Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

17 – 23 August 2015

China was last week's main topic. It devalued its currency, bringing the USDCNY exchange rate to its highest since 2011 and fuelling investor worries that this country may be in dire straits. Some market players also believe that this may make the FOMC members more hesitant about raising interest rates in September, but this is not our baseline scenario. Greece and its creditors struck a deal, so Greece is likely to disappear from the concern area, at least for some time. GDP growth in the euro zone in Q2 confirmed a further recovery, lowering investor worries about the euro zone's economy. Macro data for Poland were mostly disappointing, with lower-than-expected GDP in Q2 and higher C/A deficit in June, but lower deflation in July. In general, the data supported market expectations for an interest rate cut in Poland in 2016. This is not our baseline scenario. In Poland the heatwave was also an important issue, as drying up water supplies caused shutdowns in power plants and power shortages, affecting the Polish industry (although probably at a relatively low scale).

This week is not rich in data releases abroad. U.S. statistics offices will be releasing housing market data and weekly jobless claims. These are likely to affect expectations about the timing of the interest rate hike in the U.S. Moreover, FOMC minutes from the July meeting are due for release. In Poland we will see a bunch of important data for July – industrial and construction output, retail sales, labour market data. We expect a slightly slower note, mainly due to statistical issues, but in general these data will likely show a strong underlying trend and point to a good economic outlook in Q3.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 August)					
		No important data releases					
		TUESDAY (18 August)					
14:00	**PL**	**Wages in corporate sector**	**Jul**	**%YoY**	**3.4**	**3.3**	**2.5**
14:00	**PL**	**Employment in corporate sector**	**Jul**	**%YoY**	**0.9**	**0.9**	**0.9**
14:30	US	House starts	Jul	k	1190	-	1174
14:30	US	Building permits	Jul	k	1230	-	1337
		WEDNESDAY (19 August)					
14:00	**PL**	**Industrial output**	**Jul**	**%YoY**	**4.7**	**4.3**	**7.6**
14:00	**PL**	**Construction and assembly output**	**Jul**	**%YoY**	**0.0**	**-3.4**	**-2.5**
14:00	**PL**	**Real retail sales**	**Jul**	**%YoY**	**5.3**	**5.4**	**6.6**
14:00	**PL**	**PPI**	**Jul**	**%YoY**	**-1.6**	**-1.9**	**-1.6**
14:30	US	CPI	Jul	%MoM	0.2	-	0.3
20:00	US	FOMC minutes					
		THURSDAY (20 August)					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	272	-	274
16:00	US	Home sales	Jul	m	5.43	-	5.49
16:00	US	Philly Fed index	Aug	pts	6.8	-	5.7
		FRIDAY (21 August)					
		No important data releases					

Source: BZ WBK, Reuters, Bloomberg

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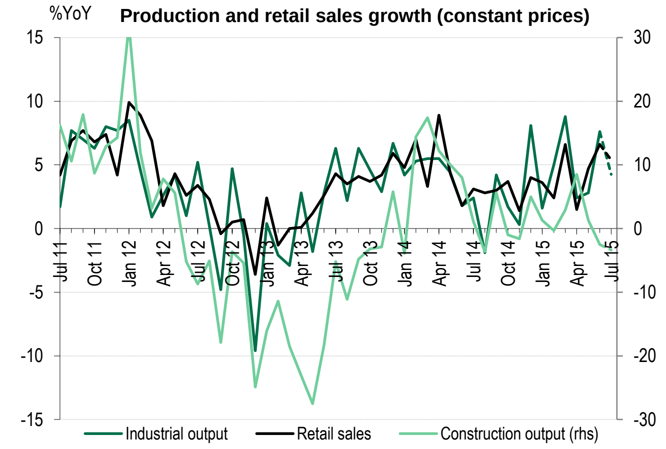
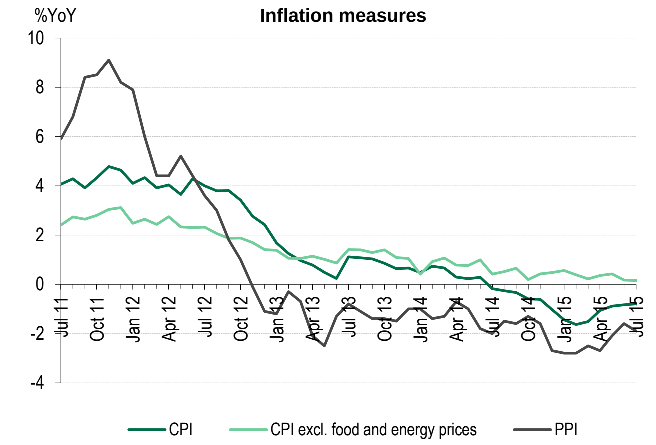
What's hot this week – Output, sales and labour market statistics

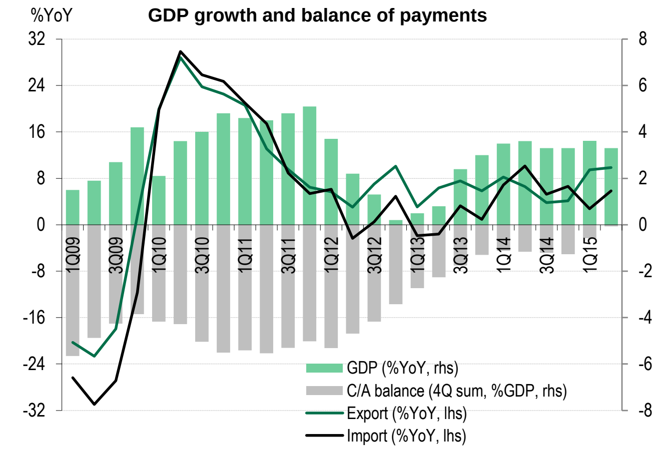


- Important data on economic activity at the start of Q3 are due this week: industrial and construction output as well as retail sales for July. We expect all of them to decelerate versus June. In case of industrial and construction output this will be due to a neutral working-day effect (vs. June's positive effect). Still, the underlying trend will remain robust. As regards retail sales, we expect them to grow more slowly as June showed exceptionally high car sales and we also see a somewhat weaker number in this category in July.
- Data on wages are likely to show an acceleration versus June as last month's result was undermined by earlier bonus payments in the mining sectors. Employment growth is likely to stay unchanged, in our view.
- Overall, the data should confirm the recovery going forward and offset the market effect of the lower-than-expected GDP figure.

Last week in the economy – Surprises in the domestic data



- CPI inflation amounted to -0.7%YoY, which was slightly above expectations, both our and market's estimates. The key factors responsible for the rise were prices in healthcare and communication categories. These factors drove core inflation excluding food and energy prices up to 0.4%YoY.
- An additional downside factor for inflation is connected with the decision by the energy regulator (URE) to lower gas prices for retail clients by 3.1%-4.5%. The new tariffs will be introduced no sooner than 14 days and no later than 45 days from the URE approval i.e. will be seen in the CPI data for September, October at the latest. We assume half of the effect in each month. The overall impact on CPI should be 0.1pp, 50% more than we had previously expected. Despite this, we do not change our forecasts that the 12M inflation will likely sit around zero in November and will reach c.0.5%YoY in December.



- The current account balance showed a deficit of €849m against expectations for a surplus (€353m according to the consensus and our forecast of 77m). This was driven by a significant rise in imports (by 10%YoY), which may point to strong domestic demand. It is worth noticing, however, that imports in the previous month were relatively weak, so some shifts could have taken place. Exports were slightly below the consensus forecast, but showed strong growth of above 10%YoY.
- Polish GDP growth in Q2 reached 3.3%YoY, considerably below expectations at 3.6%YoY and slowing down from 3.6%YoY seen in Q1. A detailed breakdown of growth will be released in two weeks' time. Still, the seasonally adjusted numbers were quite strong at 0.9%QoQ and 3.6%YoY (vs. 1.0%QoQ and 3.4%YoY in Q1). Poland's quarterly seasonally adjusted GDP growth has been in a range of 0.7-1.0% for more than two years now.

Quote of the week – Banks could shoulder 2/3 of FX loan restructuring costs

Genowefa Tokarska, PSL deputy, 12.08.2015, Bloomberg

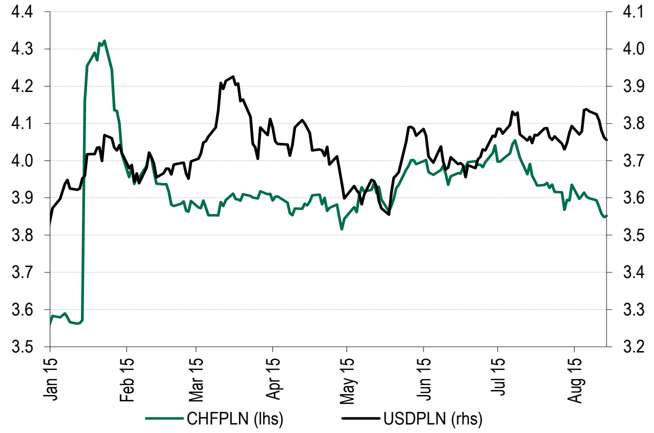
The banks could shoulder two thirds of that potential loss [of FX loan restructuring]. My party is unlikely to support the previous version of the bill.

The bill on FX mortgage restructuring has already left the Sejm (lower chamber), but deputies still have many ideas of how to change it. Let us remember that the bill is currently in the Senate (upper chamber), which may introduce its own amendments, which will later have to be confirmed by the Sejm. PO (which has a majority in the Senate) wants to reject the amendments (including the one that puts 90% of the costs onto banks), but needs the support of PSL in the Sejm to be able to do so. It seems that PSL will back lower costs for banks (they proposed 67%), but not at the previous 50% level. SLD (opposition) wants to widen the restructuring eligibility also for the low-income debtors. The Polish banks' association proposed to limit the eligibility criteria only to the low-income debtors.

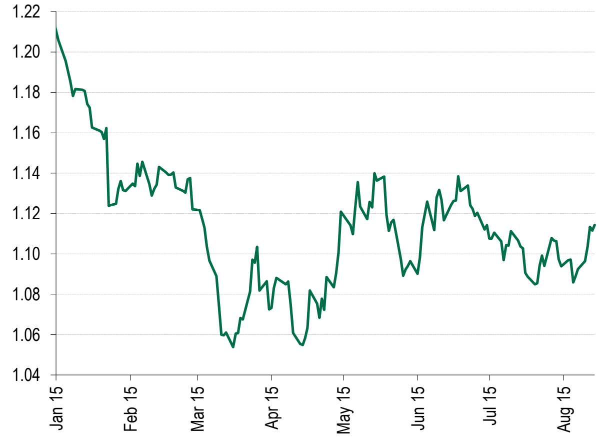
Foreign exchange market – Zloty and CEE currencies affected by global factors

EURPLN

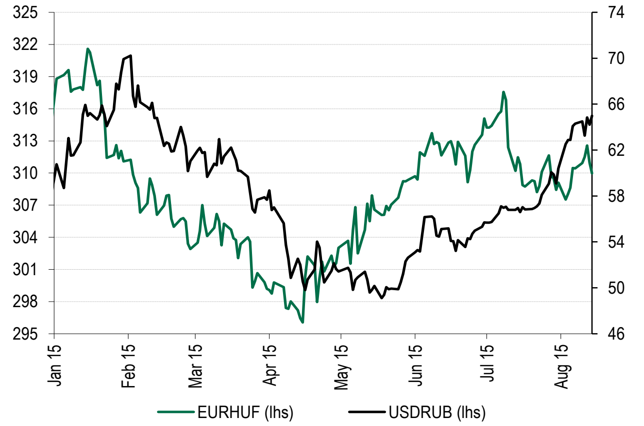
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



Zloty hit by fears about global growth

- The domestic currency lost ground against the euro in the first half of last week. The zloty weakened sharply to above 4.21 per euro on the back of the deteriorating global market sentiment that followed the unexpected Chinese central bank decision to devaluate its currency. However, it was only short-lived and, in the second half of the week, the zloty trimmed nearly all its earlier losses despite the disappointing domestic data (lower 2Q15 GDP growth, higher C/A gap). At the end of the week, EURPLN stayed slightly below 4.185.
- The zloty gained considerably against other currencies, in particular the U.S. dollar (by 2% on a weekly basis). This was caused by the sharp rise in the EURUSD. USDPLN fell towards 3.74, its lowest level since the end of July.
- Plenty of domestic data will be released this week. Our forecasts (including industrial output and retail sales growth for July) are very similar to the market consensus. In our opinion, only weaker releases could trigger a significant negative market reaction as they might fuel renewed worries about the strength and sustainability of the recovery of Poland's economy. Investors will also focus on global events, mainly the U.S. macro data and minutes from July's FOMC meeting that are due later this week. In our view, the start of monetary tightening by the Fed in September is still likely. Therefore, any confirmation of these signals could have a negative effect on the zloty. However, the technical outlook for EURPLN did not change significantly over the past week. The strong resistance level for the rate is still at around 4.24 (local maximum from mid-July), while the important support level is near 4.12.

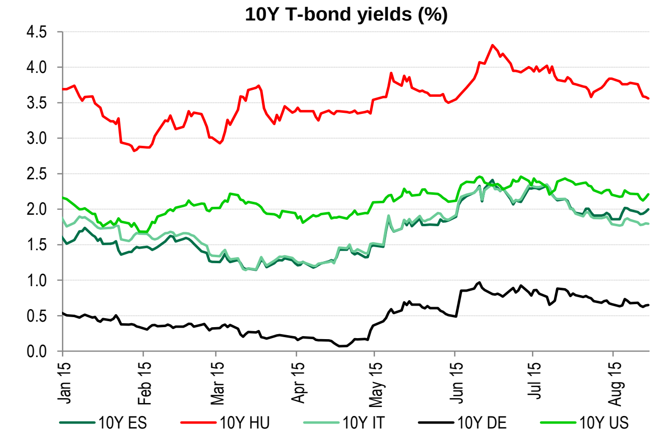
U.S. dollar under pressure from yuan devaluation

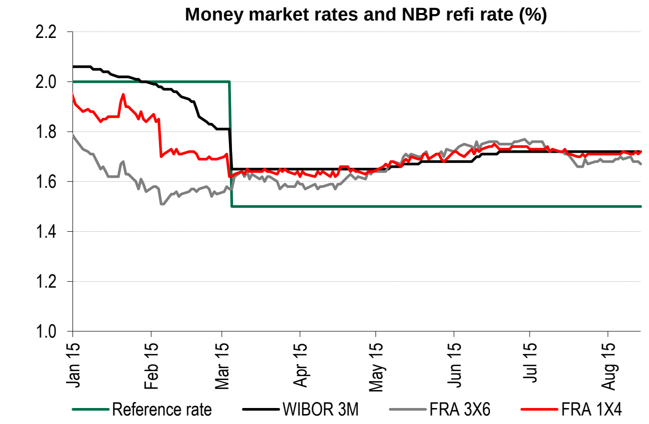
- Last week the U.S. dollar was under pressure from the Chinese central bank's decision to devaluate its currency and to change the reference rate calculation. The risk of weaker growth in China and globally weighed on the dollar because these factors could delay the Fed's rate hike prospects, investors believe. On the other hand, the euro benefited from news that Greece and its creditors reached an agreement on the terms for an €85bn bailout. As a consequence, EURUSD broke the local peak from the end of July at 1.113, reaching 1.12, the highest level since the first week of July. However, some investors decided to take profit at the end of the week, though the rate stayed around 1.115.
- This week investors will continue to focus on China and on whether changes to the CNY regime and concern over Chinese growth might cause the Fed to delay its hikes. In our view, next month's rate hike is still on the cards and we think that minutes from July's FOMC meeting should confirm this scenario. Therefore, profit-taking on EURUSD is likely to follow a week of euro strengthening.

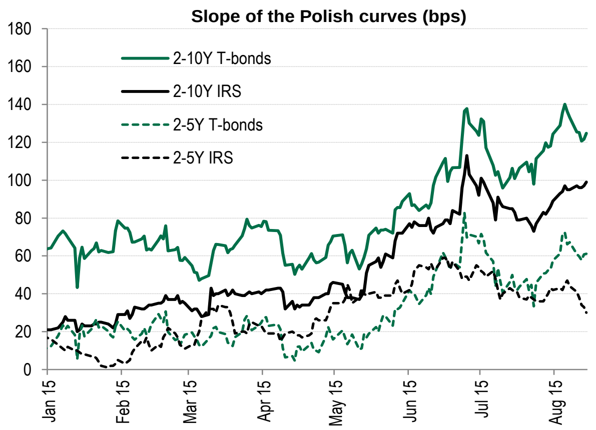
Mixed picture among CEE currencies

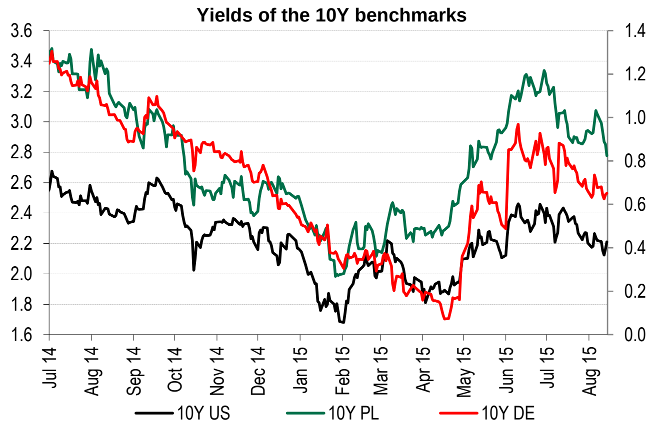
- HUF, CZK and RUB behaved differently last week. The Hungarian forint trimmed nearly all its losses against the euro, but EURHUF returned above 310 on weaker-than-expected 2Q15 GDP growth. At the same time, the Czech koruna stayed within a very narrow gap from the reference rate of 27.00, while the Russian ruble lost significantly vs. USD, with USDRUB growing to nearly 65 due to falling oil prices.
- This week global factors will also be crucial for the CEE currencies amid an absence of important events in their countries. We believe EURCZK to be well-anchored at slightly above 27.01, with EURHUF and USDRUB likely more vulnerable to news from the U.S. economy.

Interest rate market – Bullish mood after weaker GDP









Yields and IRS rates shift down

- Polish IRS and bond curves moved substantially lower in the past week. Worries over global economic growth after the Chinese central bank's decision aimed, among others, at depreciating the yuan, were the main driver of this move. Investors also believe that the falling commodity prices could reduce the likelihood of the Fed rate hike in September, leading to a worldwide strengthening of bonds. The lower-than-expected flash 2Q15 GDP growth additionally supported the decline trend in both yields and the IRS rates. The Polish market benefited from the aforementioned factors and, as a consequence, the IRS curve moved 8-27bp and the bond curve 8-26bp down on a weekly basis. The 10Y benchmark yield fell temporarily to 2.75%, the lowest since May, but ending the week near 2.78%.
- Both Polish curves continued to flatten: the 2-10 and 2-5 spreads narrowed considerably, tracking the global trend. What is more, the spread over Bunds also tightened, reflecting a lower risk aversion. It fell to 213bp, for the first time since mid-July.
- In case of the 1-12M WIBOR rates, only the 6M rate moved, rising 1bp. The past week, however, strengthened the FRA down trend. Consequently, in the market's view, the first rate hike in Poland has been postponed further. Already in the previous week FRA was pricing in a 25bp hike in 18 months. Now, it gives 90% for a hike in 21 months. At the same time, the market sees c 50% odds for a restart of the easing cycle by the MPC in the next 9 months following the weaker-than-expected flash reading of GDP growth in 2Q15.
- In mid-July we wrote that the Polish 10Y asset swap spread could narrow as worries over a possible Grexit faded. The following weeks saw a drop to nearly our target at 20bp, but this move proved temporary as the spread is now back near its resistance at c33bp.

Outcomes from the US can trigger profit taking

- Polish 5Y and 10Y yields ended the week close to their local lows from May, at 2.29% and 2.78%, respectively. Plenty of meaningful events are due this week. Our forecasts of the Polish macro data are close to the market consensus and so industrial output and retail sales data are unlikely to trigger a sharp market reaction.
- In our view, as in the previous weeks, investors will be much more sensitive to the U.S. numbers and the FOMC minutes. Worries over Chinese economic growth spurred last week have led to a drop in odds for the Fed rate hike in September. Important U.S. macro releases may also heavily influence the outlook for the Fed's monetary policy and trigger substantial volatility in the global (and Polish) FI market. Limited liquidity may also contribute to substantial swings in the market. If the U.S. data surprise to the upside, profit-taking from the recent strengthening in the bond market is likely. This, in our view, could lead to a steepening of the Polish IRS and bond curves as the long ends are likely to underperform.

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