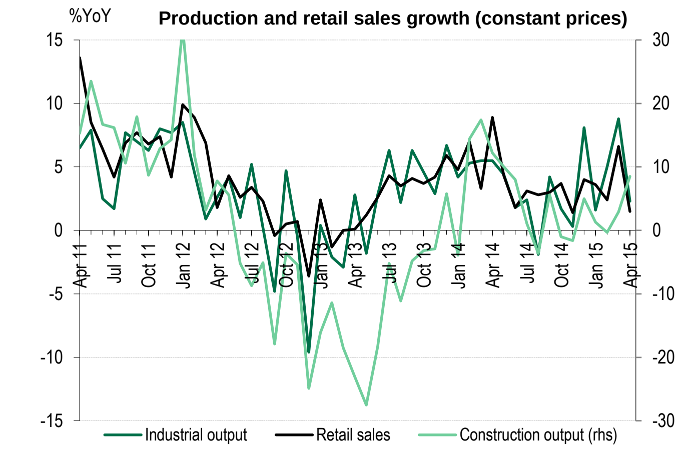
What's hot this week – Lower unemployment rate and higher GDP



- We expect the registered unemployment rate to have fallen to 11.3% in April and our forecast is consistent with the Labour Ministry's estimate, so any major surprise seems highly unlikely. We also expect unemployment to fall further in the coming months.
- We expect the detailed GDP data to show: (1) accelerating private consumption growth (labour market booming, real wages surging); (2) strong fixed investments (in both private and public sectors); and (3) renewed acceleration of exports due to reviving demand from the EU. In our view, the flash estimate of GDP growth in Q1 (3.5%) may be revised upwards, given the very positive foreign trade data in March, most probably not taken into account by the statistics office in its first release. We think that the positive trend will continue and GDP growth may accelerate to 4% before the end of the year.

Last week in the economy – Data undermined by statistical effects



- Employment in the corporate sector rose 1.1% YoY in April, slightly below our forecast, and the number dropped in monthly terms. This does not necessarily imply a deterioration of demand for labour, especially since other statistics (see chart) suggest we may already be facing a shortage of workers, translating into increasing wage pressure. Average wage growth reached 3.7% YoY in April, lower than in March and below our forecast, but we expect the positive trend to continue in the coming months.
- Industrial output growth decelerated sharply in April to 2.3% YoY, the weakest since January. Its slowdown vs. March (8.8% YoY) was primarily due to two factors: no support from the working-day effect and a slump in food output (-7.2% YoY vs. strong +10.1% YoY in March). This might have been an Easter-related effect, which we had underestimated in our forecasts. More importantly, there was no sharp weakening recorded in other categories.
- The pace of growth of construction output accelerated to 8.5% YoY mainly due to positive effects from the low statistical base.
- April's retail sales growth (in constant prices) amounted to 1.5%YoY, considerably lower than in March (6.6%YoY). This was also related to Easter, which was scheduled in April – just like in 2014. But this time around, it was celebrated at the very beginning of the month, causing a shift of some holiday shopping to the end of March. In our view, the surprise in April was primarily due to the underestimated scale of the shopping shift. Real retail sales ex food rose 2.4%YoY versus 3.7%YoY in March, according to our estimate. Still, let us keep in mind that retail sales were not a perfect proxy for private consumption growth in the last quarters. The Statistical Bulletin, to be released this week, will include the volume of retail trade data, which includes small shops, which have been consistently outperforming the retail sales in recent months.

Quote of the week – Interest rates are probably adequate

Anna Zielińska-Głębocka, MPC member, 20.05.2015, Reuters

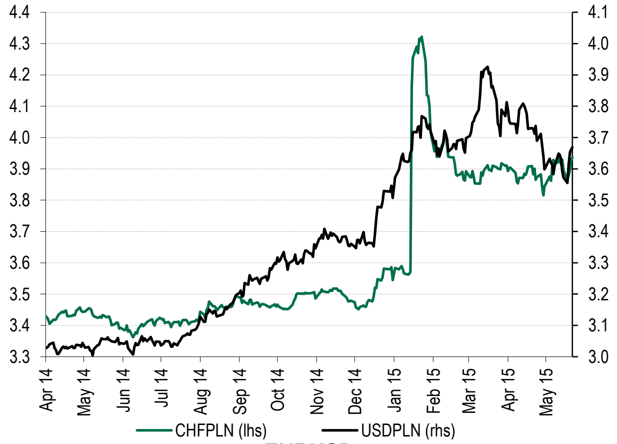
This level of interest rates is probably adequate for the current situation and I guess it is adequate for the next four quarters. I think there will be no interest rate changes until the end of our term in office, unless something happens. If some special circumstances appear, the MPC will act. (Inflation projections) will be key for decisions about interest rates. (…) MPC is aware that the effects of its actions are visible after 6-8 quarters. (…) It is really hard to say when the inflation target will be met. At this moment the projections and forecasts, which we have, are not showing inflation returning to the target in the forecast horizon.

No change on the monetary policy front. Another MPC member repeated last week that the interest rate level was adequate for the current and expected economic situation and that no changes in monetary policy were likely until the end of the MPC's term in office. Minutes from the MPC's last meeting, released by the central bank, did not change the monetary policy outlook either – in the Council's assessment, deflation will persist in the nearest quarters and the GDP growth rate will be accelerating. However the persistence of the recovery is not certain. We still believe that the next decision of the central bank will be a rate hike, and it will take place no sooner than in 4Q16.

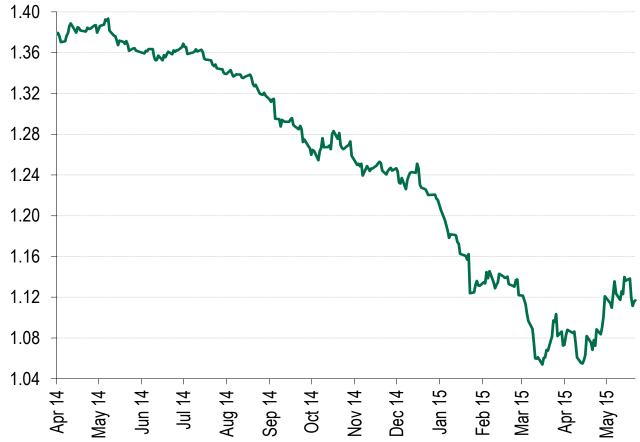
Foreign exchange market – Presidential election outcome and Greece in focus

EURPLN

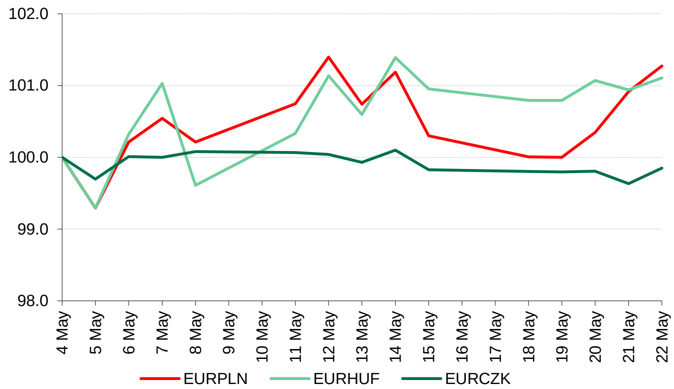
USDPLN and CHFPLN



EURUSD



Zloty and CEE currencies (beginning of May = 100)



Zloty under pressure from data, election and Greece

- The zloty weakened quite considerably over the past week due to the much weaker-than-expected domestic macro data (mainly industrial output and retail sales), worries about Greece's possible default and uncertainty over the presidential election outcome in Poland. As a consequence, the zloty was losing ground from session to session, with EURPLN climbing temporarily towards 4.106 (the highest level since March). EURPLN oscillated around 4.10 at the end of the week.
- In weekly terms, the zloty lost against the main currencies. The domestic currency weakened the most against the U.S. dollar (2.7%) due to the EURUSD decline and the British pound (by c2.1%).
- The presidential election in Poland and the situation in Greece will remain the important themes for the Polish market this week. A victory of the opposition candidate Andrzej Duda in the second round of Poland's presidential elections on May 24 could weigh on market sentiment. However, in our view, such scenario is already partly priced-in by the market. We, therefore, do not exclude some rebound of the zloty as investors could use the old trade saying "buy the rumour, sell the fact". Moreover, upcoming data from the U.S. should confirm that the Fed will not be in a hurry to raise rates. Together with the detailed Polish 1Q15 GDP data, this will be supportive for the zloty. However, the zloty's gains could be limited by the situation in Greece, especially since there are no signs of a breakthrough that could unlock the bailout funds and ensure Greece's future in the euro region. Summing up, we expect EURPLN to stay between 4.02 and 4.11 in the upcoming week. Only breaking of the support would open the door to testing of this year's minimum at 3.965.

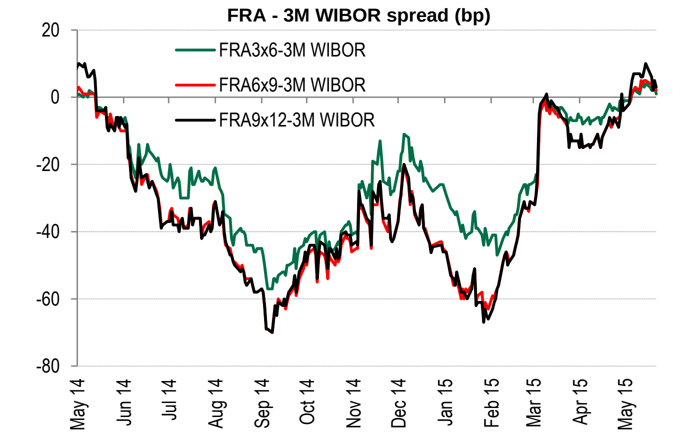
EURUSD still moving sideways

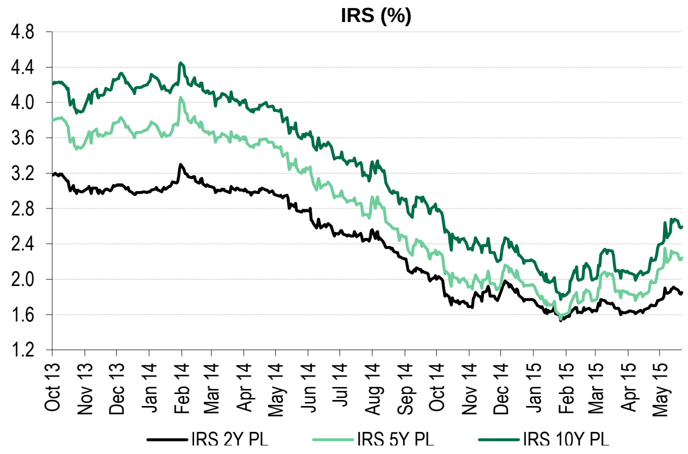
- Last week the U.S. dollar initially gained vs. the euro, with EURUSD falling to nearly 1.105 from 1.145 due to news that the ECB could increase its QE in May-June and uncertainty surrounding the deal between Greece and its creditors. The dovish FOMC minutes slightly raised EURUSD towards 1.12, but it fell again below 1.11 after U.S. inflation data.
- This week is filled with macro data releases from the U.S. In our view, these data could be relatively weak, confirming investors' bets that rate hikes in the U.S. will come rather later than earlier (the market currently expects the first hike at the end of the year). All in all, we think that EURUSD will stay in its current fluctuation range of 1.105-1.145, awaiting more details on the future monetary policy by the ECB, which meets on June 3.

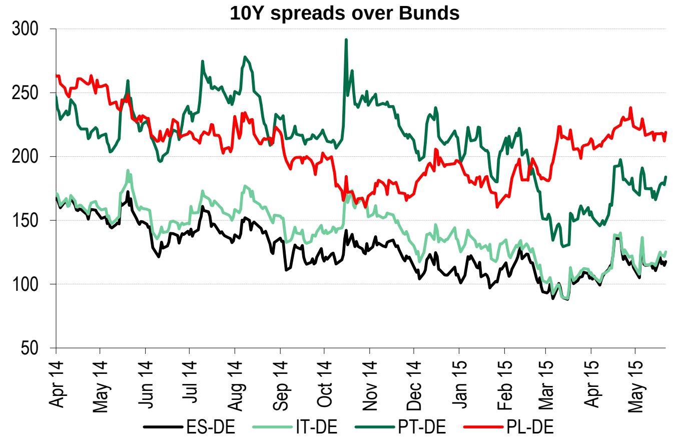
HUF loses due to global mood deterioration

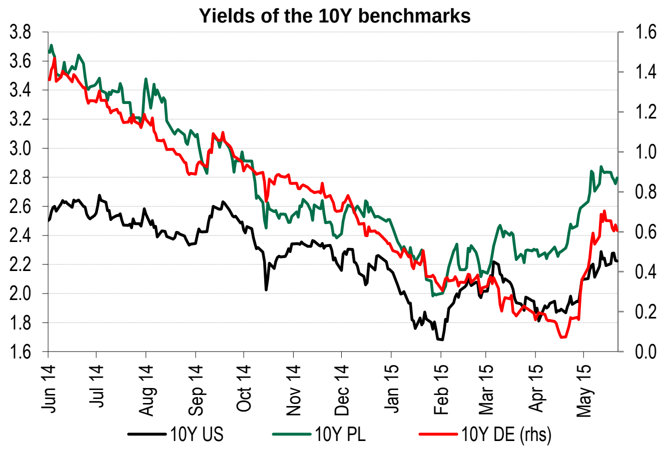
- The situation of the various CEE currencies is different. While the Czech koruna and the Russian ruble remained quite immune to the global mood deterioration, the Hungarian forint lost ground, just like the Polish zloty, due to the unsolved financial support for Greece. EURHUF temporarily increased towards 308, but, at the end of the week, the forint slightly rebounded and EURHUF declined to 306.5.
- This week Greece will remain in focus, weighing on investor mood especially in Hungary. While we expect EURCZK to continue to move sideways, HUF will be more vulnerable as the NBH will make a decision on its monetary policy (on Tuesday May, 26). It is broadly expected that it will deliver a rate cut of 15bps, which could weigh on the HUF's valuation. However, we believe the forint has already largely priced in the central bank's dovish bias, so we think further rate cuts should not put much pressure on the currency.

Interest rate market – U.S. data more important than Polish factors









Yields and IRS lower thanks to weak macro data

- Polish IRS and bond yields fell by up to 10bp last week on the back of the stabilizing global market sentiment, lower yields on the European bond market and the much weaker-than-expected industrial output and retail sales data for Poland. The Polish 2Y IRS ended the week at 1.85% (6bp below the local peak), the 5Y IRS at 2.24% (11bp below the recent peak), while the 10Y IRS at 2.59% (9bp below the peak from mid-May).
- The disappointing Polish macro data also affected the FRA market, where longer rates fell more than 10bp, with the market now pricing in 80% odds for a 25bp rate hike in 18 months. In early May, FRAs had expected a 50bp hike in 18 months. The market's expectations are now roughly in line with our scenario assuming a 25bp rate hike in 4Q16.
- The Polish Finance Ministry sold OK0717 and PS0420 bonds for cPLN1.1bn and over PLN2.9bn, respectively. The auction's total supply reached PLN4.06bn, slightly above the initial plan (PLN4bn), with the total demand at PLN6.1bn. Yields at the auction were higher than on the secondary market, but we still think that the auction was successful since more bonds were sold than had been planned despite the recent strong volatility on the Polish FI market. We estimate Poland's borrowing needs are covered in c69% after this auction.

U.S. data key

- The coming days could be quite interesting for the Polish debt market as domestic factors could be in the spotlight at the beginning and at the end of the week, with external issues in focus in between. However, in our view, it will be data from the U.S. that will have the crucial impact on the domestic IRS and yields.
- Yet just two weeks ago, poor U.S. macro releases fueled global market volatility and risk aversion, as well as worries over global economic growth. However, the global sentiment stabilised in the past week and the below-consensus U.S. data pushed back interest rate hikes by the Fed, supporting the global debt market. Plenty of U.S. data is on the agenda this week and we expect the market to echo the last week – weak numbers might push the core yields down and some positive impact could also be recorded on the Polish market. The domestic 10Y yields have been clearly following the recent developments on the core markets and this pattern may also continue this week.
- The outcome of the presidential election could affect the domestic market at the beginning of the week, but we think that any reaction should be only short-lived and limited in scale. We think that Poland's detailed 1Q GDP numbers have a bigger potential to trigger noticeable swings in the market. Given the recent data on the record-high March C/A surplus, we see an upside risk to the flash GDP estimate at 3.5% and the revised number could be released as soon as this week. However, the impact of the stronger 1Q GDP may be limited by last week's below-consensus output and retail sales data, as well as the recently rather weaker euro zone and U.S. numbers that cooled market expectations regarding the pace of the global economic recovery in 2Q15.
- On Friday the Finance Ministry will announce its bond auction plans for June. Initially, it was planning one standard auction and one conditional switch auction. However, the final schedule may differ as May's standard auction was called off due to higher market volatility.

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