Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

4 – 10 May 2015

The last week of April saw a significant selloff on the Polish debt market, with yields of the 5-10Y bonds soaring to this year's highs on the back of growing worries over Greece and a surprising turnaround in the euro zone's debt market – yields of the German Bunds soared in spite of the continuing ECB's QE programme. The EURPLN's drop below 4.0 was only short-lived again as global risk aversion weighed on the currency, though the zloty gained versus the dollar and Swiss franc.

The release of April's PMI index and the MPC meeting will be the key domestic events in the coming week. However, they are not likely to be the key market drivers as the PMI index is widely expected to show only a slight drop, still confirming expansion in manufacturing remains solid, while the MPC will probably keep its monetary policy and rhetoric unchanged. The market will focus on events abroad. Greece remains an important risk factor as its government's coffers are running empty and talks on the bailout extension do not seem to be heading towards an agreement. U.S. data releases will also be key for market sentiment (Friday's non-farm payrolls in particular) since after the surprisingly weak 1Q15 GDP, investors are on a lookout for fresh hints on possible changes in the Fed's monetary policy outlook.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (4 May)					
3:45	CN	PMI – manufacturing	Apr	pts	49.4	-	49.6
9:00	**PL**	**PMI – manufacturing**	**Apr**	**pts**	**54.6**	**54.5**	**54.8**
9:55	DE	PMI – manufacturing	Apr	pts	51.9	-	52.8
10:00	EZ	PMI – manufacturing	Apr	pts	51.9	-	52.2
16:00	US	Industrial orders	Mar	%MoM	2.2	-	0.2
		TUESDAY (5 May)					
11:00	EZ	European Commission's spring economic forecasts					
16:00	US	ISM – non-manufacturing	Apr	pts	56.1	-	56.5
		WEDNESDAY (6 May)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
9:55	DE	PMI – services	Apr	pts	54.4	-	55.4
10:00	EZ	PMI – services	Apr	pts	53.7	-	54.2
14:15	US	ADP report	Apr	k	185	-	189
		THURSDAY (7 May)					
8:00	DE	Factory orders	Mar	%MoM	1.5	-	-0.9
9:00	CZ	Industrial output	Mar	%MoM	6.3	-	4.5
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Initial jobless claims	week	k	-	-	
		FRIDAY (8 May)					
8:00	DE	Exports	Mar	%MoM	0.3	-	1.4
8:00	DE	Industrial output	Mar	%MoM	0.4	-	0.2
9:00	HU	CPI	Mar	%YoY	-	-	-0.6
14:30	US	Non-farm payrolls	Mar	k	220	-	126
14:30	US	Unemployment rate	Mar	%	5.4	-	5.5

Source: BZ WBK, Reuters, Bloomberg

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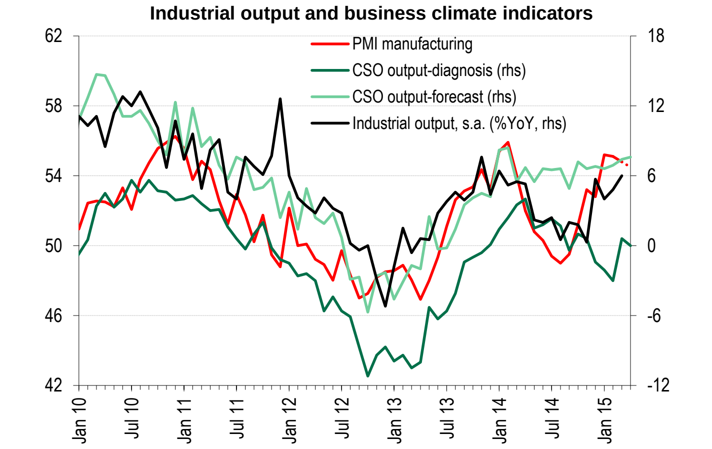
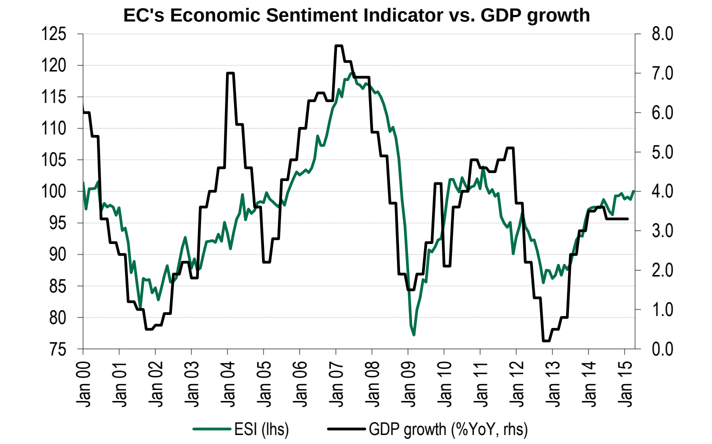
What's hot this week – Monetary policy unchanged as long as recovery is under way





- We expect that the Polish manufacturing PMI index slightly fell in April, for the third month in a row. The recently released indicators of economic sentiment from the euro zone showed some evidence that the prolonging uncertainty about Greece has started to weigh on the sentiment of European entrepreneurs and consumers, which may also be reflected in the Polish PMI survey. The recent strengthening of the zloty was another factor limiting optimism among Poland's companies.. However, we think that the fall of the main index should be moderate, signalling that the manufacturing sector remains in an expansion mode.
- Other leading indicators for Poland that had recently been released failed to offer a clear signal – the CSO's business climate in manufacturing fell slightly, but remained close to its one-year high. While forecasts of future output decreased, assessment of the current production rose in April to the highest level in 15 months. The employment sub-index also rose. The European Commission's Economic Sentiment Indicator (ESI) increased in April to its highest level since May 2011 and this is consistent with GDP growth accelerating towards 4%YoY.
- May's MPC meeting will probably fail to bring any surprising changes in the monetary policy stance since the recent macro data confirmed that economic growth was accelerating (we think that GDP growth in 1Q15 probably accelerated to 3.4%YoY), while the zloty's appreciation trend has stalled since the Council's last meeting. As we wrote last week, the stronger macro data releases, the bigger the scale of the zloty's strengthening needed to trigger any action (or substantial worries) by the central bank.

Last week in the economy – Government plans to continue fiscal consolidation

	2015	2016	2017	2018
Real GDP (%YoY)	3.4	3.8	3.9	4.0
Potential GDP (%YoY)	3.3	3.4	3.7	4.0
Private consumption (%YoY)	3.4	3.7	3.8	3.8
Investment (%YoY)	6.9	6.1	6.5	6.9
Unemployment (%)	8.2	7.6	7.0	6.5
GG deficit (% GDP)	2.7	2.3	1.8	1.2
GG debt (% GDP)	51.7	51.6	50.7	49.1

- The government approved the Multi-Year Financial Plan for 2015-2018. The plan assumes there will be a gradual acceleration of GDP growth from 3.4% in 2015 to 4.0% in 2018, mainly on the back of strong private consumption and exports, with the trade deficit shrinking to almost zero. In our view, these assumptions are a bit too optimistic – their implementation would imply an unusually long cycle of economic expansion.
- The government's deficit is expected to fall persistently below 3%, starting with 2.7% in 2015. Considering that the general government's deficit was already close to the 3% target in 2014 and that there are credible plans of its further reduction, it is possible that the EC could lift the excessive deficit procedure for Poland already on 19 June, which would surely be credit-positive. Moreover, this could be followed by an improvement of Poland's rating outlook by some credit agencies, although we do not expect to see upgrade of the rating itself anytime soon.

Quote of the week – No problem with the zloty at the moment

Jerzy Hausner, MPC member, 27 April, Wall Street Journal
Looking at the current economic situation and taking into account that we approach the end of the council's term, the scenario of keeping rates at the current level for a prolonged period of time seems probable to me. I see no problem with the zloty at the moment. It is possible the economy will grow faster than the latest projection showed, meaning inflation will return to the target range we see as optimal at a faster pace.

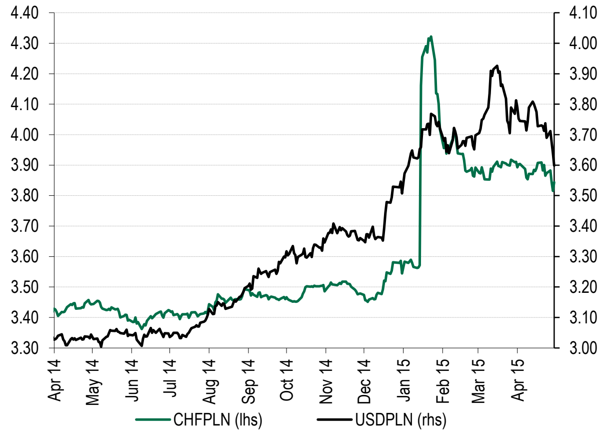
Jerzy Osiatyński, MPC member, 28 April, Wall Street Journal
Poland's interest rates could stay unchanged for 20 months or more depending on the health of the economy, which has room to grow faster. (…) We are not convinced (the zloty could appreciate excessively).

Questions about the impact of the zloty's appreciation on the monetary policy outlook dominated the MPC's post-meeting press conference in April and it cannot be excluded that the situation will also be similar in May. However, we suspect that the NBP governor will continue to downplay the significance of the recent PLN movements and avoid elaboration on the subject. The recent comments of MPC members and NBP officials (deputy president Andrzej Raczko), clearly confirmed that the central bank was still far from mulling any actions aimed at limiting the zloty's strengthening, especially now that the trend has stalled on growing worries about Greece.

Foreign exchange market – External factors remain in the spotlight

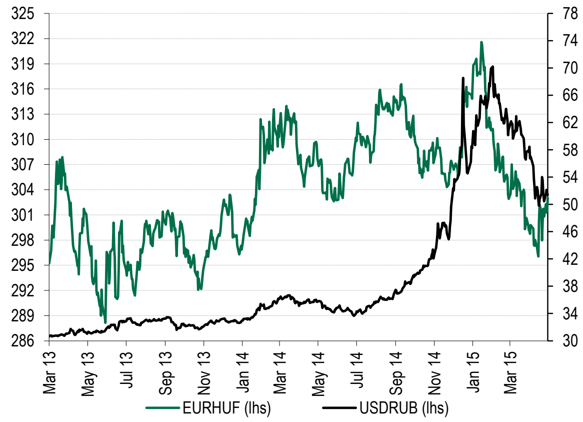
EURPLN

USDPLN and CHFPLN



EURUSD

EURHUF and USDRUB



EURPLN still close to 4.0

- Last week EURPLN stayed in the 3.965-4.045 range, the same as in the previous week. The zloty again moved temporarily below 4.0 vs. the euro, however, later in the week, rebounded to 4.04 as there was elevated volatility on the global market and EM currencies were under severe pressure. At the same time, rising EURUSD and EURCHF backed the Polish currency vs. the dollar and Swiss franc – USDPLN dropped to 3.58 from 3.73 (the lowest since mid-January) and CHFPLN eased from 3.90 to 3.80 – the lowest since the memorable January 15, when the SNB dropped the EURCHF floor.

External factors still in the spotlight

- Just like we had suggested last week, the EURPLN's downward move stopped and the exchange rate was hovering around 4.0. As negotiations on the conditions of the Greek bailout's extension remained unsuccessful, investors have become more concerned with the potential outcome. EM currencies suffered last week and more pressure could come if the deadlock in talks persists.
- We think that sentiment on the global market could improve if the U.S. monthly nonfarm payrolls disappointed again. Before then, Poland's manufacturing PMI is due, which we think may show a third drop in a row in April. However, the zloty's reaction should be muted if the drop does not prove much stronger than the consensus forecast. The MPC's decision and statement should not affect the currency too much, in our view.
- We have already mentioned several times that the zloty used to be a cyclical currency and we expect this pattern to work in the coming quarters since Poland's GDP should accelerate, according to our forecast, even to 4%YoY in 4Q15. But in the near term, the zloty's appreciation could be halted by geopolitical risks.

U.S. data could push EURUSD higher

- EURUSD rose for the third consecutive week as the dollar weakened on the back of poor U.S. macro data (particularly the preliminary 1Q GDP). The exchange rate easily broke the local peak at c.1.105 and surged to 1.125 from 1.08.
- EURUSD has tried to rebound more noticeably from its multi-year low at c1.045 since mid-March and this increase is already the most significant rebound in the down trend observed since mid-2014, generating more upside bias in the market from this point of view.
- Important U.S. data are due this week with the monthly U.S. nonfarm payrolls likely drawing most of the attention. The last release was very disappointing and investors will now try to assess whether this only was a temporary weakening related to the severe winter or whether the slowdown continued. Should the latter be the case, the ongoing rebound in EURUSD could accelerate.

Russian central bank trims rates

- Russian central bank cut interest rates to 12.5% from 14%. According to Reuters, median forecasts for Russia's key interest rate have dropped since December 2014 to 11% from 16.25% for 2Q15 and to 11% from 13.5% for 3Q15. The down move in USDRUB halted recently and further rate cuts could weigh on the ruble as the risk premium would diminish while the economic situation is unlikely to improve significantly in the coming quarters.
- The prospect of rates falling further and the risk that a stronger currency may hurt the economy should limit the potential for the ruble to appreciate. The continuing conflict with Ukraine is a significant risk, which may also prevent the ruble from any sustained gains.

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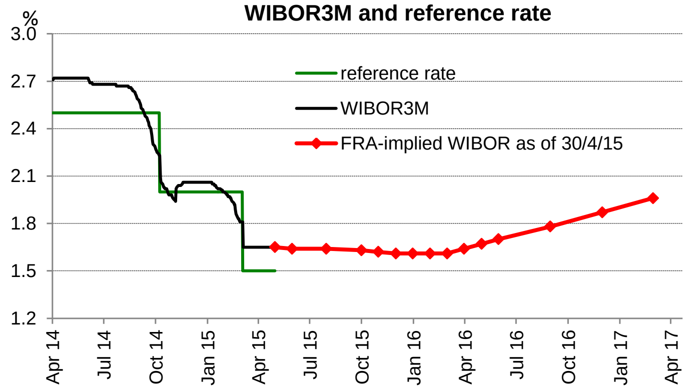
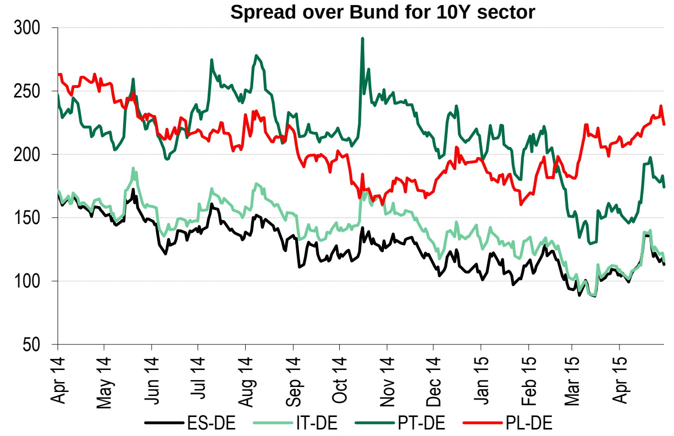
Interest rate market – Greece and weaker core markets push Polish yields higher

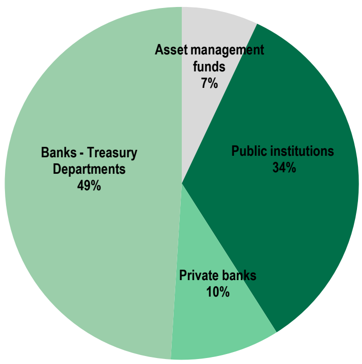
WIBOR3M and reference rate



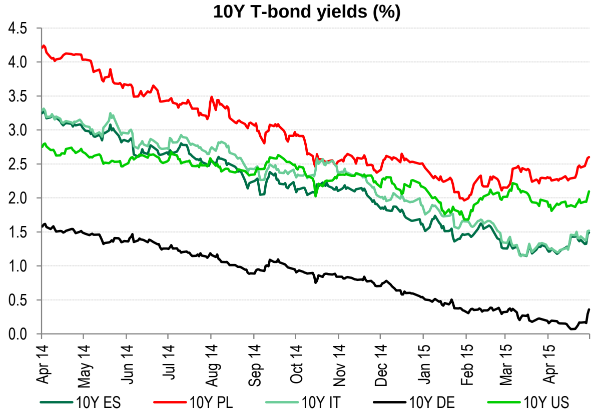
Spread over Bund for 10Y sector



Structure of institucional distribution of 3Y CHF-denominated bond



10Y T-bond yields (%)



Another wave of a strong sell-off across the debt market

- WIBORs, as in the previous weeks, remained nearly unchanged (only the 9M rate increased by 1bp), while FRAs shifted up significantly by 2-17bp across the curve due to the sharp weakening of the IRS. The FRA rates for tenors longer than 12M currently indicate that the market has started to price-in monetary tightening by nearly 25bp in 18 months' time, which is consistent with our baseline scenario.
- Last week brought a significant weakening of the domestic assets, with yields and IRS rates rising by 2-18bp across the curves. This was a continuation of the previous week's upward move following strong industrial output and retail sales. This time around, growing uncertainty over Greece and the sharp sell-off on both the core and peripheral debt markets were the main culprits. As a consequence, the Polish 10Y benchmark yield temporarily rose towards 2.70%, the highest since October 2014. This level drew demand and yields quickly returned to nearly 2.60%.
- The Polish curves steepened noticeably over the past week and the long-end of the curves performed the worst. Moreover, the spread over Bunds also widened significantly, rising temporarily to nearly 240bp, the highest since May 2014.

Poland issued CHF-bonds with negative yield

- Poland successfully launched 3Y CHF-denominated zero-coupon bonds worth CHF580mn with a 37bp spread above the mid-swap rate. This implies a yield of -0.213%. Finance Minister Mateusz Szczurek said that Poland had joined the elite club issuing treasury bonds with a negative yield. He added that this was the biggest auction with a negative yield on the Swiss market next to issuances carried by the Swiss government. For the first time in history, Poland is going to receive money instead of paying interest for issuing bonds. The net revenue is estimated at CHF3.7mn. The bonds were placed among investors from Poland (47%), Germany (34%) and Switzerland (19%). The cash raised will be allotted to a buyback part of CHF1.5bn bonds maturing in May.
- In line with the quarterly issuance plan, the Ministry of Finance will offer T-bonds through two regular auctions in May. However, supply will be limited (PLN3-9bn in total) compared to April's sale worth PLN11.44bn.

Global sentiment will continue to be a major driver

- This week global sentiment will continue to be a major driver on the T-bond and IRS markets. The ongoing "Greek negotiations" will still take centre stage as reaching an agreement with creditors, in our view, will not happen quickly. The Greek saga will, therefore, weigh on the domestic assets valuation, keeping yields/rates at elevated levels (in particular on the long-end of the curves).
- On the domestic side, investors will focus on macro data (April's manufacturing PMI) and the MPC's meeting. In our view, the manufacturing PMI, despite its slight decline, should confirm that the outlook for Poland's manufacturing sector is strong, which should be rather neutral for the domestic assets. At the same time, we think that May's MPC meeting is set to be rather uneventful as we expect the Council to keep its monetary conditions and rhetoric unchanged.
- From the technical point of view, a rebound on the T-bond and IRS markets is very likely after their significant weakening over the past two weeks, especially now that the recent rise in the core yields is more likely just a correction in the downward trend than a beginning of a new trend. Therefore, we think that current levels of the domestic yields should attract some demand in the upcoming weeks.

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.