

WEEKLY ECONOMIC UPDATE

24 – 30 August 2015

Sentiment on the world's financial markets remains negative, with a long list of risk factors pending: political uncertainty ahead of the snap elections in Greece and Turkey, the intensifying conflict between South and North Korea, slowdown in China and outflow of capital from the emerging markets. All these factors may continue to affect the zloty negatively in the near term. As regards the domestic situation, after the somewhat disappointing flash GDP estimate for 2Q15, industrial production and retail sales data for July were also lower than forecast, indicating that the third quarter started on a weaker note than had been anticipated. The recent data releases have moved the risk balance for GDP growth slightly to the downside, but we still believe it is too early to say that economic growth is stagnating, especially since the labour market situation remains positive, consumer confidence is surging and the business climate survey for August signalled no deterioration in economic activity. We think that the economy should accelerate in 2H15, buoyed by reviving growth in the euro zone (fuelling Polish exports) and strong domestic demand.

Friday's GDP data will be the key domestic publication of the week. The flash release disappointed, showing a slowdown of growth to 3.3%YoY, and we see little scope for an upward revision this time (unlike in 1Q15) after the balance of payments data for June showed a smaller-than-expected surplus in foreign trade. However, we expect to see solid consumption and investment growth, which should weaken market expectations for further monetary easing in Poland. Still, this week will likely be dominated by data releases abroad, mainly in the U.S., which may cause more volatility in the global and Polish markets.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (24 August)							
No important data releases							
TUESDAY (25 August)							
8:00	DE	GDP	Q2	%YoY	1.6	-	1.1
10:00	PL	Unemployment rate	Jul	%	10.1	10.1	10.3
10:00	DE	Ifo index	Aug	pts	107.5	-	108.0
14:00	HU	Central bank decision		%	1.35	-	1.35
16:00	US	New home sales	Jul	k	515	-	482
16:00	US	Consumer confidence index	Aug	pts	93.0	-	90.9
WEDNESDAY (26 August)							
14:30	US	Durable goods orders	Jul	%MoM	-0.5	-	3.4
THURSDAY (27 August)							
14:30	US	Initial jobless claims	week	k	3.2	-	0.6
14:30	US	Preliminary GDP	Q2	%YoY	-	-	277
16:00	US	Pending home sales	Jul	%MoM	1.5	-	-1.8
FRIDAY (28 August)							
9:00	CZ	GDP	Q2	%YoY	4.4	-	4.0
10:00	PL	GDP	Q2	%YoY	3.3	3.3	3.6
10:00	PL	Private consumption	Q2	%YoY	3.1	3.0	3.1
10:00	PL	Investments	Q2	%YoY	9.8	9.0	11.4
14:30	US	Personal income	Jul	%MoM	0.4	-	0.4
14:30	US	Consumer spending	Jul	%MoM	0.4	-	0.2
16:00	US	Michigan confidence index	Aug	pts	93.2	-	92.9

Source: BZ WBK, Reuters, Bloomberg

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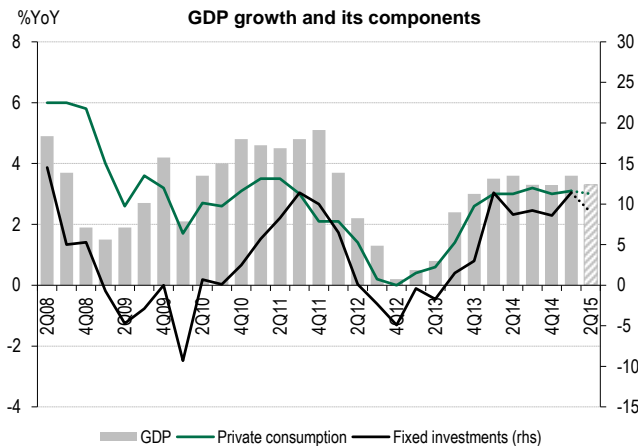
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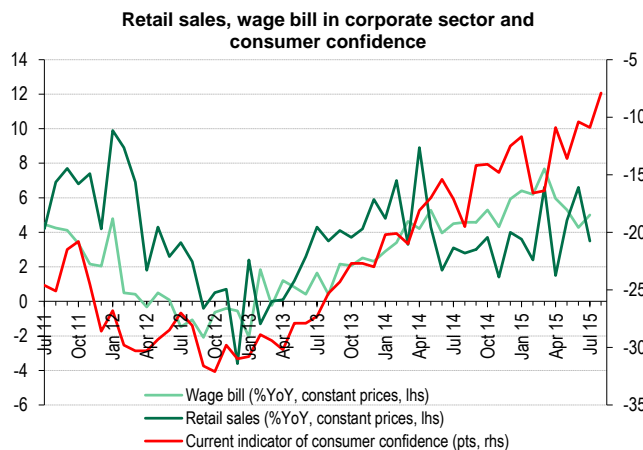
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What's hot this week – Detailed GDP data breakdown and unemployment rate

Friday's GDP data will be the key domestic publication of the week. The flash release disappointed, showing a slowdown of growth to 3.3%YoY, and we see little scope for an upward revision this time (unlike in 1Q15) after the balance of payments data for June showed a smaller-than-expected surplus in foreign trade. We estimate that consumption growth remained solid in 2Q, at around 3%YoY, and fixed investment growth slowed only slightly to 9%YoY, with the biggest part of the GDP slowdown attributed to lower net exports.

Other domestic releases, including the registered unemployment rate and monthly statistical bulletin, are likely to be overshadowed by news from abroad. The jobless rate probably fell in July to 10.1%, its lowest since December 2008, in line with the Labour Ministry's estimate.

Last week in the economy – Weaker retail sales despite surging consumer confidence

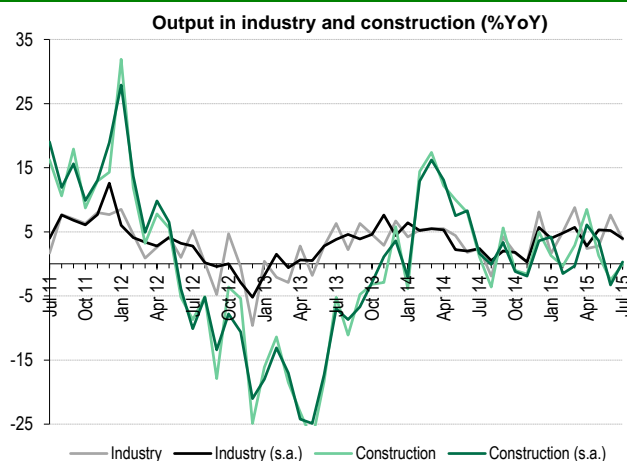
July's labour market data were in line with expectations – wage growth accelerated to 3.3%YoY and employment growth stayed at 0.9%YoY. On a monthly basis, the number of the employed rose by as much as 5.6k and this was the best result since 2010. Demand for labour remains strong. We, however, expect some slowdown in employment growth in the coming months amid a shrinking stock of potential employees. In the medium term, this could lead to a stronger wage pressure.

Good financial standing of households and solid economic growth are among the factors boosting consumer confidence. The current confidence index soared in August to the highest level since September 2008 and assessment of the households' financial situation was at the highest level in the survey's history (1997).

Retail sales growth disappointed in July, slowing to 3.5%YoY (in constant prices), but given the continuously good situation on the labour market and improving consumer climate we think that sales growth should regain speed in the coming months.

Industrial production rose in July by 3.8%YoY (3.9%YoY seasonally adjusted), which was slightly below expectations. At the same time, construction output growth improved to -0.1%YoY (rose 0.3% in seasonally adjusted terms).

The data for July suggest that, after the somewhat disappointing GDP growth in 2Q15, the third quarter also started on a weaker note than anticipated. The recent data releases have moved the risk balance for GDP growth slightly to the downside, but we still believe it is too early to say that economic growth is stagnating. We think that the economy should accelerate in 2H15, buoyed by reviving growth in the euro zone (fuelling Polish exports) and strong domestic demand.

**Quote of the week** – Room for a cut or a hike?

Elżbieta Chojna-Duch, MPC member, 20.08.2015, PAP

The MPC's declaration of stabilisation of rates remains in place. If fiscal easing (...) turns out to be excessive, monetary tightening would become an open possibility, rather than monetary easing.

Jerzy Osiatyński, MPC member, 18.08.2015, Reuters

In my view there are no reasons now to raise interest rates. But due to two factors that I mentioned earlier (turmoil on the Asian markets and quantitative easing in the euro zone) I am ready to check if there is room, and how big, for a move in the opposite direction.

Anna Zielińska-Giębocka, MPC member, 17.08.2015, PAP

We will watch the economy. I would not declare definitely that there will be no (policy) change. In case of unexpected events, the Council could still react.

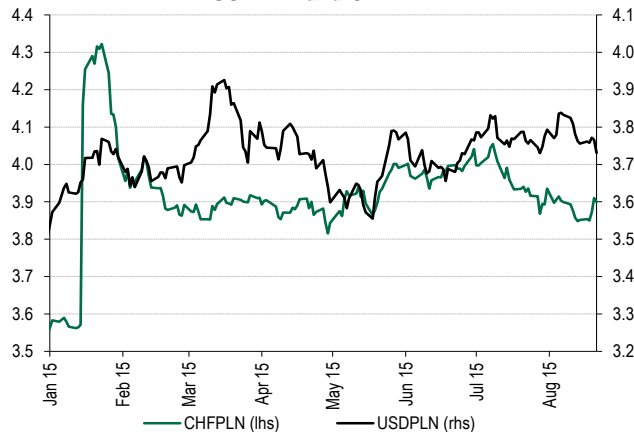
The recent turmoil on the emerging markets and some disappointments on the domestic data front have fuelled market speculation about possible interest rate cuts in Poland in 2016 after the current MPC members are replaced by their (presumably) more dovish successors. The current MPC is highly likely to leave rates on hold until the end of its term in office (despite the recent comments of some of its members suggesting this was not 100% certain) and we think that there will be no real need for monetary easing next year as economic growth should remain healthy and inflation will likely be in an upward trend towards the MPC's target. However, interest rate hikes in 2016 seem to be increasingly questionable and may be off the table if the pickup in growth and inflation proves to be slower than we expect.

Foreign exchange market – Zloty depreciates vs. euro and gains vs. dollar

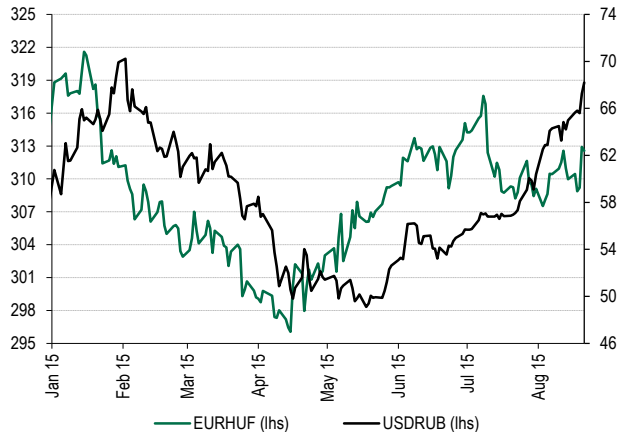
EURPLN



USDPLN and CHFPLN



EURHUF and USDRUB



EURUSD



EURPLN near its recent peak

▪ The Polish currency weakened against the euro and gained versus the dollar last week. EURPLN rose above 4.21, just below the local peak at c4.22 from early August, on the back of worries about global growth and rising geopolitical risk. The zloty was also pressured by the below-forecast domestic macro data on industrial output and retail sales. At the same time, USDPLN dropped to c3.72 (just above the local low at 3.70) thanks to the rising EURUSD.

▪ The other CEE currencies were also under pressure from global risk aversion and weak sentiment on the emerging markets. EURHUF rose to 313 from 308, while USDRUB climbed above 68 from just below 65. The past week was already ninth in a row of the ruble losing vs. the dollar. The Russian currency is falling even despite the greenback's depreciating on the global markets. The main factor standing behind the surge in USDRUB seems to be the oil price, which is approaching this year's low at nearly \$45.

▪ U.S. data clearly dominate this week's calendar and so the outlook for the Fed's monetary policy is likely to be the main market driver in the coming days. Minutes from the last FOMC meeting were perceived by the market as quite dovish, but failed to improve EM sentiment. If U.S. data releases prove more disappointing, they could further weaken expectations for a rate hike by the Fed in September, which would be negative for the dollar, but not necessarily positive for the EM currencies (as it would imply a gloomy scenario for the world economy and a risk of further capital outflows). U.S. data are, therefore, likely to be analysed carefully this week. They could trigger noticeable moves in the market.

▪ Crucial levels to watch for EURPLN: 4.22 (next resistance at 4.24) and 4.153 (next support at 4.09).

▪ The Hungarian central bank's decision is unlikely to trigger any significant moves in the HUF market. The MNB last cut rates to the 1.35% all-time low and concluded the easing cycle. We do not think that the central bank's rhetoric could change meaningfully from the previous month.

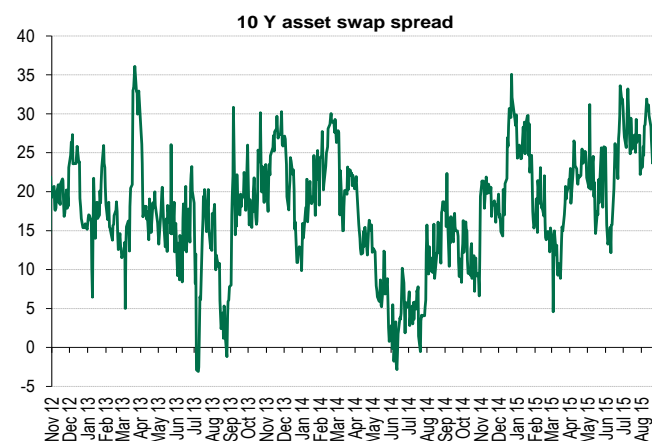
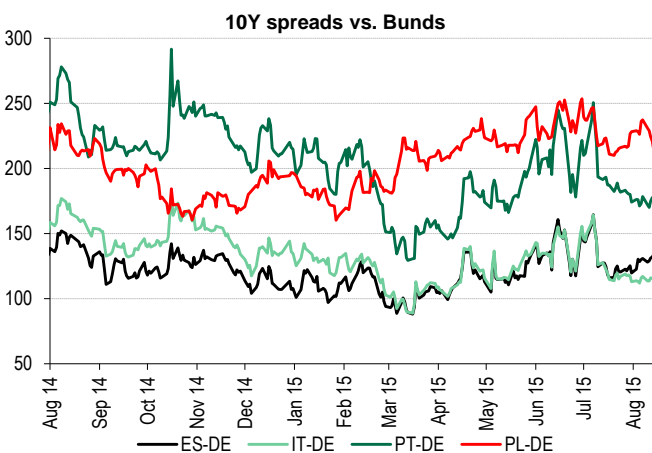
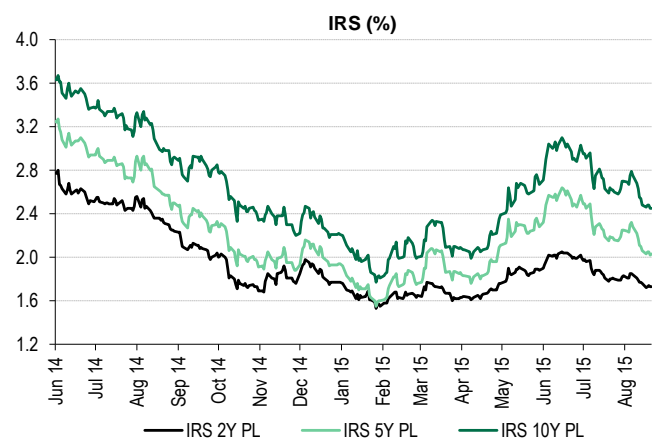
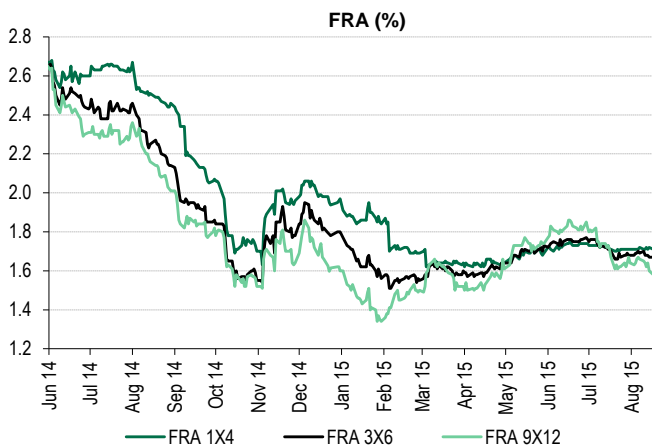
Euro stronger thanks to FOMC and despite Greece

▪ EURUSD rose for the second consecutive week and reached 1.13, its highest since late June. The euro gained thanks to the dovish FOMC minutes and despite fresh worries about Greece, spurred by the resignation of PM Tsipras just one day after the country received money from the third bailout package.

▪ In the market's view, odds for a September rate hike by the Fed have fallen recently below 50%. As this week's calendar is filled with important macro data – 2Q GDP in particular – U.S. monetary policy is likely to be key for the market this week. Weak U.S. numbers should favour the euro and the exchange rate could rise further towards c1.145, its peak from mid-June and mid-May.

▪ Greece, previously expected to lose in importance after it had reached a final deal with the creditors, may again become an important factor affecting EURUSD as the looming snap elections will probably be held in September. The unstable political scene in Greece may limit the scope for euro's appreciation, but, so far, there has been no noticeable impact on EURUSD from this.

Interest rate market – Concerns over global growth keep rates low

**IRS and yields lowest since April/May**

Polish bond yields plunged noticeably in the past week thanks to the dovish FOMC minutes and concerns over the world's economic growth, which triggered strengthening of the global bonds. In addition to the external factors, domestic data on industrial output and retail sales also proved supportive for the market as July's numbers were below expectations. Yields fell 4-7bp on a weekly basis, with the IRS curve dropping 3bp. The scale of the drop was even bigger, but there was some profit-taking at the end of the week. After the 10Y benchmark yield broke the support at c2.86% in the previous week, recent days saw its further decline that ended up pausing at the bottom of c2.70% from May (tested but not broken for good). FRA did not move much as they already priced in 50-60% odds for a Polish interest rate cut in the next 6-9 months.

The Polish long-term debt performed better than its German counterpart and the 10Y spread narrowed temporarily below 210bp, its lowest since early April. At the same time, the 10Y Spanish, Portuguese, Italian, Irish and Hungarian 10Y debt gained less than the Bund.

The domestic bond curve is the flattest since early May as the 2-10 spread fell below 100bp last week. The 10Y asset swap spread declined by 4bp to 26bp, but remains quite close to the 33bp resistance.

U.S. data in the spotlight this week

Falling odds of a Fed rate hike in September were among the drivers of the IRS/yields' recent downtrend in Poland. The 2Y, 5Y and 10Y IRS rates are now at their lowest levels since April/May and all but the longest one have pared more than half of the upside wave that started with the all-time lows hit in January and continued until May/June (10Y pared roughly half). Concerns over global economic growth and the recent lower-than-expected domestic data have fueled market expectations of a restart of the rate cut cycle in Poland (and delayed hikes abroad) and now the IRS rates are closer to their record lows than to their recent peaks. We think this is a pretty good indicator of the kind of sentiment that is likely to persist in the fixed income market. Worries about economic growth in China, the FOMC's cautious assessment of the outlook for the U.S. economy and the below-consensus Polish macro releases are all likely to keep the IRS and yields low in the short run. However, the first leading indicators for August (consumer confidence and business climate indicators in Poland, the flash manufacturing PMIs in Germany and the euro zone) were surprisingly good, which suggests that if next month's data releases end up confirming these optimistic signals, yields could rise.

Plenty of U.S. data are on the agenda this week and these release are likely to introduce more volatility in the global and Polish FI markets. More subdued or mixed numbers are likely to work in favour of the debt instruments. The summer holidays are also approaching their end and this offers hope that liquidity in the fixed income market could improve.

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