Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

27 April – 3 May 2015

Recent economic data releases offered a clear confirmation that Poland's economy already was in a recovery mode, with GDP growth supported by both reviving external orders and strong domestic demand. The outlook for private consumption looks particularly bright since the unemployment rate is falling, real wage growth is accelerating, and consumers are already the most optimistic since before the Lehman Brothers' collapse in 2008. Meanwhile, the euro zone's accelerating GDP growth bodes well for Polish exports.

In such an environment, we believe there are fundamental arguments for the zloty to appreciate further. In the medium run, the currency should be supported by the country's high real interest rates, its accelerating economic growth, low external imbalances, the improving fiscal position and the ECB's QE. However, we think that, in the short run, the downward EURPLN move will be halted and the rate will stabilise near the 4.0 level, which was breached recently. Geopolitical risks are the main reason for investors' caution as concerns about the future of Greece are growing and this may weigh heavily on the market until some kind of a solution emerges. Another factor that may limit the zloty's appreciation scope could be uncertainty about the Fed's monetary policy.

In absence of domestic data releases or events ahead of the long May weekend, the market will focus on events abroad. The FOMC meeting will be the most important as investors will be looking for any hints in the Fed's statement about the impact of the recent weaker data on the monetary policy outlook. In this regard, new data from the U.S. economy will also be watched closely, with the flash GDP, manufacturing ISM, consumer confidence and personal spending all having a potentially significant impact on market expectations. The market is currently pricing in the first U.S. rate hike in October 2015. The fate of Greece will probably continue to weigh on market sentiment as time for agreeing on the bailout terms is running out and the Greek government is running out of cash.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 April)					
		No important data releases					
		TUESDAY (28 April)					
16:00	US	Consumer confidence index	Apr	pts	102.5	-	101.3
		WEDNESDAY (29 April)					
14:30	US	Advance GDP	Q1	%QoQ	1.0	-	2.2
16:00	US	Pending home sales	Mar	%MoM	1.0	-	3.1
20:00	US	FOMC decision					
		THURSDAY (30 April)					
11:00	EZ	Flash HICP	Apr	%YoY	0.0	-	-0.1
14:00	**PL**	**Inflation expectations**	**Apr**	**%**	**-**	**-**	**0.2**
14:30	US	Personal income	Mar	%MoM	0.2	-	0.4
14:30	US	Consumer spending	Mar	%MoM	0.5	-	0.1
14:30	US	Initial jobless claims	week	k	-		295
		FRIDAY (1 May)					
	PL, DE	**Market holiday**					
16:00	US	Michigan index	Apr	pts	96.0	-	93.0
16:00	US	ISM – manufacturing	Apr	pts	52.0	-	51.5

Source: BZ WBK, Reuters, Bloomberg

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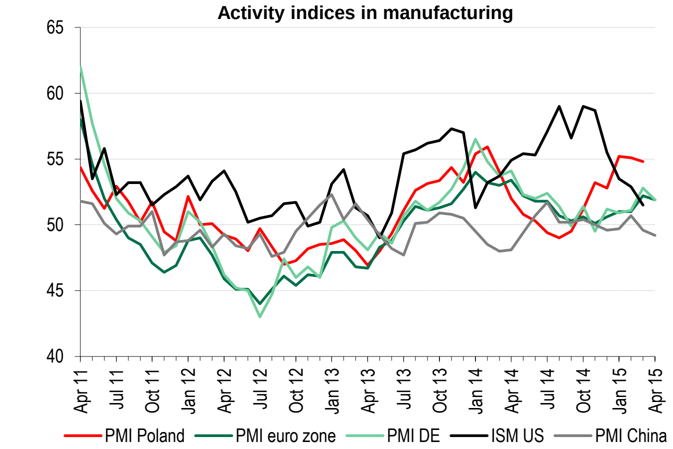
What's hot this week – Fed meeting and U.S. data in the spotlight



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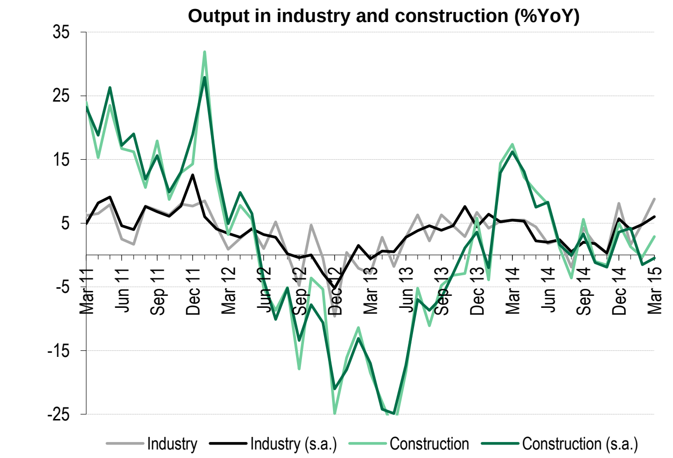
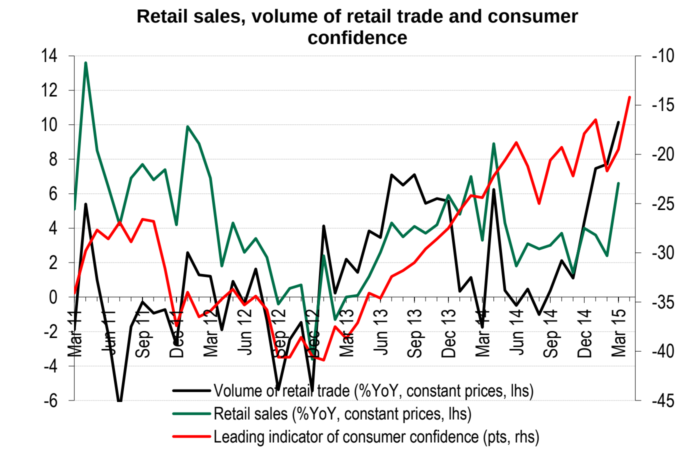
- The fate of Greece will probably continue to weigh on market sentiment as time for agreeing on bailout terms is running out and the Greek government is running out of cash.

Last week in the economy – Strong industry, consumers on a buying spree





- March output and retail sales surprised to the upside. Industrial output grew 8.8% YoY, with construction and assembly up 2.9% YoY and retail sales 6.6% YoY (in constant prices). Growth in the manufacturing sector (9.6%YoY) was the strongest in over four years. The result was also boosted by the positive effect of the number working days and probably by a likely one-off rebound in mining and quarrying. But even taking these factors into account, the result was quite robust. Seasonally adjusted production growth reached 6%YoY and was highest since January 2014.
- Retail sales drew support from the Easter holiday, which boosted spending on food. However, other categories also accelerated (especially clothing, furniture and household appliances), which probably reflects a general strengthening of domestic demand and quickening income growth (recall wage growth noticeably accelerated in March), improving consumer confidence, low interest rates and lower prices of basic goods (food, fuels).
- According to GUS, consumer confidence soared in April to its highest level since September 2008. Meanwhile, the volume of retail trade (which excludes car sales, but takes into account small shops) surged in March by 10.1%YoY (the most since December 2010), confirming that consumers were on a buying spree.
- The registered unemployment rate fell in March to 11.7%, as suggested earlier by the Labour Ministry's estimates. The monthly drop of the number of the unemployed was slightly lower than last year, however, it should be noted that this time around the impact of interventionist government policies was much smaller. According to our estimate, Poland's seasonally adjusted jobless rate fell to 11.1%, the lowest level since July 2009.

Quote of the week – 'Wait and see' approach for longer

Jerzy Osiatyński, MPC member, 22 April 2015, Reuters

The Council said that it had ended adjustment of its monetary policy, at least as long as nothing important and unexpected takes place. I think that we should thus adopt a 'wait and see' mode. (…) This can be a relatively long period. In my view, there are currently many question marks in the financial markets so we should stay calm and observe what is going to happen.

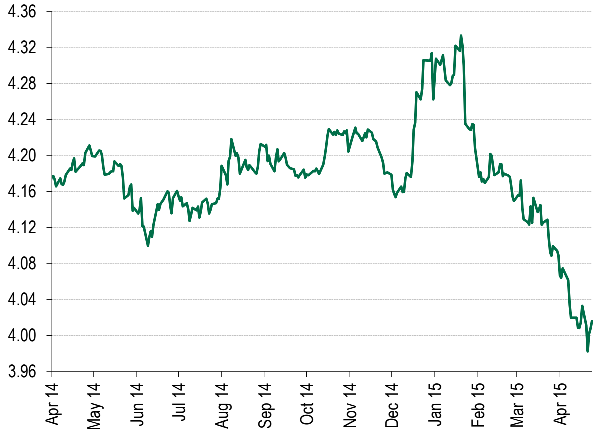
Adam Glapiński, MPC member, 20 April 2015, Bloomberg

Rates should remain unchanged at least until this Council ends its term. For me, that means no cuts and no hikes.

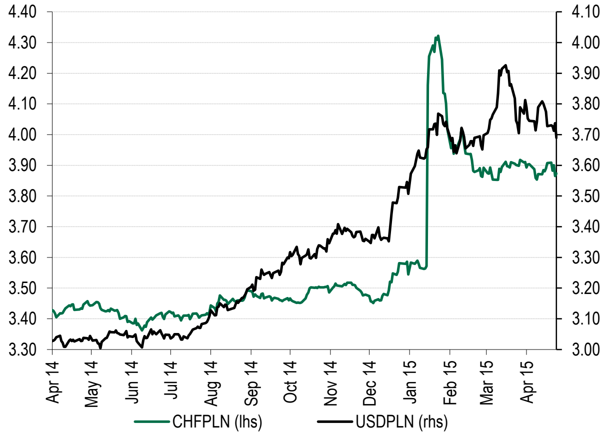
We have written before that excessive zloty appreciation is the factor that could make the MPC consider a reopening of its monetary easing cycle as a strong zloty could undermine the economic recovery and lower inflation. However, it seems likely that the better the economic data releases, the bigger the scale of zloty strengthening needed to trigger any action by the central bank. The recent comment of Jerzy Osiatyński, one of the most dovish MPC members, shows that, at the current levels, it is probable that no one in the Council is mulling further rate cuts and that there is a broad consensus about staying in the 'wait and see' mode. The export profitability breakeven for EURPLN estimated by the NBP is at c3.90, but, in our view, the rate would have to fall much further to trigger significant concerns among the MPC.

Foreign exchange market – FOMC meeting and Greece's fate in the spotlight

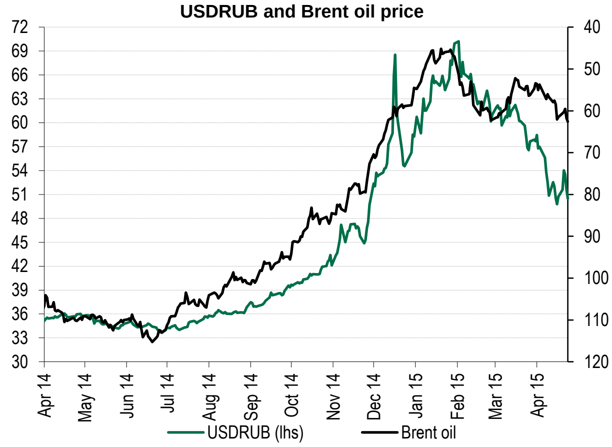
EURPLN



USDPLN and CHFPLN



USDRUB and Brent oil price



EURUSD

Correction on the zloty …

- The zloty firmed quite visibly in the first part of last week, supported by better-than-expected domestic macro data. EURPLN fell temporarily to 3.965, the lowest level since 2011. However, in the second part of the week, investors decided to take profit before the Eurogroup summit in Riga, where the Greek bailout agreement was to be discussed. Consequently, EURPLN rose towards 4.03 and ended the week slightly below 4.025.
- The domestic currency gained nearly 1% against the U.S. dollar last week amid the rising EURUSD. The zloty also strengthened by 0.9% vs. the Swiss franc and by only 0.2% vs. the British pound.
- We believe there are fundamental arguments for the zloty to appreciate further as, in the medium run, the currency should be supported by high real interest rates, accelerating economic growth, low external imbalance, improving fiscal position and the ECB's QE. However, we think that in the short run, the downward EURPLN move will stop and the rate will stabilise near the 4.0 level, which was breached recently. Geopolitical risks are probably the main reason behind investors' caution as concerns about the future of Greece are growing and this may weigh heavily on the market until some kind of a solution emerges. Another factor that may limit the scope for the zloty to appreciate could be uncertainty about the Fed's monetary policy, which means that the outcome of April's FOMC meeting and the upcoming macro data releases in the U.S. will be crucial for the zloty. From the technical point of view, the fluctuation range for the EURPLN between 3.965 and 4.05 remains intact.

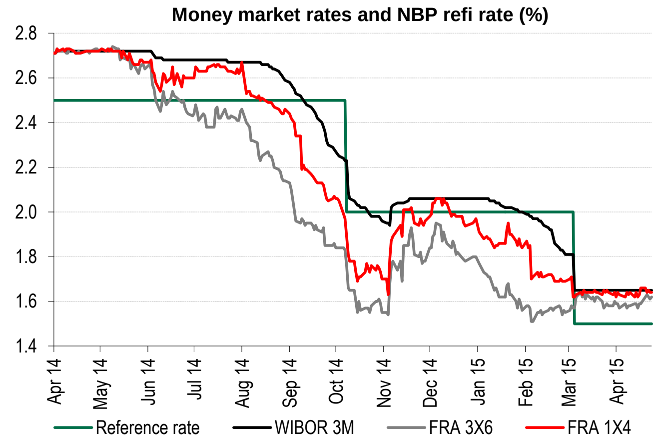
… and other regional currencies

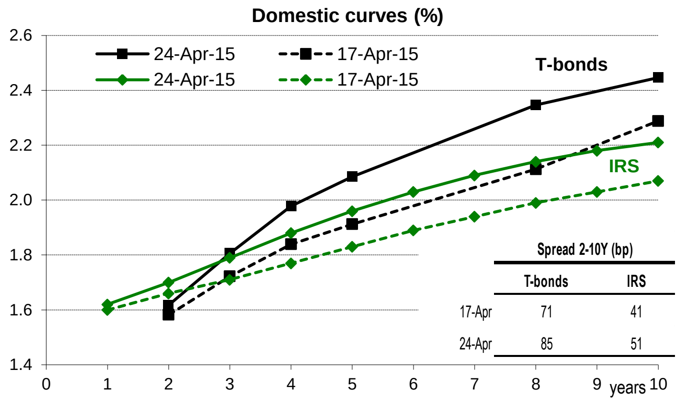
- Last week also brought a correction on the other regional currencies. The Hungarian forint depreciated noticeably against the euro, mainly due to fears about Greece rather than the rate cut by the NBH, with EURHUF increasing temporarily to 302.4 from 297. The scale of the Czech koruna's depreciation was small in comparison with the Polish zloty and the Hungarian forint. At the same time, the Russian ruble dropped to 50 from 54.1, supported by a rebound in the oil price, which outweighed concerns about the economic situation in Russia.
- This week external factors will also be crucial for the CEE currencies as there are no important local events on the agenda. We expect both EURHUF and EURCZK to move sideways in the near term, fluctuating between 295-305 and 27.2-27.6, respectively.

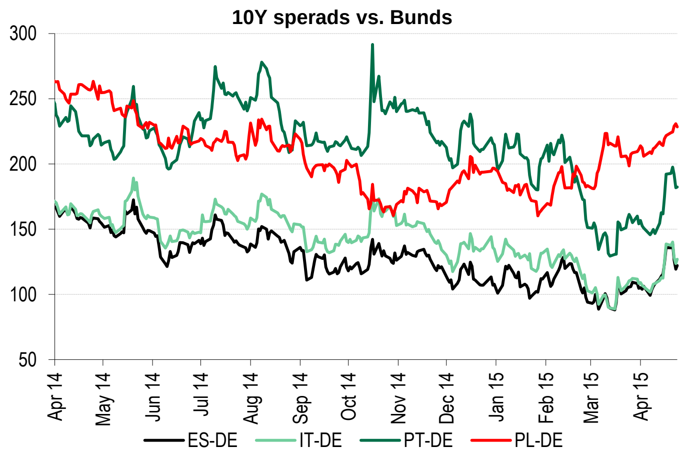
EURUSD slightly rebounded, but still range-bound

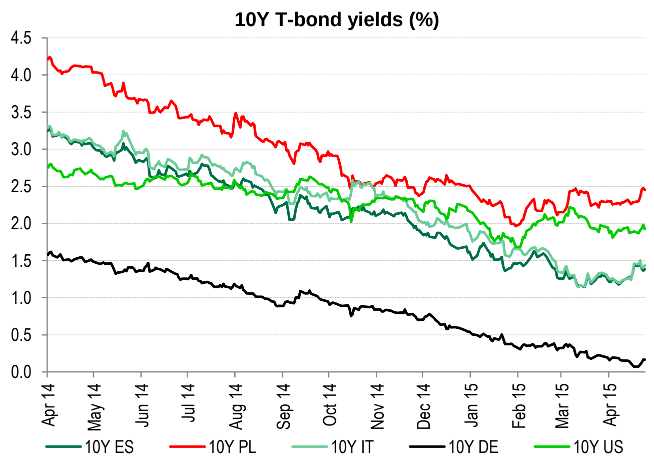
- Last week EURUSD moved towards the upper limit of its fluctuation channel of between 1.045 and 1.105 as data for the U.S. economy were mixed and investors believed in some agreement between Greece and its creditors. Germany's higher-than-expected Ifo for April also provided some support for the European currency. Consequently, EURUSD rose to 1.0885, the highest level in two weeks.
- This week investors will focus on U.S. macro data releases (mainly GDP for 1Q15) and the FOMC meeting. We do not anticipate any critical announcement at this meeting and, therefore, do not expect any changes in the EURUSD outlook. We expect a continuation of the sideways move. However, the euro zone's improving economic outlook should provide support for EUR, keeping EURUSD closer to the upper limit of the range.

Interest rate market – Rebound very likely to follow significant weakening









Sell-off pushed yields towards end-2014 levels

- WIBOR money market rates were quite stable over the past week, for the sixth week in a row. At the same time, FRAs increased significantly, in particular the longer tenors due to a sell-off on the IRS market. FRA21x24 rose to c.1.80%, implying some odds of monetary tightening at the beginning of 2017.
- The T-bond and IRS markets were more vulnerable. Both yields and the IRS rates increased due to much better-than-expected domestic macro data and due to profit-taking on the core debt markets (yield of the 10Y Bund increased temporarily to 0.18% from the historically low of 0.05%). As a result, the 10Y benchmark yield increased towards 2.50%, the highest level since the end of December 2014, while the 10Y IRS rose to nearly 2.25%, the highest level since mid-March. Positive auction results helped the market rebound slightly at the end of the week, though yields of 5Y and 10Y benchmarks stayed at elevated levels (2.08% and 2.45%, respectively).
- The belly and long-end of the curves lost the most and, consequently, the 2-10Y spread widened quite visibly towards levels that were seen in mid-March (to 85bp for T-bonds and to nearly 55bp for IRS). Moreover, the spread over the 10Y Bund grew slightly above 230bp, the highest level since August 2014.
- Last week the Finance Ministry sold debt worth slightly over PLN7bn (the planned offer amounted to PLN5-7bn) amid demand at PLN10.7bn. These results can be viewed as quite positive, considering the auctions from the start of the month, when demand and supply were relatively weak. PS0420 was the most desired paper and its sales amounted to PLN5.4bn (together with the top-up auction). We estimate that after the auction, this year's borrowing needs had been covered in almost 65%.

The FOMC meeting is this week's key event

- There is no important data releases or events in Poland this week, which means that external factors will be key. The FOMC meeting may introduce some nervousness in the bond market. However, we expect status quo in the Fed's monetary policy (as compared to the previous meeting), which could activate some demand on the risky assets, including Poland's, and help the market rebound slightly from the significant weakening in the previous week.
- One should notice that this week will be shorter due to May's long-weekend, yields/rates changes may, therefore, be more significant amid the likely thin liquidity. In the short run, we do not exclude that the yield of the 10y benchmark could return to the previous fluctuation range of 2.25-2.35%. Our scenario is based on the assumption that the massive bond purchases by the ECB will support the yield's low levels in the euro zone's core market, which should positively affect the domestic assets valuation. One should remember, however, that there is one significant risk factor here, which could potentially harm investor sentiment, also pushing the Polish yields higher - namely rising worries about the fate of Greece as the country is getting closer to liquidity shortages every day.
- As usually is the case in the last week of the month, Poland's Ministry of Finance will present its issuance plan for May. According to its quarterly plan, the Ministry plans one regular auction and one switch tender and we expect this to be confirmed. In our view, the YTD completion of the 2015 gross borrowing needs allows the ministry to be more flexible (than aggressive) in offering T-bonds on the primary market.

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.