Bank Zachodni WBK
Grupa Santander

BI-WEEKLY ECONOMIC UPDATE

1 – 14 June 2015

Greece and U.S. data have been and are likely to remain the main factors influencing investor sentiment on the global markets in the next two weeks. Greece faces a payment to the IMF in early June, but the Fund gave the green light for bundling its next month's payments, which could offer more time for negotiations. The prolonging talks weigh on the market as many ambiguous comments generate big confusion among investors. U.S. data, particularly the nonfarm payrolls, may also affect the global market as expectations for the Fed's first rate hike could change again. We think that the ECB and the Polish MPC meetings will prove to be non-events and should not trigger any sharp moves in the market.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (1 June)					
3:45	CN	PMI – manufacturing	May	pts	49.2	-	48.9
9:00	**PL**	**PMI – manufacturing**	**May**	**pts**	**53.5**	**53.5**	**54.0**
9:55/10:00	DE/EZ	PMI – manufacturing	May	pts	51.4/52.3	-	52.1/52.0
14:30	US	Personal income/consumer spending	Apr	%MoM	0.3/0.2	-	0.0/0.4
16:00	US	ISM – manufacturing	May	pts	52.0	-	51.5
		TUESDAY (2 June)					
11:00	EZ	Flash HICP	May	%YoY	0.1	-	0.0
16:00	US	Industrial orders	Apr	%MoM	-0.1	-	2.1
		WEDNESDAY (3 June)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
9:55/10:00	DE/EZ	PMI – services	May	pts	52.9/53.3	-	54.0/54.1
13:45	EZ	ECB decision		%	0.05	-	0.05
14:15	US	ADP report	May	k	200	-	169
16:00	US	ISM – services	May	pts	57.0	-	57.8
		THURSDAY (4 June)					
	PL	**Market holiday**					
14:30	US	Initial jobless claims	week	k	-	-	274
		FRIDAY (5 June)					
9:00/11:00	HU/EZ	GDP	Q1	%YoY	3.4/1.0	-	3.4/0.9
14:30	US	Non-farm payrolls/Unemployment rate	May	pts/%	223/5.4	-	223/5.4
		MONDAY (8 June)					
8:00	DE	Industrial output/Exports	Apr	%MoM		-	-0.5/1.3
9:00	CZ	Industrial output	Apr	%MoM	4.0	-	6.2
		TUESDAY (9 June)					
9:00	CZ/HU	CPI	Apr	%MoM	0.5	-	0.5/-0.3
		THURSDAY (11 June)					
14:30	US	Retail sales	Apr	%MoM		-	0.0
		FRIDAY (12 June)					
11:00	EZ	Industrial output	Apr	%MoM		-	-0.3
14:00	**PL**	**Money supply**	**May**	**%YoY**	**7.6**	**-**	**7.2**
16:00	US	Flash Michigan	Jun	pts		-	88.6

Source: BZ WBK, Reuters, Bloomberg

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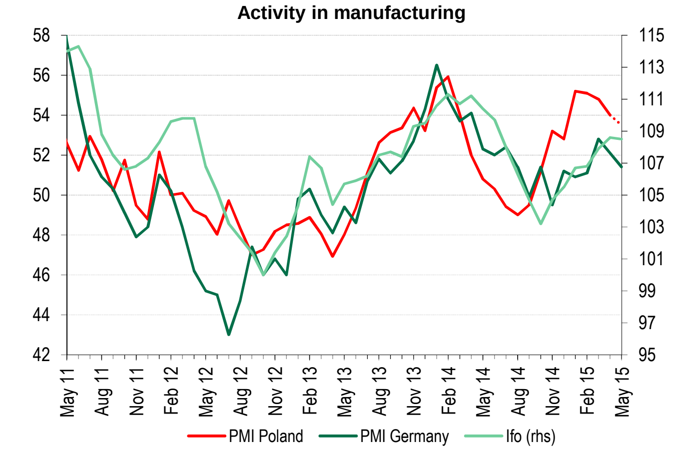
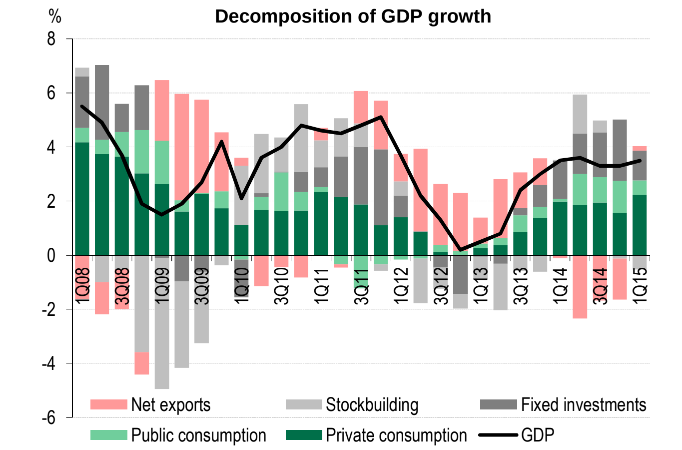
What's hot in next two weeks – PMI and MPC before the long weekend



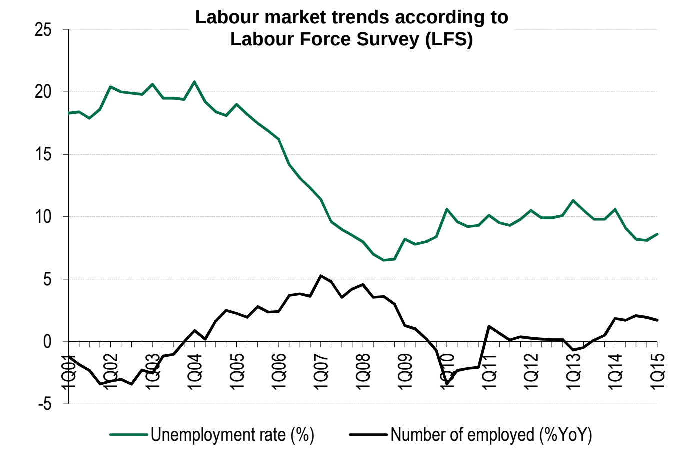
▪ We predict that the manufacturing PMI will fall further in May because the prolonging uncertainty about Greece is weighing on business sentiment in Europe. However, readings well above the 50 point mark show expansion of the manufacturing sector, driven by reviving external demand. And we still see no reason why the euro zone's recovery could be derailed. Other advance indicators for Poland offer a mixed message – while the EC's ESI fell slightly in May, it remained at a level consistent with GDP growth of over 3.5%. Other indicators (CSO business climate in manufacturing, BIEC leading indicator) have improved, signalling that the Polish economy was still expanding.

▪ The MPC's meeting in June should be a non-event again since its monetary policy is broadly expected to remain on hold.

Last week in the economy – GDP rising faster than expected



▪ 1Q15 GDP growth has been revised up slightly to 3.6%YoY from the flash estimate at 3.5%YoY, confirming our bet on strong foreign trade data for March. Net exports added 1.1 pct. point to the GDP growth, while its contribution was strongly negative in the four preceding quarters. However, growth was also supported by other components – private consumption growth accelerated to 3.1%YoY, while fixed investments soared 11.4%YoY (highest pace since 1Q14, despite their high base effect). While the overall domestic demand decelerated to 2.6%YoY, it was mainly due to a drop of inventories. In general, the data were strong, pointing to a healthy and broad-based economic growth at the start of 2015. We think that positive trends in all the three components (consumption, investments, exports) will continue, driving Poland's GDP growth higher in the following quarters, up to 4%YoY in 4Q. We estimate the average GDP growth in 2015 at 3.8%.



▪ The registered unemployment rate fell in April to 11.2% from 11.7% and was slightly lower than the Labour Ministry had estimated. On an annual basis, the jobless rate dropped 1.8pp and the number of the unemployed fell by c300k to 1.78mn. Detailed data showed that the number of initial registrations was higher compared with last year, while the number of removals from the unemployment rolls was lower than a year ago. This suggests that the pace of the unemployment's decline is fading. We still expect the unemployment rate to fall further in the coming months, but at the slightly slower pace than recently. Our forecast for the year-end is at 10.2%.

▪ Detailed data on wages in different branches of the enterprise sector confirmed our estimate that April saw a strong rise of wages in mining, but other branches recorded a slowdown. This may have been due to an earlier payment of bonuses (before Easter), so we expect a rebound in the months to come.

Quote of the week – Belka to continue his mission

Marcin Kaszuba, head NBP's Communications and Promotion Department, PAP, 27.05.2015

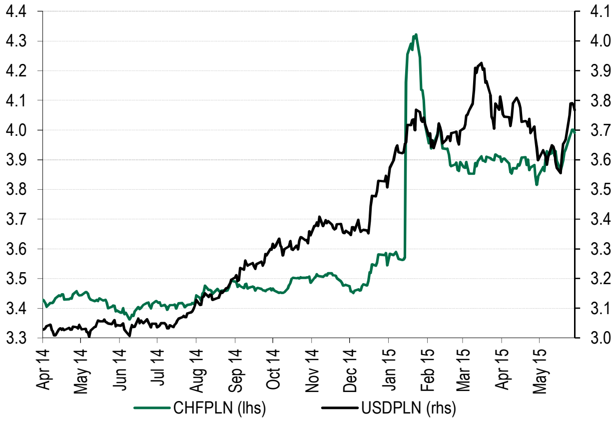
The President of the National Bank of Poland and of the Monetary Policy Council intends to continue his mission in line with his mandate given to him in June 2010.

Andrzej Duda's victory in Poland's presidential elections considerably increased the probability that Marek Belka would not be re-elected for a second term, raising uncertainty over the future monetary policy. Let us keep in mind that it is the President of Poland, who appoints the NBP governor and that his choice needs to be approved by the Sejm (lower house of parliament). The presidential election results sparked speculation that Belka could resign to in order to enable the incumbent president Bronisław Komorowski to nominate his candidate before his term of office expires and Duda takes over the post. However, apart from one article in the Polish press, nothing pointed to such a scenario, which also seemed quite absurd to us. Still, speculation had spread through the market, until the NBP had denied it.

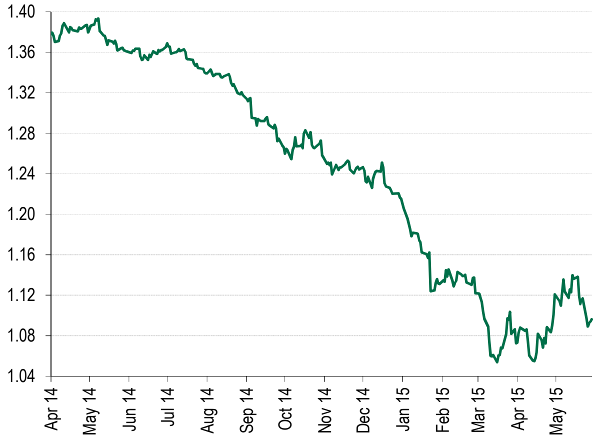
Foreign exchange market – Zloty weaker and may depreciate further

EURPLN

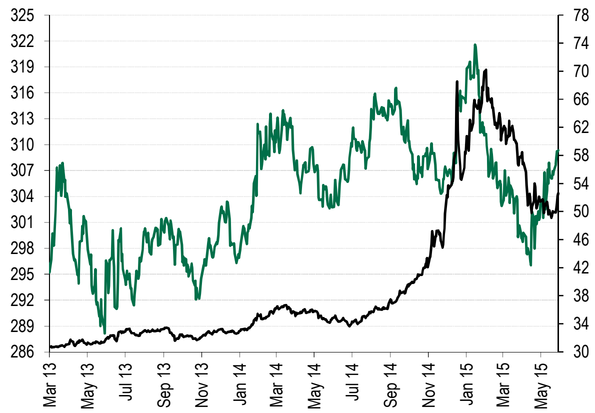
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



Further EUR/PLN rise likely

- The zloty depreciated vs. the euro and the dollar for the second week in a row with the biggest part of the move taking place just after the weekend when the U.S. and the main European markets were closed and worries over Greece elevated. To some extent, the zloty was pressured by the surprising result of the Polish presidential election, but, in our opinion, this event's impact on the currency was rather muted. EUR/PLN reached its weekly peak at 4.15 and USD/PLN at nearly 3.83. But once it recovered at the end of the week, when compared to other EM currencies, its performance was rather average in this group.
- Two weeks ago – when EUR/PLN was close to 4.05 – we had mentioned the emergence of zloty-negative signs in technical analysis. Since then, the Polish currency has clearly depreciated and the door for more weakening remains open as these technical signals are still intact. PMI is the only data release from Poland in the next two weeks and we do not expect it to be an important driver. The country's political issues are also likely to recede into the background. The main factors affecting the zloty in the coming weeks include the next acts of the Greek saga and U.S. data influencing market expectations for rate hikes by the Fed.

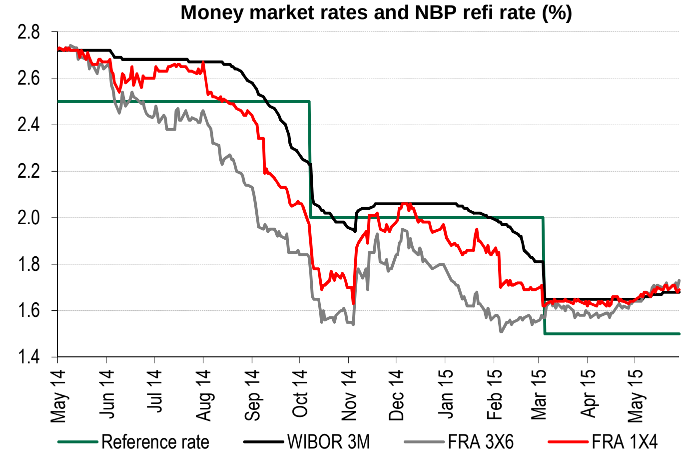
Euro volatile vs. the dollar amid Greek talks and U.S. data

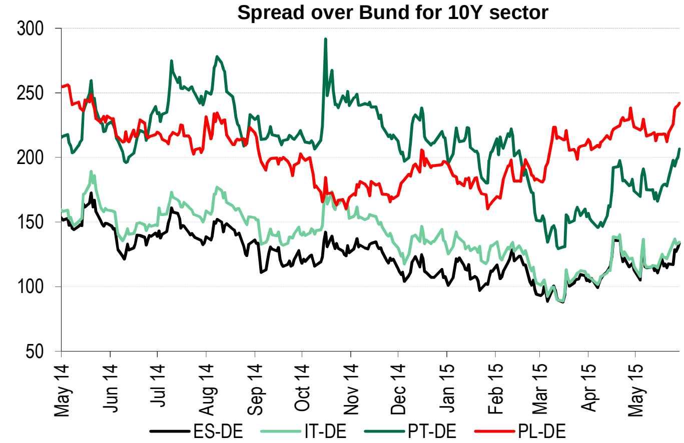
- EUR/USD was very volatile last week as there were plenty of ambiguous comments on the progress of negotiations on the Greek bailout funds and some mixed U.S. data. EUR/USD continued to fall at the beginning of the week and reached nearly 1.08. However, later on, the exchange rate rose to nearly 1.10.
- Greece and data from the U.S. have been and are likely to remain the main factors driving EUR/USD in the next two weeks. Greece faces a payment to the IMF in early June but the Fund gave the green light for bundling its next month's payments, which could offer more time for negotiations. The prolonging talks weigh on the euro as plenty of ambiguous comments generate big confusion among investors. U.S. data, particularly the nonfarm payrolls, may change market expectations for the Fed's first rate hike. We think that the ECB meeting will prove to be a non-event and should not trigger any sharp moves in the market.

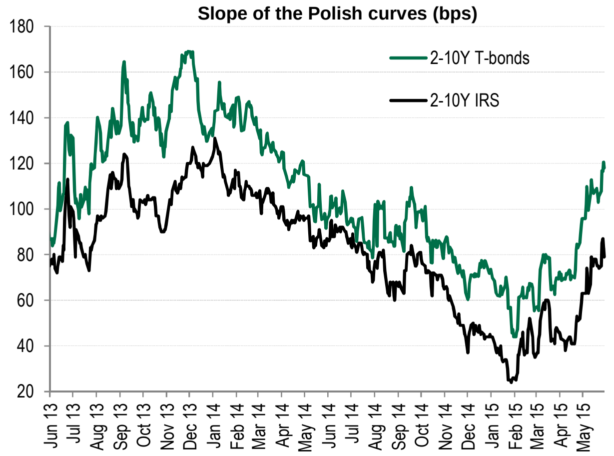
Ruble under pressure, Czech and Hungarian CPI ahead

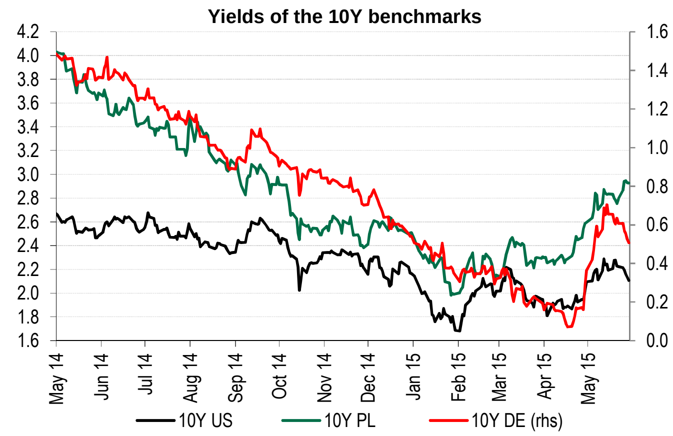
- The Russian ruble was the worst performing CEE currency last week, losing more than 4% vs. the euro and the dollar. The weekly jump was the biggest since the end of January when the Russian currency's recovery had started. USD/RUB rose last week above 53 (its highest level since mid-April) from c49 on the back of the falling oil price and the dollar's appreciation in the global markets. We still think that the bias is tilted towards a weaker ruble, given the poor economic outlook and the recent change in monetary policy. The central bank and the finance ministry have started buying foreign currencies in the market and this should also limit the scope for USD/RUB to fall.
- Inflation data for the Czech Republic and Hungary are due in the coming two weeks. Their annual CPIs have been gradually rising so far this year, preventing the Czech central bank from introducing additional measures aimed at pushing prices up and possibly stopping the Hungarian central bank from cutting rates more decisively. Thus, a further gradual rise in inflation could work in favour of the koruna and the forint, while any release pointing to sluggish growth in prices could weigh on these two currencies.

Interest rate market – Yields remain at elevated levels









Market weakening, curves steepening

▪ Last week brought significant weakening on the Polish interest rate market, but the pace of the increases was varied depending on the market. While growth of the money market rates (in particular the WIBORs) was muted, bond yields and the IRS rates climbed quite noticeably. FRAs grew by 1-7bp across the curve, with the biggest rise recorded on the longer tenors. The market is currently pricing-in the start of monetary tightening in Poland in 15 months' time (FRA15x18 is 21bps higher than WIBOR 3M), which is close to our baseline scenario, which assumes a 25bp rate hike in 4Q16.

▪ At the same time, bond yields and the IRS rates rose considerably on a weekly basis, by 1-13bp and 2-9bp, respectively. This stemmed from concerns about the political situation in Poland following Andrzej Duda's, an opposition candidate, win of the presidential election and from fears about Greece (higher probability of a Grexit). As a consequence, the 10Y bond yield climbed towards its YTD maximum, approaching 3%. The end of the week brought a gradual rebound due to the strengthening of the Bunds, with the yield of the 10Y German benchmark declining to 0.50%. Notwithstanding the spread over the Bunds, the10Y sector remained at an elevated level, oscillating near 240bp, the highest since May 2014.

▪ Both curves steepened quite noticeably, with the long end moving the most – the 2-10Y spread widened to c120bp for the bonds and to 80bp for the IRS.

▪ June's issuance plan was in line with our expectations. It assumes two auctions: regular and switch. At the first one the Ministry will offer OK0717/WZ0120/DS0725 worth PLN1-4bn, while on switch tender it will buy back OK0715 and DS1015.

Higher risk premium due to political situation and Greece

▪ Investors will continue pricing-in an increase in political risk in Poland ahead of the parliamentary election in the autumn. This should add to the risk premium and raise volatility on the debt market, keeping yields/rates at elevated levels in the coming months.

▪ The domestic macro and event calendar is relatively light in the upcoming two weeks. Poland's PMI index for the manufacturing sector could fall slightly in May (due to fears about Greece), but it will likely remain well above 50pts. Moreover, June's MPC meeting (June 4) should be uneventful as the Council is set to uphold its current monetary policy stance. All in all, domestic events should be rather neutral for the bond and the IRS markets. However, the long weekend in Poland might significantly decrease market liquidity, adding to the higher volatility.

▪ Global events will play the main role in the market. June's ECB meeting, which takes place on the same day as Poland's MPC, will be key for investors. In our view, the ECB should confirm that its QE programme will stay in place until its previously announced deadline, helping the market to get a slight relief. Investors will also pay more attention to macro data from the U.S., in particular the May non-farm payrolls. Further improvement in employment in the U.S. could strengthen expectations for a rate hike later this year (we expect the first hike in September). Consequently, an increase in the UST yields may translate into higher domestic yields as the correlation of the U.S. Treasury 10Y and the Polish 10Y yield changes has been around 0.63 over the past five months. Still, the unsolved situation in Greece will weigh on the Polish assets, keeping their yields/IRS rates at an elevated level.

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