

WEEKLY ECONOMIC UPDATE

26 January – 1 February 2015

The European Central Bank did not disappoint this time and extended its asset purchasing programme, which now will combine monthly purchases of public and private sector securities for up to €60bn a month as from March. The much-awaited decision triggered sharp euro depreciation and strengthening of Polish zloty and bonds. At the start of this week the market attention will probably switch to situation in Greece after the general election held during the weekend. Investors will scrutinize information whether the radical Syriza party wins enough votes to create majority government and what it may imply for the Greece's economy and for euro zone integrity. Later on the focus will be on the FOMC meeting. After recent US data and dollar strengthening market expectations regarding the timing of possible first rate hike in the USA have moved away in time. If the tone of the Fed statement becomes softer than previously, the euro and the zloty may get some support.

Recent data from Polish economy surprised to the upside, showing decent production growth and continuing labour market recovery at the year-end. It seems quite likely that the next figures, to be released this week, will confirm quite optimistic picture. Deputy president of the statistical office hinted recently that retail sales growth in December was much higher than in previous months, while GDP growth in the whole 2014 should be close to this recorded in the first three quarters. It suggests that we should be prepared for quite strong readings on Tuesday. Our forecasts were at 1.5%YoY for retail sales and 3.3% for 2014 GDP growth, however after such comments we see upward risk in both cases. Consumer sentiment indicators maintained upward trend in January, confirming that Polish households are still willing to spend money amid rising income.

We are pleased to inform that in the Puls Biznesu daily's competition of FX forecasts we have ranked 3rd in overall classification. We were the best performer in case of EURPLN, third in CHFPLN and at the fifth place as regards USDPLN.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (26 January)							
10:00	DE	Ifo index	Jan	pts	106.2	-	105.5
TUESDAY (27 January)							
10:00	PL	GDP	2014	%YoY	3.3	3.3	1.6
10:00	PL	Retail sales	Dec	%YoY	2.0	1.2	-0.2
10:00	PL	Unemployment rate	Dec	%	11.7	11.5	11.4
14:00	HU	Central bank decision		%	2.1	-	2.1
14:30	US	Durable goods orders	Dec	%MoM	0.6	-	-0.9
16:00	US	New home sales	Dec	k	450	-	438
16:00	US	Consumer confidence index	Jan	pts	95.0	-	92.6
WEDNESDAY (28 January)							
20:00	US	FOMC decision					
THURSDAY (29 January)							
14:30	US	Initial jobless claims	week	k	-	-	307
16:00	US	Pending home sales	Dec	%MoM	0.5	-	0.8
FRIDAY (30 January)							
11:00	EZ	Flash HICP	Jan	%YoY	-0.5	-	-0.2
14:00	PL	Inflation expectations	Jan	%YoY	-	-	0.2
14:30	US	Advance GDP	Q4	%QoQ	3.3	-	5.0
16:00	US	Michigan index	Jan	pts	98.2	-	98.2

Source: BZ WBK, Reuters, Bloomberg

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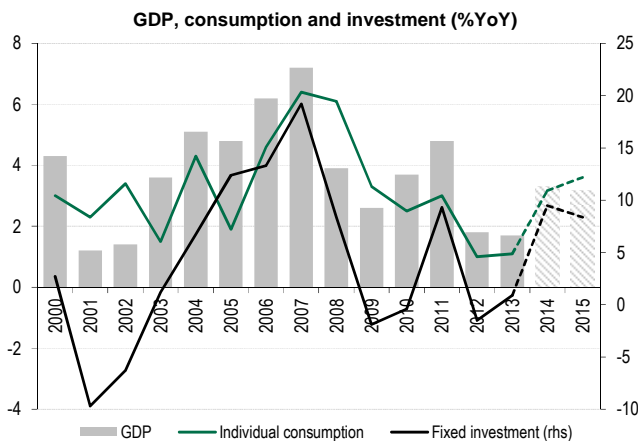
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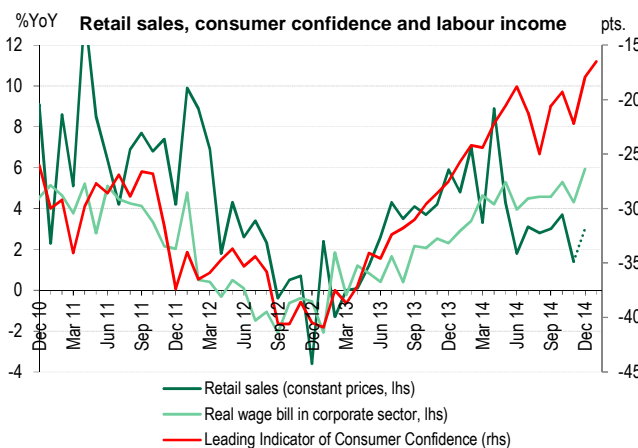
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What's hot this week – GDP and retail sales data should be positive

■ We have lifted our forecast of retail sales growth for December after news about surge in new car sales (almost 20%MoM), and now we expect a moderate rebound of sales growth, after quite poor result in November. The risk is to the upside, as according to CSO deputy head retail sales growth should be “much higher” than in recent months.

■ Consumer demand is strongly supported by labour market recovery, which should be confirmed by unemployment rate, reaching 11.5% in December. This would be the smallest seasonal increase at the year-end for 7 years.

■ Flash GDP estimate for 2014 will show, in our view, 3.3% growth, implying that growth in the last quarter remained above 3%. Domestic demand was probably the key driver of growth last year, rising nearly 5%, with private consumption up 3.2% and fixed investment higher by almost 10%. Hint from stat office suggests again a risk to the upside.

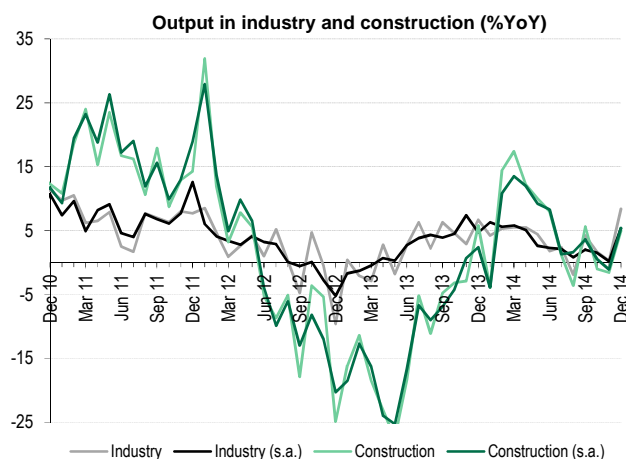
Last week in the economy – Strong production and employment growth in December

■ Data on wages and employment for December surprised positively, showing growth by 3.7%YoY and 1.1%YoY, correspondingly. We find it especially optimistic that Polish companies keep hiring, which shows that they did not get scared of the uncertain situation abroad and probably keep investing. At the same time, wage growth remains decent, which – amid deepening deflation caused by lower food and fuel prices – implies that households’ purchasing power is rising quickly. In December the real wage bill soared nearly 6%YoY, most since late 2008. It would allow, in our view, to maintain private consumption growth at quite high level in the nearest quarters, even despite potential deterioration of moods due to surge in CHF exchange rate.

■ Industrial output rose 8.4%YoY in December, more than expected, while construction and assembly output increased by 5.0%YoY. Acceleration of production growth was partly due to positive working day effect and statistical base effect. Still, it was astonishing result, implying upward risk to our 4Q14 GDP forecast. We do not expect such a high growth rate to maintain in the upcoming months, but a strong revival in export-oriented sectors is a positive signal (let us remind that foreign trade data for last months showed an improvement of export growth to some EU countries).

■ PPI inflation amounted to -2.5%YoY in December, below expectations, which was mostly due to a strong decline in oil price in the international markets

■ Neither labour market data nor production figures add to list of arguments supporting further monetary easing in Poland. However, we think it is deepening deflation that will tip the balance in favour of additional rate cut, as CPI growth may approach -1.5%YoY in 1Q15. Exchange rate fluctuations due to recent CHF appreciation may delay the moment of interest rate cut, so we think that the decision may take place in March.

**Quote of the week – FX volatility may be argument to postpone rate cut**

Marek Belka, NBP governor, 21.01.2015, Puls Biznesu

I still see room for cuts, but in such situation maybe we should wait a little longer.

Elżbieta Chojna-Duch, MPC member, 21.01.2015, Reuters

This situation (in FX market) may be argument that may stop us from cutting rates.

Jerzy Hausner, MPC member, 21.01.2015, PAP

If we are to cut rates, then better sooner than later, which does not mean in February. Surely not at the moment of serious turbulences.

Andrzej Bratkowski, MPC member, 21.01.2015, TVN24 BiS

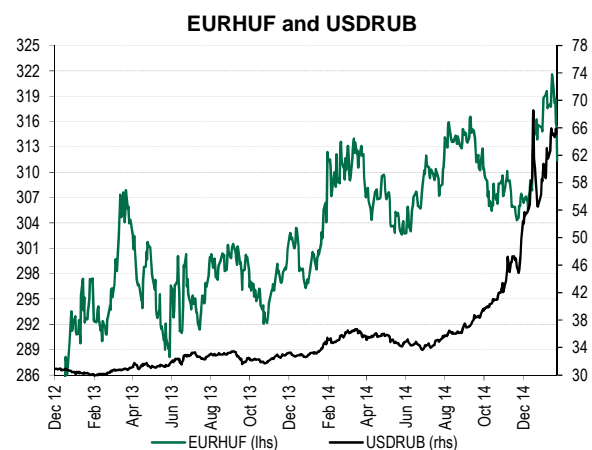
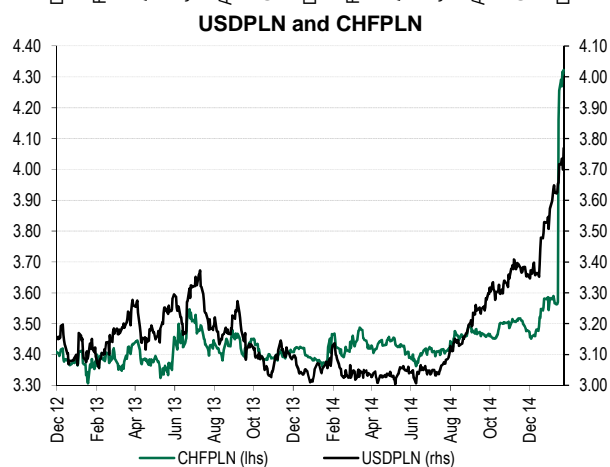
We have to be more careful now. If nothing “weird” happens, we could lower rates by 25bp at next meeting, but I doubt if I will find majority for that.

Jerzy Osiatyński, MPC member, 22.01.2015, PAP

I don't think we should wait. Earlier I mentioned there was room for 5-75bp cut. I don't say it should be done at once. But what happened in Switzerland is a signal we should rather act sooner than later.

Recent events have clearly postponed prospects for interest rate cuts in Poland. Elevated volatility in the FX market as well as good macroeconomic data (industrial output, wages and employment, and most probably retail sales and GDP) make cut in February rather doubtful, as only Osiatyński and Bratkowski seem convinced to cut rates as soon as possible while other MPC members prefer to wait until the situation in the financial markets stabilises. Even Bratkowski has become a bit more cautious, mentioning only 25bp cut in February, while earlier he was opting for a 100bp in one move. We think rate cut at the nearest meeting would be possible only if next economic data clearly disappoint and the zloty appreciates significantly.

Foreign exchange market – ECB did not disappoint, now time for the Fed



Zloty gains vs. euro, loses vs. dollar, stabilizes vs. franc

Central banks continued to play main role in the Polish FX market last week. After the significant weakening triggered by the SNB decision, the zloty more than recovered vs. the euro after the extension of ECB's assets purchase program. EURPLN dropped below 4.22 from 4.32 with the biggest part of the move seen in the hours just after the Draghi's press conference. At the same time, the domestic currency failed to gain vs. the Swiss franc (as EURCHF decreased) and lost vs. the dollar – CHFPLN remained close to 4.3, while USDPLN surged temporarily above 3.78 from 3.68.

This week will be already third in a row when the investors' attention is likely to focus on signals from the central banks as the US FOMC announces its decision on Wednesday. The last statement was perceived as slightly more hawkish than the previous ones. However, since then numerous central banks in the world have cut their interest rates (Denmark, Canada, Switzerland, Turkey, India, Peru) or implemented other measures aimed at monetary policy easing (ECB). On top of that, the dollar strengthened sharply versus euro. Those factors may generate some pressure on the Fed not to fuel further market expectations for looming rate hikes or even to make the statements' tone slightly less hawkish.

We think that the last ECB decision will continue to support the zloty in the coming months. The EURPLN down trend should be also supported by the recent decent Polish macro data. Should the FOMC sound less hawkish than in the past month, the pace of the zloty's appreciation could even gain pace. 4-22-4.24 is an important support area to watch for EURPLN.

EURUSD lowest since September 2003

The ECB delivered even more than the market had been expecting and this pushed EURUSD further down to nearly 1.11 from above 1.15 at the week opening. The exchange rate reached its lowest level since September 2003. EURCHF also dropped on weekly basis, to 0.98 from 1.02. Although demand for low risk assets clearly faded after the ECB decision, this was not reflected in the Swiss franc and correlation between EURCHF and EURUSD proved stronger.

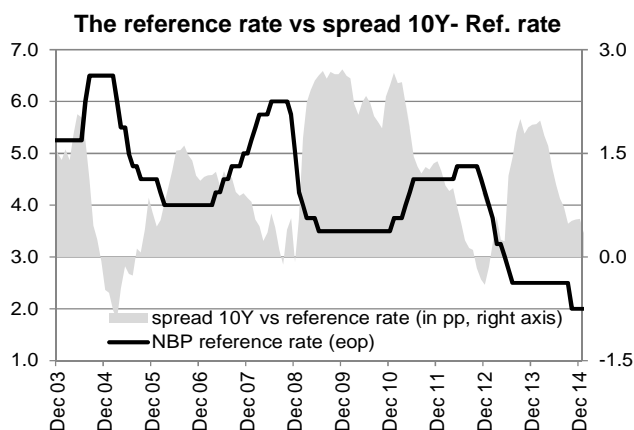
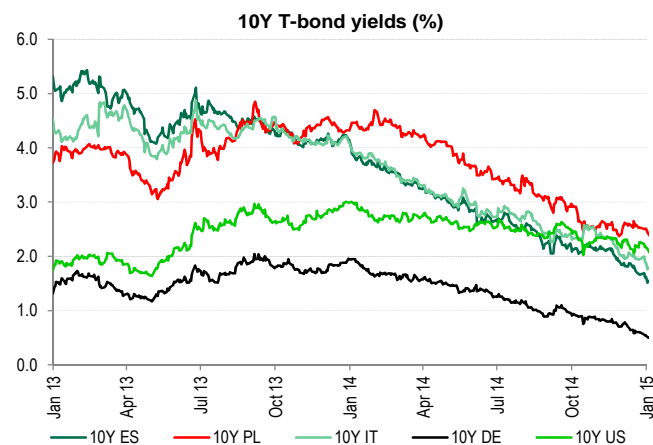
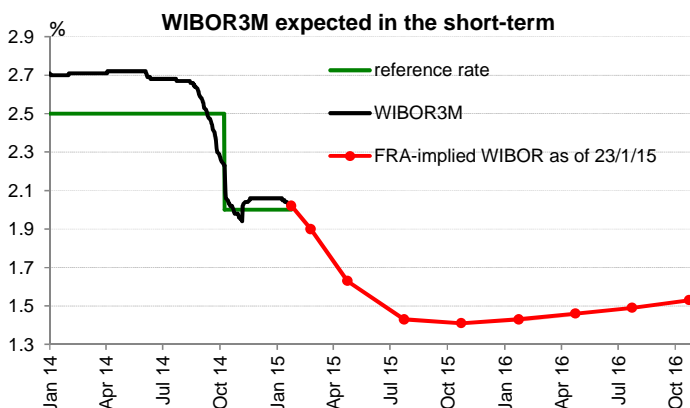
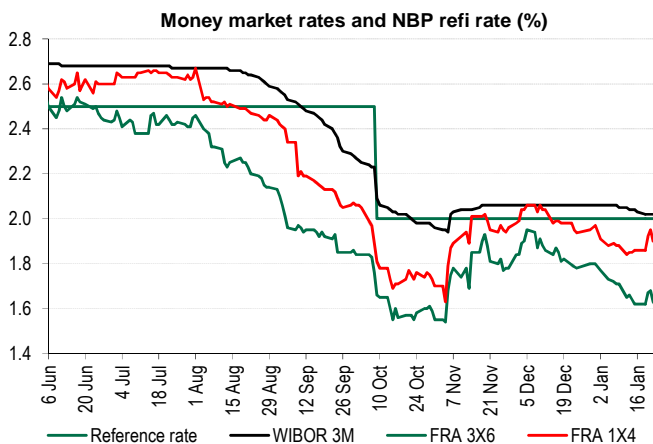
The scale of planned ECB purchases surprised investors and so there was no up correction in EURUSD as the "buy the rumour sell the fact" strategy would suggest. The outlook for the euro is gloomy and it seems that only a less hawkish tone of the FOMC statement could give it a bit of relief. Syriza victory in the Greek parliamentary elections may also limit the room for a EURUSD rebound.

Forint also appreciates on the ECB

EURHUF recorded biggest weekly drop since June 2012 in reaction mainly thanks to the ECB decision – the exchange rate plunged to nearly 310 (lowest since mid-December) from 320. At the same time, the ruble remained roughly stable vs. the dollar at around 65.

The Hungarian central bank announces decision on rates this week. Recent inflation data surprised to the downside and this fuelled speculation that rates could be cut in the nearest future. Market expects no change this week and if this proves correct, then the statement will be carefully analysed for any clues on any possible changes in rates in the future.

Interest rate market – Domestic assets reach fresh record lows after ECB



Market still expects substantial rate cuts

- Money market rates have continued gradual decline despite mixed statements from the MPC members and decent macro data releases. WIBOR rates (1M, 3M, 6M and 9M) declined by 1bp over the past week and curve continued to flatten. Changes in FRAs were more substantial, in particular after the ECB's decision. However, in weekly terms rates fell by 2-6bps.
- The market is currently pricing-in more than one rate cut of 25bps in the next three months and c75bps in total monetary easing in the nearest 6-9 months, which in our view is excessive. Moreover, investors are expecting that after those cuts rates will remain roughly unchanged for quite long (FRA21x24 at 1.53%).
- In our view, money market rates should stabilise near current level or even slightly lower as expectations for further monetary adjustment are still present despite decent macro data. FRAs might be more sensitive to mood on IRS market.

Bonds and IRS rally after ECB

- Yields and IRS rates, in particular on the long end of curves slightly increased in the first part of the week as domestic macro data releases surprised to the upside. Waiting for the ECB's decision debt market was quite stable. The surprisingly large expansion of the ECB asset purchase programme had very positive impact on Polish bonds and IRS. Yields and IRS rates plunged significantly (following rally on core and peripheral debt markets in euro zone), reaching fresh record lows across the curves. Yield of 10y benchmark fell below 2.10%.
- The belly and long end of the curves benefited the most after the ECB's announcement. Consequently, 2-10Y spread narrowed towards 50bps for T-bonds (the lowest level since 2013) and to 25bps for IRS.
- Poland's Ministry of Finance successfully launched a new series of 2Y and 5Y T-bonds (OK0717 and PS0420) despite gradual worsening of market mood just before the auction due to ECB's uncertainty. The Ministry sold OK0717 and PS0420 worth PLN7bn with yields at 1.734% and 1.978%, respectively. It is worth noting that it accepted nearly all offers (93% of recorded demand) for OK0717. We estimate that after January's auctions the Ministry of Finance covered 39% of the 2015 gross borrowing requirements.

Will Fed's decision influence the trend?

- We think that Poland's assets might benefit further from the expectations of a significant inflow of cash into the Eurozone market. Sound Polish macro data (expectations for improvement in retail sales in December, suggestions on stronger GDP growth in 2014) could weigh on the Polish bonds, but, in our view, this will be not enough to resist the dovish pressure from the ECB. We think that only a noticeable correction in the core debt markets could push Polish IRS/yields significantly up in the coming weeks. The key question is whether the FOMC decision (on 28 January) will bring such impulse.
- Recent changes in yield of 10Y benchmark caused narrowing spread over the NBP reference rate. Currently this spread is less than 10bps and further strengthening of domestic debt market could push it into negative territory. Last time such situation took place in 4Q 2012, when the market expected significant monetary policy easing – the reference rate fell by 225bps in 10 months' time (see chart). We expect the MPC to cut rates by only 25bps in March, while market is looking for reduction by 50-75bps. Even though we think that market expectations on monetary loosening are excessive, we do not exclude the spread between 10Y bond yield and NBP reference rate may turn negative in short term.

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