WEEKLY ECONOMIC UPDATE

20 – 26 April 2015

The Monetary Policy Council kept interest rates on hold last week and the central bank governor tried to play down the possible impact of zloty appreciation on the monetary policy outlook, emphasising that only a significant worsening of the economic outlook could make the MPC reconsider its monetary policy stance. The problem is that if the zloty's appreciation went too far, it could change the outlook for both inflation and economic growth. And this could pose a problem for the MPC (even if it does not want to admit it). However, the currency's move would probably need to be much stronger than had been the case so far to cause a significant impact. Meanwhile, economic data from Poland keeps surprising to the upside. GDP growth for 2014 was revised up, export growth started accelerating in 1Q15 and wage growth surged in March, boding well for private consumption.

We expect to see more positive news from the Polish economy this week, including a solid rebound in industrial and construction output (even though biased, to some extent, by calendar effects), stronger retail sales and falling unemployment. Investors will also focus on a bunch of important releases abroad, such as the most important leading indicators for the euro zone (expected to show a gradual improvement of economic conditions) and in the USA. Greece will also remain one of the most important topics for the market since there is still little progress in talks on its bailout extension and the country may run out of cash by the end of the month.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (20 April)					
14:00	**PL**	**Industrial output**	**Mar**	**%YoY**	**7.2**	**8.3**	**4.9**
14:00	**PL**	**Construction and assembly output**	**Mar**	**%YoY**	**2.1**	**3.6**	**-0.3**
14:00	**PL**	**Retail sales (constant prices)**	**Mar**	**%YoY**	**4.5**	**4.7**	**2.4**
14:00	**PL**	**PPI**	**Mar**	**%YoY**	**-2.5**	**-2.6**	**-2.7**
		TUESDAY (21 April)					
11:00	DE	ZEW index	Apr	pts	55.0	-	55.1
14:00	HU	Central bank decision		%	1.80	-	1.95
		WEDNESDAY (22 April)					
16:00	US	Home sales	Mar	m	5.01	-	4.88
		THURSDAY (23 April)					
3:45	CN	PMI – manufacturing	Apr	pts	49.4	-	49.6
9:30	DE	PMI – manufacturing	Apr	pts	53.0	-	52.8
10:00	EZ	PMI – manufacturing	Apr	pts	52.5	-	52.2
11:00	**PL**	**Bond auction**					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	-		294
16:00	US	New home sales	Mar	k	509	-	539
		FRIDAY (24 April)					
10:00	DE	Ifo index	Apr	pts	108.3	-	107.9
10:00	**PL**	**Unemployment rate**	**Mar**	**%**	**11.7**	**11.7**	**12.0**
14:30	US	Durable goods orders	Mar	%MoM	0.6	-	-1.4

Source: BZ WBK, Reuters, Bloomberg

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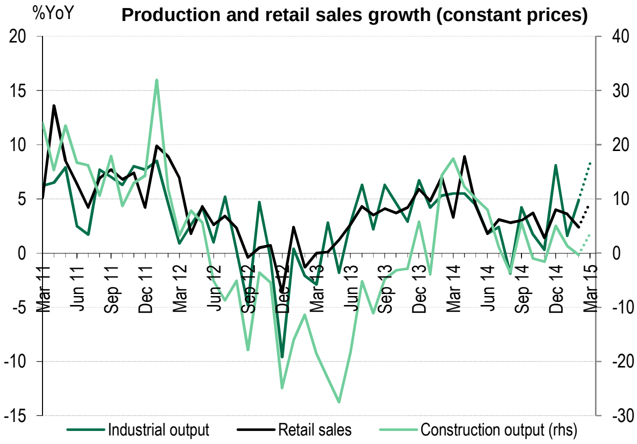
What's hot in coming week – Growing output, falling unemployment

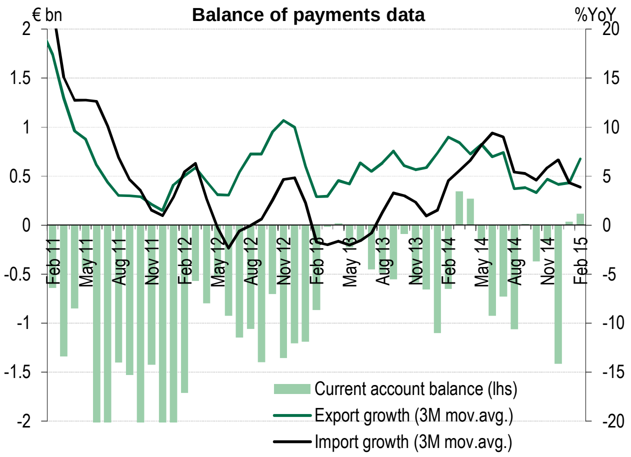


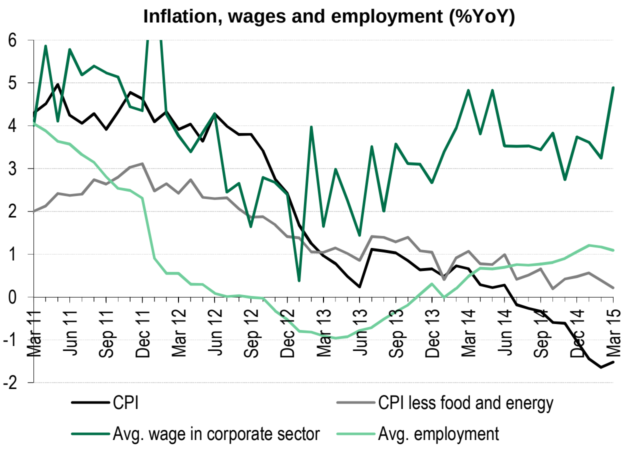
▪ We expect to see solid industrial production growth in March not only because of the higher number of working days (22 vs. 21 last year), but also thanks to an accelerating inflow of export orders amid the euro zone's economic recovery. Construction output is also likely to accelerate thanks to its relatively low base and working days effect.

▪ Retail sales growth acceleration should be supported by calendar effects (some Easter shopping was probably done at the end of March) and strong growth of household income. Data on car registrations showed decent growth in March (18%MoM), pointing to solid consumer demand for durable goods.

The registered unemployment rate fell to 11.7%, according to the Labour Ministry's estimates, confirming that the labour market kept on improving. It seems very likely that the jobless rate will drop below 10% in the middle of the year.

Last week in the economy – Inflation still very low, but wages keep accelerating





▪ The current account balance posted a €116mn surplus in February thanks to strong exports and moderate imports. The former rose 10.7% YoY, the fastest pace since December 2013, probably mainly driven by the economic recovery in the euro zone. At the same time, low commodity prices capped import growth. We expect the decent foreign trade numbers to help Poland's GDP growth accelerate significantly this year, even to c4% YoY in 4Q15.

▪ CPI inflation reached -1.5% YoY in March, starting a rebound from the trough albeit at a clearly slower pace that had been expected. The following months should show CPI rising further but we expect it to remain below zero until at least the end of 3Q15.

▪ Labour market data surprised with a much stronger- than-expected wage growth in March (4.9% YoY). Although the rate of employment growth slightly decelerated (to 1.1% YoY), the pace of real growth of labour income accelerated sharply to levels that were seen last in 2008. However, it is still uncertain whether the surge in March can be sustained or whether it was just a one-off effect caused by higher bonuses. Either way, these data allow us to expect faster consumption growth in 1Q.

▪ GDP growth for 2014 was revised up: 4Q14 to 3.3%YoY from 3.1% and for all of last year to 3.4% from 3.3%. These data confirm that the Polish economy did very well last year despite several negative external impulses (crisis in Ukraine, Russian sanctions, weaker growth in the euro zone) and its slowdown in 2H14 was only symbolic with domestic demand surging 5%. We expect GDP growth to accelerate this year, reaching 4%YoY in 4Q15, driven by both private and external demand.

Quote of the week – Nothing surprising has happened

Marek Belka, NBP Governor, 15 April, MPC conference

It (the declaration of the end of the easing cycle) remains intact.

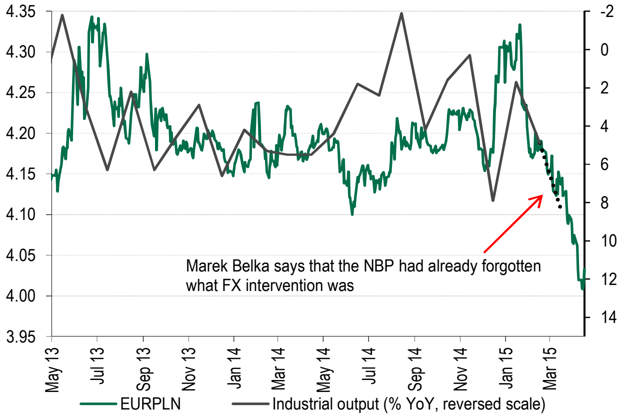
We have a free floating currency and its moves up and down are natural. (…) It would be unnatural and ridiculous if we started mulling changes just one month after we had decided to end the easing cycle. Nothing surprising has happened.

The European economy started to accelerate, Poland's economy is in a very good shape, the labour market is improving, fuel prices have rebounded – why would we even consider re-opening of the easing cycle? Sudden, notable weakening of economic activity would be something that we could treat as a significant change of the situation. (…) The prospect (of rate hikes) is so distant that speculating about it is worthless.

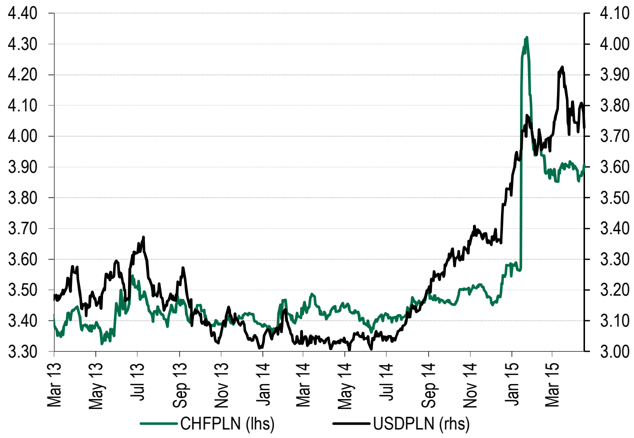
The NBP's Governor Marek Belka reiterated that chances for re-opening of the easing cycle were minimal since nothing surprising has happened since the previous MPC meeting. In his view, a significant economic slowdown could be a factor that could convince the Council to review its stance (meanwhile, we expect the opposite scenario!). At the same time, Belka admitted that prospects of policy tightening were so distant that it was not even worth talking about. Even though journalists and market players have focused in recent weeks on zloty appreciation and its possible impact on monetary policy, the Governor tried to play down this issue and to avoid any unambiguous comments. The problem is that if the zloty's appreciation goes too far, it could change the outlook for both inflation and economic growth. And this could pose a problem for the MPC (even if it does not want to admit it).

Foreign exchange market – EURPLN could test 4.0 again, Greece remains a risk factor

EURPLN and Polish industrial output

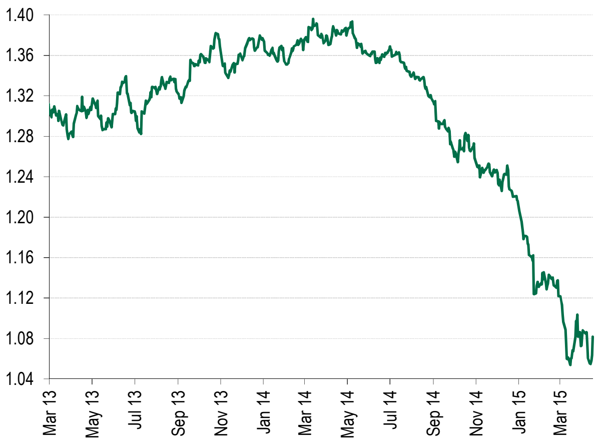


USDPLN and CHFPLN



USDCNY

EURUSD



EURPLN remains close to 4.0, waiting for an impulse

- EURPLN continues to trade near 4.0, but its attempts to break this level have failed so far due to a downside surprise of the Polish CPI and resurfacing worries over Greece. On the other hand, the potential for the zloty's depreciation was capped by the rhetoric of the MPC. At the same time, USDPLN dropped to 3.72 from 3.82 thanks to the higher EURUSD.
- During the March press conference of the MPC, Marek Belka said that the NBP "had already forgotten" what FX intervention was (suggesting the bank would not respond to substantial zloty appreciation), contributing to the EURPLN's drop seen in the following weeks. Last week, the NBP Governor tried to play down the issue of the zloty's recent appreciation, avoiding any unambiguous comments, but it seems that this strategy was not very effective either. Suggesting that nothing would be done to limit the zloty's excessive appreciation in a world of "currency wars" and pretending to be neutral about FX developments might simply attract foreign capital flows.
- Last week, however, neither the ECB nor MPC managed to trigger any breakthrough changes in the EURPLN market. The psychological level has already been tested several times, but the attempts were not overly aggressive. On the other hand, rebounds from 4.0 were rather moderate in their scale and so the exchange rate remains close to this important support level. We think that the recent MPC rhetoric about the exchange rate may act in favour of the zloty. Additionally, Poland's industrial output data for March is due at the beginning of the new week and our forecast is well above the market consensus. Should it materialise, EURPLN could be testing 4.0 again. However, Greece remains a risk factor for the zloty since talks on its bailout terms are not even near a happy end, which raises worries about a possible Grexit as the country could run out of cash by the end of this month. This means that the Eurogroup summit at the end of this week may be an important event and we think that its outcome could determine the direction of EURPLN for the coming weeks. We also stick to our view that the zloty will firm later in the year.

Chinese yuan stable despite poor data

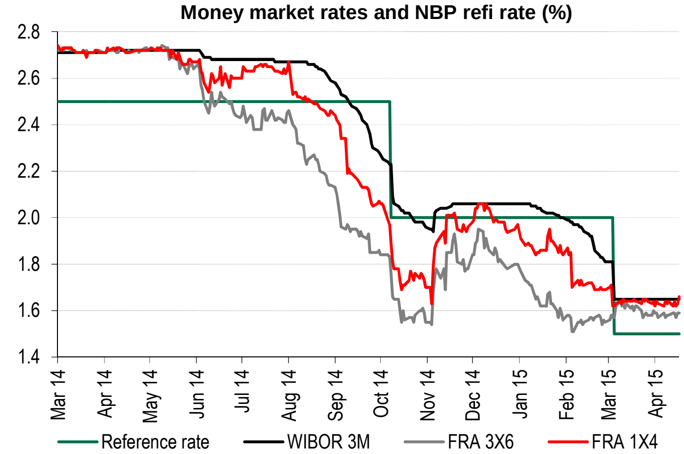
- Chinese data released last week fuelled worries that China's economy could be slowing. March exports and industrial output were below consensus and 4Q14 GDP growth reached 7%, a level targeted by the government for all of 2015. However, the yuan remained roughly stable at about 6.20 per dollar, below its peak of above 6.27 reached in early March.
- Despite the recent releases of pessimistic macro data, the market does not expect China's authorities to take actions aimed at currency depreciation as China wants the IMF to include the yuan in the Special Drawing Rights basket of reserve currencies this year. Sharp currency moves are, therefore, not desired from the Chinese authorities' point of view.

Euro stronger on U.S. data and despite Greek worries

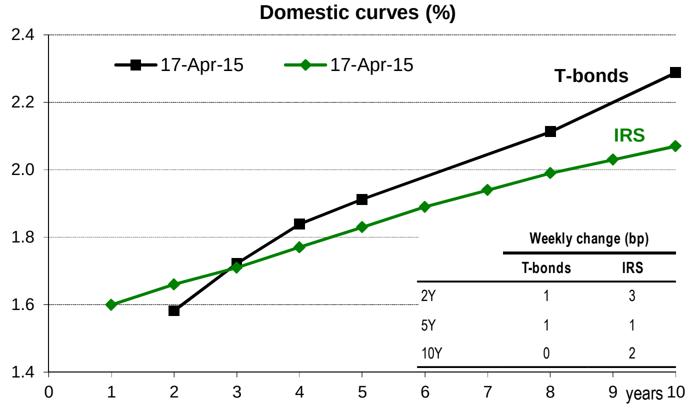
- EURUSD rebounded last week to 1.08 from 1.05 and the exchange rate ended its series of six consecutive sessions of falls. An equally long series was last seen in late January 2014 and an even longer one (eight sessions) in May 2012. Rising concerns over Greece's financial problems stood in the shadow of the poor U.S. macro releases.
- The past week offered no breakthrough and the exchange rate remains above the local low at 1.046 and below the mid-March peak at 1.105. It seems the euro zone's economic activity data are set to be overshadowed by the Eurogroup meeting and expectations of its outcome. This is likely to determine the direction for EURUSD in the coming weeks.

Interest rate market – Strong domestic data and fears about Greece may push yields higher

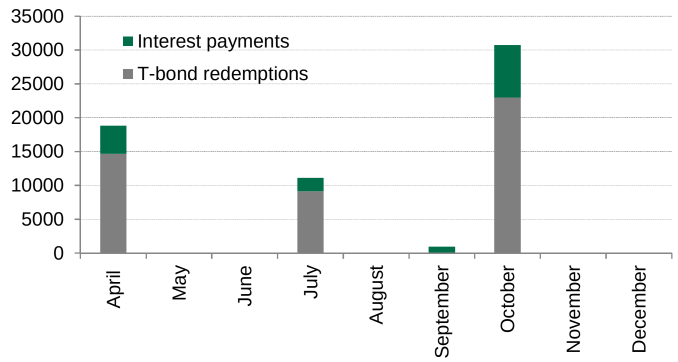
Money market rates and NBP refi rate (%)



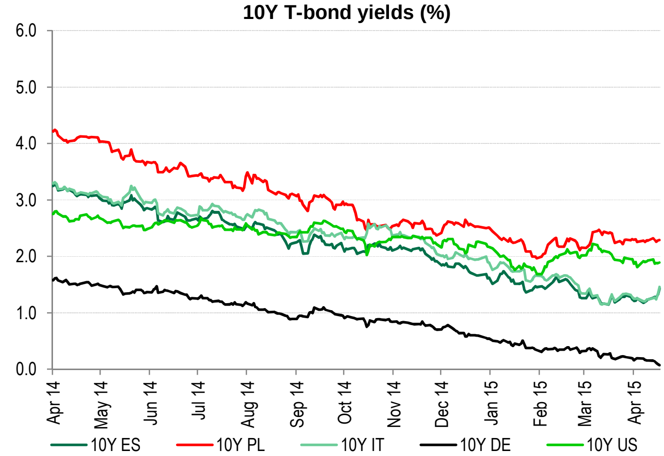
Domestic curves (%)



Flows of funds into the market related to T-bonds redemption and interest payments in April-December period (in PLN m)



10Y T-bond yields (%)



Stable WIBORs, other assets vulnerable

- Last week was filled with important events and macroeconomic data releases. Money market rates were roughly stable compared with the IRS and T-bond market. However, FRAs rose across the board this past week. Notwithstanding, FRA6x9 and FRA9x12 stayed c10bp below the current level of WIBOR 3M, confirming that the market continues to discount some probability of a rate cut before the end of 2015.
- While central bank meetings did nothing to increase investors' appetite for Polish assets, the IRS and T-bond market gained quite visibly in response to the surprisingly low inflation data for March (with the yield of the 10Y benchmark dropping towards 2.25%). However, this strengthening was only short-lived as fears about Greece pushed yields of the euro zone peripheries' and CEE bonds higher. At the same time, German bonds benefited from the risk-averse mood, with the yield of the 10Y Bund approaching zero (it hit a new record low, falling below 0.06%). Consequently, the spread over Bunds widened again towards 220bp for the 10Y Polish bonds, the highest level since mid-March.
- In sum, yields of T-bonds and IRS rates were roughly stable when compared with the end of the previous week. However, one should note that intraday changes were quite considerable as domestic investors were reacting nervously to news flow from abroad (in particular Greece or U.S. macro data).

Domestic macro data and Greece are key

- The weak ahead will be eventful and exciting, filled with the most important domestic data releases (industrial output, retail sales) and a regular T-Bond auction. In our view, these data should be relatively strong and we expect above-consensus production growth and accelerating retail sales growth. All in all, both these data should confirm that Poland's economy is gaining momentum, which may be negative for bonds. However, the impact of the domestic data may be short-lived because, in the second part of the week, investors will shift their attention to the Eurogroup's meeting and its potential decisions on the Greek bailout and on new macro data releases in Europe and in the U.S. This may weigh on the domestic assets, especially the long end of the curves.
- This coming week the Finance Ministry will offer T-bonds worth PLN5-9bn, according to the issuance plan for April. We do not expect any significant changes to the offer, but the Ministry may slightly narrow the range as it had done previously. When it comes to the T-bonds that are to be tapped – we expect a range of instruments, including 2Y and 5Y benchmarks (OK0717, PS0420) and floating rate T-bonds WZ0120. The auction's results will be supported with high inflows from the PS0415 redemption worth cPLN14.7bn and interest payments from the April's series of PS and WS worth PLN4.2bn. We expect healthy demand and the ministry should have no problem selling the entire offer.
- In our view, the front end of the curve should remain stable until the probability of further monetary policy adjustments changes significantly. Please note that the NBP governor, Marek Belka, reiterated firmly during the press conference after the policy meeting in April, that chance for continuing or re-opening of the easing cycle were minimal. At the same time, he said that policy tightening was very distant at the moment. Last week did not bring any significant changes in the outlook for the 10Y T-bonds. Yield on the 10Y benchmark moved sideways, oscillating between 2.25% and 2.35%. A similar fluctuation range is expected this week.

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.