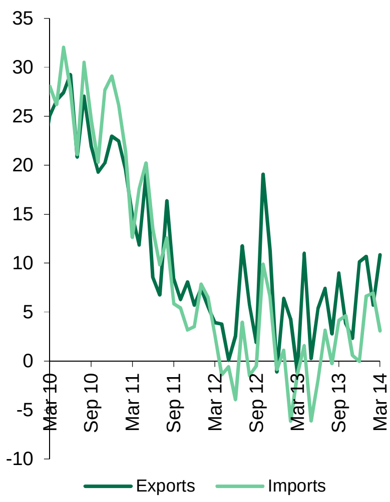
INSTANT COMMENT

15 May 2014

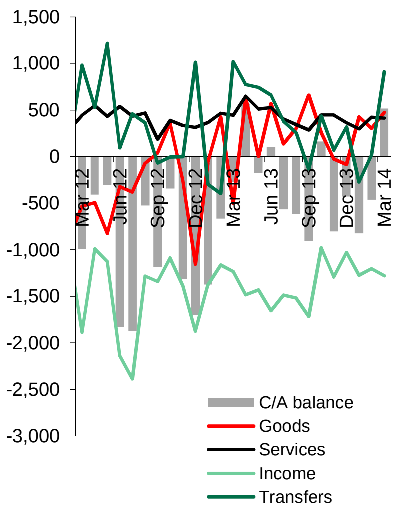
Continuation of non-inflationary growth

GDP growth in 1Q14 accelerated to 3.3%YoY and was faster than expected. Export growth rebounded to high level of almost 11%YoY in March, and current account balance was positive again (EUR517m). The data confirmed that Polish economy was doing very well at the start of the year. The prolonging crisis in Ukraine is raising some uncertainty regarding economic growth outlook for the following quarters, however we think that our forecast of 3.5% GDP growth in 2014 is not endangered. Higher economic activity is still not causing higher inflationary pressure (core inflation at 0.8%YoY in March), however in our view both the CPI and core inflation will be slowly rising in the remainder of the year.

Foreign trade turnover, % YoY



Current account, EURm



Exports accelerating, current account balance in surplus

Just like we expected, data on balance of payments proved much more optimistic than expected by the market. Current account recorded a surplus of €517mn thanks to the sizeable positive balances in trade of goods (€475mn), services (€412m) and transfers (€911mn). In line with our suspicions, and just like the CSO trade data has shown earlier this week, sudden slowdown of trade volumes in February occurred to be only temporary. In March the pace of export growth returned to the two-digit level (10.9%YoY, highest for almost a year), consistent with the pace of growth of Polish industrial output. So far, the weaker performance of exports to the eastern markets is compensated by higher exports to western Europe amid an economic revival in the euro zone, particularly in Germany. Import growth has clearly disappointed in March, as it slowed down to 3.1%YoY and lead to a higher than we expected surpluses in trade and current accounts.

In Q1, exports increased by 9.1%YoY and imports by 5.5%YoY (February's data was revised up). In both cases, these are the highest growth rates since the end of 2012. Cumulated 12-month current account balance to GDP ratio narrowed to -0.9% after March. At the same time, the coverage of the current account deficit by the long-term capital has increased substantially – after March, the total inflow of net foreign direct investments (FDI) and EU funds for the last 12 months reached over 300% of C/A deficit in this period. However, this was mainly due to high inflow of the EU funds as sole net FDI remain subdued (only €545mn in last 12 months vs. €5.8bn in the same period last year). March saw also an outflow of foreign portfolio capital (€673mn has been withdrawn from the Polish bond market by foreign investors).

GDP growth above expectations

According to flash estimate, the pace of GDP growth in 1Q14 reached 3.3%YoY, slightly above expectations (market consensus and our forecast at 3.1%YoY). After the seasonal adjustment, growth accelerated to 1.1%QoQ and 3.5%YoY, which places Poland again on top of the list of the fastest-growing EU economies (among the countries that have already released their estimates, only Hungary recorded equally fast GDP growth).

Polish economy seems to have exited the slowdown phase of the economic cycle and is now operating at a pace close to its potential. We do not know the structure of this growth yet (this will be released on May 30), but our estimates and observations point to rising role of the domestic demand with consumption demand and investments gaining speed. At the same time, exports remains vital engine driving the recovery and – just like CSO and NBP data shows – its growth accelerates due to economic revival in the Western Europe.

Of course, 1Q data have not been affected substantially yet by the Ukrainian crisis. The main concern right now is whether (and for how long) the fast recovery may be maintained

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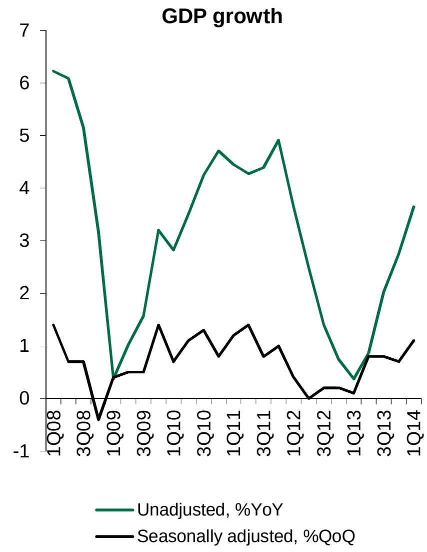

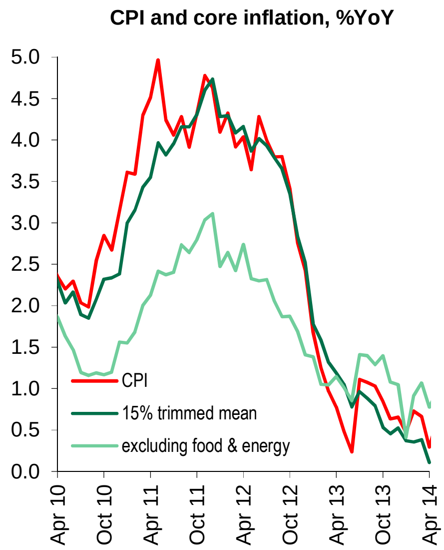

given the risk that the situation in Eastern Europe will rather not stabilize soon. We have already mentioned several times that although the direct impact of Russian and Ukrainian crisis on Poland may be rather limited due to the relatively small share of these markets in Polish exports (5% and 3%, respectively), the much bigger threat is the potential impact of the situation in the east on the euro zone's economy, which in turn may influence pace of Polish GDP growth. More severe economic and financial sanctions imposed on Russia may hit Germany and other western countries and thus pose a threat to our scenario of a gradual rebound of Polish GDP in coming 2-3 years. For the time beging, however, our forecast of 3.5% GDP growth in 2014 seems does not seem to be engangered. Moreover, we think that the market consensus forecast of GDP for 2014 may go up after today's data – in recent Bloomberg and Reuters' surveys it was at 3.1-3.2%, which implies a slowdown in the remaining part of the year.

Decline in all core inflation measures

All core inflation measures declined in April. Inflation after excluding food and energy prices fell to 0.8%YoY (after increase in prices by 0.3%MoM) from 1.1%YoY in previous month, in line with our estiamte after the headline CPI release. This core inflation measure reached the lowest level since August 2007. One should notice that as regards two measures od core inflation i.e. net of most volatile prices and 15% trimmed mean, today's releases at 0.3%YoY and 0.1%YoY, respectively were the lowest in history, i.e. since the start of these data publication in 2001. Core inflation excluding administered prices fell below zero (reaching -0.1%YoY), first time since 2006.

Today's core inflation data releases confirm lack of inflationary pressure in domestic economy. We expect inflation net of food and energy prices to increase gradually in upcoming months, towards 1.5%YoY at the end of this year.

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