WEEKLY ECONOMIC UPDATE

10 – 16 August 2015

Global sentiment was mixed this past week. It deteriorated temporarily due to hawkish comment from a Fed member and voter, who said that the U.S. economy was ready for normalization in monetary policy and that only some significant deterioration could prevent him from supporting a rate hike in September. Moreover, Poland's assets underperformed visibly (with EURPLN breaking the local peak slightly above 4.18, the stock market posting huge losses and the 10Y benchmark yield rising to its highest level since mid-July) due to fears over stability in Poland's banking system after the parliamentary approval of a bill that offers special terms for FX debt restructuring. Ahead of the U.S. non-farm payrolls, the market's sentiment was roughly stable, and final reading was high enough to keep expectations for the near rate hike by Fed. However, market reaction was muted, but market volatility was high and we saw some strengthening on debt market globally, including the Polish one.

This week the first set of domestic macro data will be released, including inflation CPI for July and flash 2Q GDP growth. Our forecasts of the inflation rate and GDP growth for 2Q 15 are similar to the market consensus (-0.8%YoY and 3.6%YoY, respectively). We expect the C/A surplus for June to be lower than market expectations. All in all, these data are likely to be a mixed bag and will probably not change the economic outlook substantially. This means that global factors will continue to be decisive for the market's direction. Further improvement in the euro zone's economic sentiment, suggested by the flash 2Q15 GDP growth for the European Union countries, could offer some revival for the market in coming week.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (10 August)					
9:00	CZ	CPI	Jul	%YoY	0.6	-	0.8
		TUESDAY (11 August)					
9:00	HU	CPI	Jul	%YoY	0.6	-	0.6
11:00	DE	ZEW index	Aug	pts	64.0	-	63.9
		WEDNESDAY (12 August)					
11:00	EZ	Industrial output	Jun	%MoM	0.2	-	-0.4
		THURSDAY (13 August)					
14:00	**PL**	**CPI**	**Jul**	**%YoY**	**-0.8**	**-0.8**	**-0.8**
14:00	**PL**	**Current account**	**Jun**	**€m**	**630**	**77**	**1 184**
14:00	**PL**	**Exports**	**Jun**	**€m**	**14 551**	**14 632**	**14 131**
14:00	**PL**	**Imports**	**Jun**	**€m**	**13 700**	**13 673**	**13 185**
14:00	**PL**	**Money supply M3**	**Jul**	**%YoY**	**8.0**	**8.2**	**8.3**
14:30	US	Retail sales	Jul	%MoM	0.5	-	-0.3
14:30	US	Initial jobless claims	week	k	-	-	270
		FRIDAY (14 August)					
10:00	**PL**	**Flash GDP**	**Q2**	**%YoY**	**3.6**	**3.6**	**3.6**
11:00	EZ	HICP	Jul	%YoY	0.2	-	0.2
14:00	**PL**	**Core inflation**	**Jul**	**%YoY**	**0.2**	**0.2**	**0.2**
15:15	US	Industrial output	Jul	%MoM	0.3	-	0.2
16:00	US	Flash Michigan	Aug	pts	93.5	-	93.1

Source: BZ WBK, Reuters, Bloomberg

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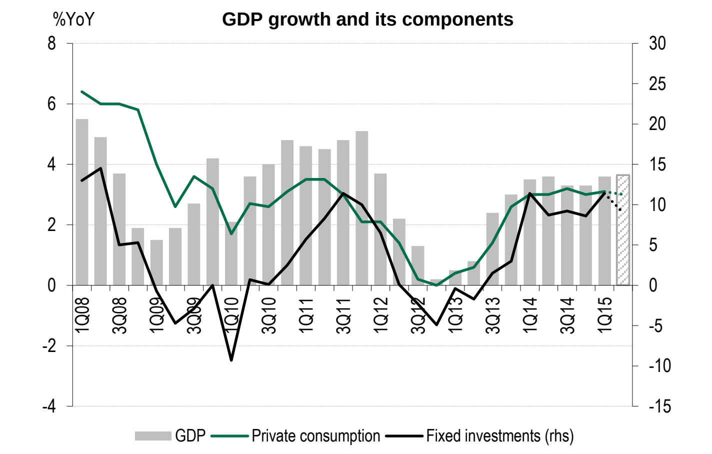
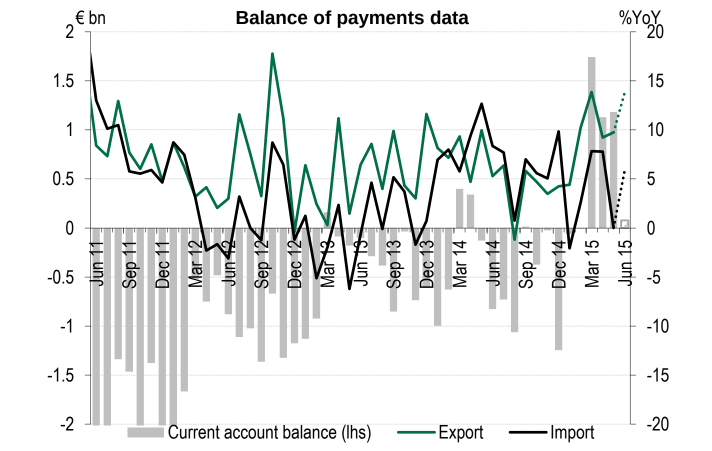
What's hot this week – Q2 GDP, inflation and balance of payments





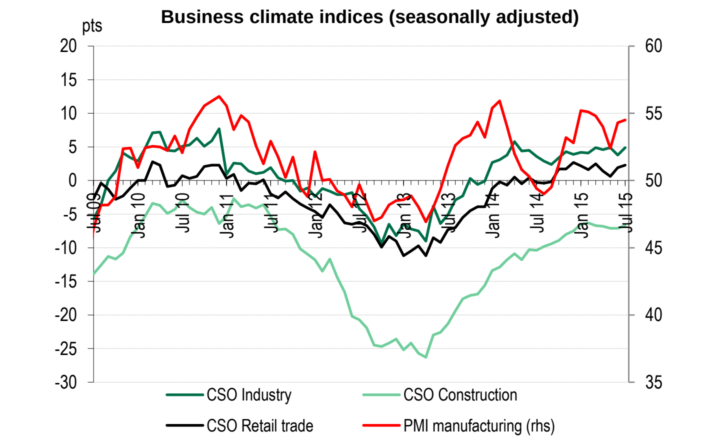
▪ Flash GDP data for Q2 is the key Polish statistic this week. We believe that economic growth was the same as in Q1, i.e. 3.6%, and we are in line with the market consensus (market forecasts range between 3.4% and 3.8%). The statistics office will release a detailed growth breakdown at the end of August, but, in our view, the Q2 growth structure was healthy and similar to Q1, with strong contributions from private consumption, investment and net exports.

▪ CPI and core inflation excluding food and energy prices remained unchanged in July at -0.8%YoY and +0.2%YoY, respectively, in our view. We expect some rebound in food and fuel prices, but other categories are likely to remain subdued. Still, inflation is slowly rising and we expect it to reach 0.5%YoY for CPI and 0.8%YoY for core inflation at year-end.

▪ June's balance of payments data are set to show strong exports and rather weaker imports, so a high trade surplus (at c€950mn, like in May) is very probable. However, low inflows of EU funds will likely cause a big income deficit, so the total current account balance should only show a small surplus. Still, the 12M rolling current account balance is likely to show a surplus for the first time since comparable data are available.

▪ We expect the M3 money supply to grow 8.2%YoY in July, which we believe would confirm trends that we have been seeing over the last months – healthy growth of both deposits and loans.

Last week in the economy – PMI on the rise



▪ The Polish manufacturing PMI Index rose in July to 54.5pts, in line with our forecast and above the market consensus. This was the second month of improvement, with the index now at its highest level since March. The pace of output growth was weaker than in June, but orders rose at the fastest pace in five months. Export orders rose the fastest since February 2014. Employment rose at its fourth fastest pace ever. The prices of finished goods rose for the first time since June 2012, but the increase was only marginal, while production costs rose only slightly. Nevertheless, this could be the first sign of rising price pressures, which would be in line with our forecast of a slow rise in inflation. Overall, this data confirms our expectation of faster GDP growth in 3Q vs. 2Q.

Quote of the week – FX loan restructuring may lead to deterioration of sentiment

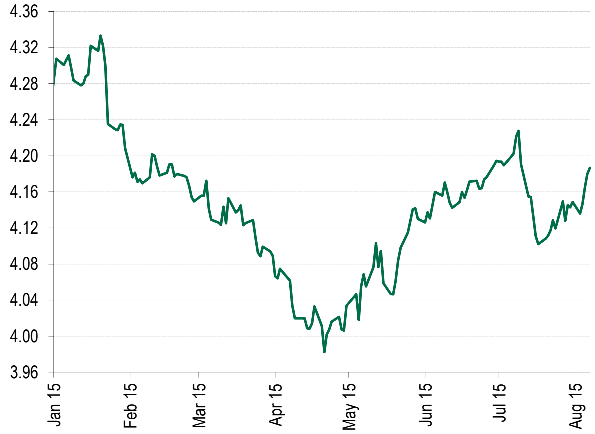
ECB, opinion on a draft law on specific terms of restructuring of home loans denominated in foreign currency, 05.08

The draft law might also have some negative effects if it leads to a deterioration of foreign investor sentiment due to a perceived increase in legal uncertainty and country risk. Consequently, the ECB suggests that the Polish authorities carry out a thorough analysis of the possible effects on the economy of introducing measures having retroactive effect.

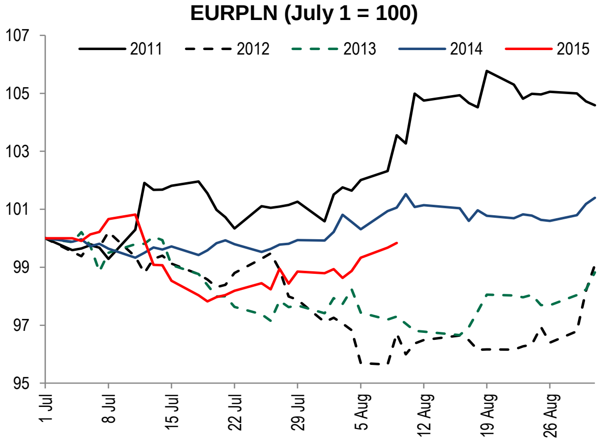
The Sejm's approval of the FX-loan restructuring bill and especially the last-minute amendments increasing the burden on the banking system were one of the main drivers of the Polish market last week. The bill now needs to be approved by the Senate in early September. The PO's senators (PO has a majority in the Senate) have already stated that they will seek to scrap the last-minute changes and return the bill in its more or less original shape to the Sejm for final approval. If this time the PO manages to mobilise its coalition partner PSL to vote with it, the odds of the law returning to its original shape would be relatively high. Then the main uncertainty remaining would be the President's move. The bill (before the amendments) was criticised by the ECB, which pointed out that the law was retroactive, failed to account for the debtors' income, could undermine lending capacity of some institutions and hit foreign investor sentiment. The ECB also assessed that CHF loans did not pose a threat to financial stability. Still, Polish deputies ignores the ECB's opinion.

Foreign exchange market – Zloty hit by US rate hike expectations and Polish politics

EURPLN

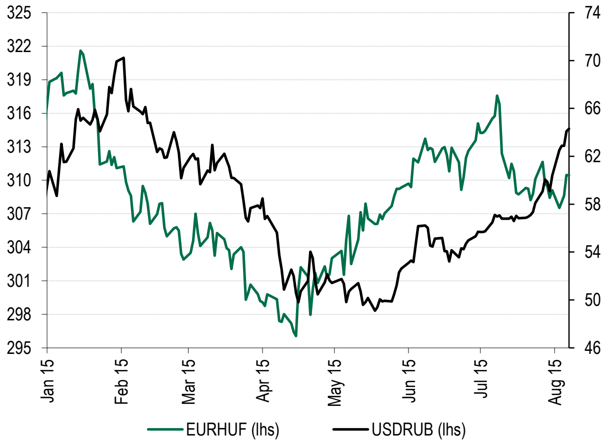


EURPLN (July 1 = 100)



EURUSD

EURHUF and USDRUB



Zloty hit by US rate hike expectations and Polish politics

- The zloty depreciated last week on the back of the hawkish comment of the FOMC's Dennis Lockhart and worries over stability of the Polish banks. This pushed EUR/PLN to nearly 4.20, its highest since the first decade of July. USD/PLN rose above 3.85 but this was only temporary and, at the end of the week, the exchange rate was below the peak from early July. Roughly half of the EM currencies lost vs. the euro last week and the zloty was in the middle of this group with a c1% loss. As regards the dollar, nearly all the EM currencies depreciated against it and the zloty was the 6th weakest performer with a c1.5% loss.
- As the second chart shows, the July-August period for the past four years lacks a firm pattern for EUR/PLN. However, the Polish currency weakened in August in the last four years and so far this is the case this time around as well. Plenty of Polish data are on the agenda this week. Our forecasts suggest that the releases could be rather neutral (retail sales, GDP, industrial output) or slightly negative (C/A) for the zloty. The recent voting on FX loans in the Polish parliament has created additional pressure for the currency and this factor is likely to limit the scope for any sustained and significant drop in EUR/PLN as well.
- We think the exchange rate will stay above its previous week's low of c4.10 in the coming days.

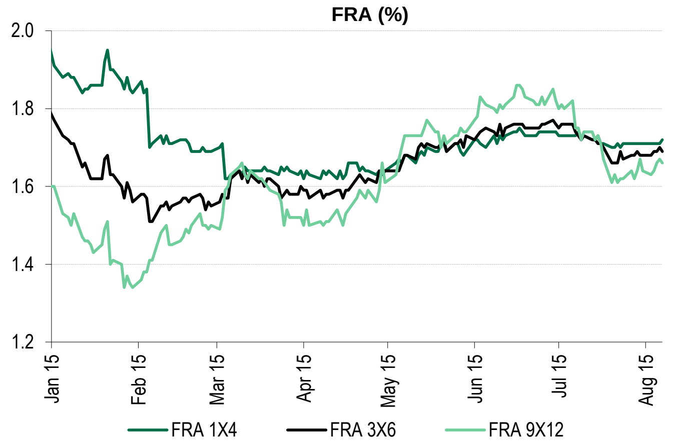
Very stable EUR/USD

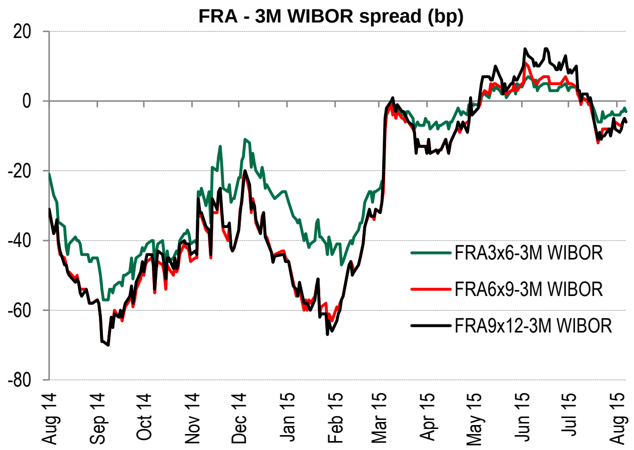
- Since the beginning of the past week, the EUR/USD volatility (measured as a weekly high-low spread) was noticeably lower than before. Actually, even after the U.S. non-farm payrolls data trigger sharp moves in the market, volatility measured as such was the lowest so far this year at the end of the European session as the rate was hovering within the c1.085-1.10 range.
- At the end of the past week EURUSD was just above the local low at c1.08. The US data nonfarm payrolls was interpreted as rather decent and so the exchange rate could be trying the break this support in the coming days. There are some US macro releases on the agenda also this week and so they could decide whether any attempts to break through 1.08 will be successful.

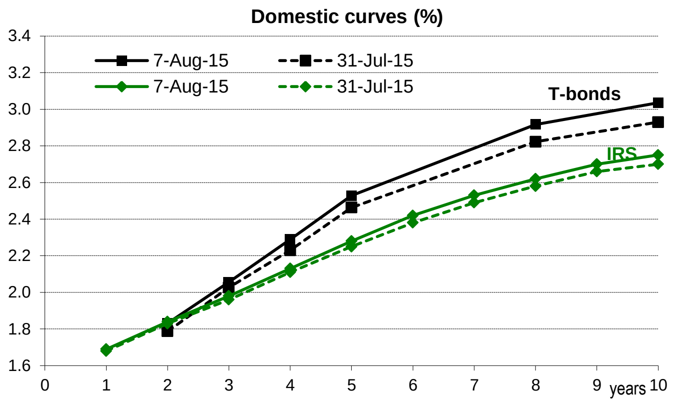
CZK stable, HUF and RUB weaker

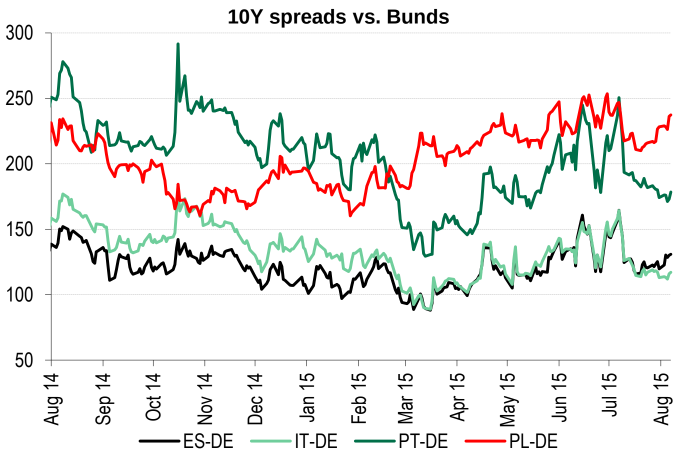
- The Czech central bank left interest rates unchanged. Its governor said that there was no deep discussion on further rate cuts or on lifting of the EURCZK floor. The exchange rate was testing 27.0 on this comment, but, in general, the situation did not change significantly.
- At the same time, the ruble continued to underperform in the EM universe. USDRUB rose for the 7th consecutive week and broke 65. The exchange rate surged to its highest level since mid-February on the back of further falls in the global oil prices.
- The forint also depreciated last week. EUR/HUF rose above 311 from c306, but stayed comfortably below the local peak at 318.
- Czech and Hungarian CPI data are due this week. The most recent signals from the Czech and the Hungarian central banks were rather straightforward (MNB ended the easing cycle, CNB did not discuss more cuts) and so the inflation numbers are unlikely to be the key drivers for the koruna and the forint this week.

Interest rate market – Curve steepener trade still in place









Yields and IRS rates at their highest levels since mid-July

- Money market rates were roughly stable (WIBOR 9M rose 1bp in weekly terms) over the past week. At the same time, FRAs climbed 1-3bp across the curve, following the IRS market. Investors upheld their expectations that the MPC could start normalising its monetary policy at the turn of 2016-2017.
- Contrary to our expectations, Poland's bonds and IRS continued to weaken in the first week of August. This was caused by the risk that the Fed could tighten its policy in September and foreign investor fears about the stability of Poland's banking system. As a result, the 10Y benchmark yield and the IRS 10Y reached their highest levels since mid-July. The US non-farm payrolls were roughly in line with expectation, and figures were high enough to keep the Fed on course for an interest rate hike in September. Market reaction was muted, with Poland's yield of 10Y benchmark falling slightly below 3.05% at the end of the week.
- Last week investors continued the curve steepener trade in line with our expectations. Both the T-bond and IRS curves steepened considerably as the long-end of the curves lost the most. Domestic bonds did not benefit from strengthening on the core and peripheral debt markets and, as a consequence, the spread over Bunds widened significantly, reaching nearly 240bp for the 10Y sector, the highest since the beginning of July.
- Poland's Ministry of Finance successfully launched long-matured T-bonds at its August auction, selling the 10Y DS0725 benchmark and new WZ0126 floaters worth cPLN4.65bn in total (both at the regular and top-up auctions). The DS0725 yield stood at 3.076%, roughly the same as on the secondary market. The recorded demand amounted to over PLN6.7bn and we believe that domestic investors preferred the WZ0126 (floater), while the non-residents bid for the fixed-rate DS0725. According to our estimates, 84% of this year's gross borrowing needs are now covered after the auction.

Domestic macro data rather neutral for the market

- We stick to our forecast of the WIBOR rates continuing to move in a horizontal trend in the coming months and to rise gradually in the medium to long term. Volatility on the FRA market should remain high, with rates strongly dependent on the IRS market.
- The first set of domestic economic data is due this week, including inflation CPI for July and the flash 2Q15 GDP growth. Our forecasts of the inflation rate and GDP growth for 2Q 15 are similar to the market consensus (-0.8%YoY and 3.6%YoY, respectively), while our forecast of the CA balance for June is less optimistic than market expectations. All in all, these data are likely to be a mixed bag and will probably not change the economic outlook substantially. Therefore, the front-end of the curves should remain roughly stable, oscillating near their current levels.
- The belly and the long-end of the curves could be more vulnerable to global sentiment changes. Macroeconomic data for Europe (including flash 2Q15 GDP) should confirm that the euro zone's economy is gradually improving. This, together with expectations for an earlier rate hikes in the US, could increase yields on the core markets and negatively affect Poland's T-bond and IRS markets in the upcoming week. Consequently, the curve steepener remains in place.

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