Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

9 – 15 February 2015

Greece remains an important risk factor for the financial markets. It was the source of volatility last week, especially after the ECB decided to stop accepting Greek debt as collateral for liquidity operations. The issue will remain in focus, with Greece as the probable key subject of discussions at the European Council meeting on Thursday. The situation in Ukraine will also be important theme of the summit.

Poland's Monetary Policy Council did not surprise in February and kept interest rates on hold. But it also made it clear that a rate cut was very likely in March and that the total scale of policy easing could exceed 25bps. We expect CPI deflation to deepen in January to almost -1.5%, which should boost hopes for monetary easing ahead. On the other hand, the Polish PMI for January surprised to the upside, suggesting that industrial production growth in January may not have been as bad as we had thought. News about new car sales were also quite upbeat, suggesting that private consumption was resilient. This and the persisting geopolitical uncertainty show that a 25bp rate cut is more likely in March than 50bp. In the euro zone, the growth outlook is improving, helped by the lower oil prices, weaker euro and the ECB's QE. This week's data releases – the first estimations of GDP growth in 4Q14 in many European countries and the euro zone's industrial production may confirm this picture. Tuesday's meeting of the Polish Financial Stability Committee on how to reduce the burden of the CHF-indebted households may also be an attention-grabber.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (9 February)					
8:00	DE	Exports	Dec	%MoM	1.5	-	-2.1
9:00	CZ	CPI	Jan	%YoY	-0.2	-	0.1
		TUESDAY (10 February)					
		No important data releases					
		WEDNESDAY (11 February)					
9:00	HU	CPI	Jan	%YoY	-1.2	-	-0.9
		THURSDAY (12 February)					
11:00	**PL**	**Bond auction**					
11:00	EZ	Industrial output	Dec	%MoM	0.3	-	0.2
14:30	US	Retail sales	Jan	%MoM	-0.4	-	-0.9
14:30	US	Initial jobless claims	week	k	-	-	278
		FRIDAY (13 February)					
8:00	DE	Flash GDP	Q4	%YoY	1.0	-	1.2
9:00	CZ	Flash GDP	Q4	%YoY	1.8	-	2.4
9:00	HU	Flash GDP	Q4	%YoY	2.7	-	3.2
10:00	**PL**	**Flash GDP**	**Q4**	**%YoY**	**3.1**	**3.1**	**3.3**
11:00	EZ	Flash GDP	Q4	%YoY	0.8	-	0.8
14:00	**PL**	**CPI**	**Jan**	**%YoY**	**-1.2**	**-1.4**	**-1.0**
14:00	**PL**	**Current account**	**Dec**	**€m**	**-386**	**-539**	**-268**
14:00	**PL**	**Exports**	**Dec**	**€m**	**12016**	**12549**	**13 556**
14:00	**PL**	**Imports**	**Dec**	**€m**	**12251**	**12810**	**13 652**
14:00	**PL**	**Money supply**	**Jan**	**%YoY**	**9.0**	**8.8**	**8.4**
15:55	US	Flash Michigan	Feb	pts	98.1	-	98.1

Source: BZ WBK, Reuters, Bloomberg

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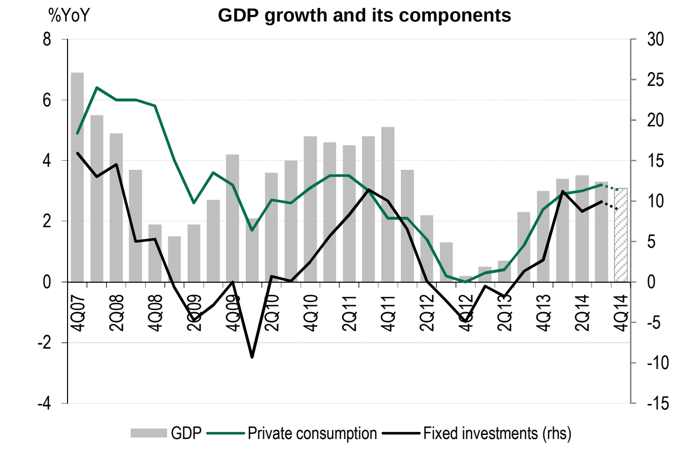
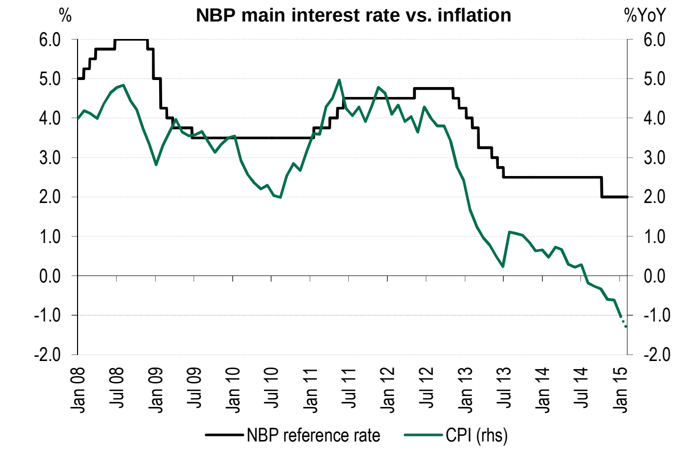
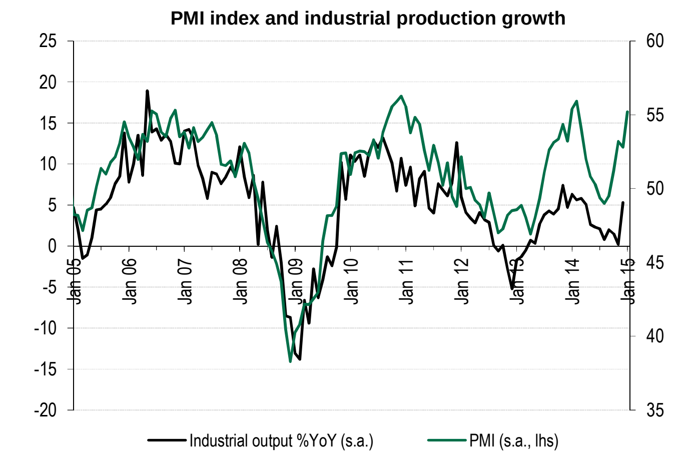
What's hot this week – Lower GDP growth, lower CPI, lower C/A balance



- Flash GDP data for 4Q14 are likely to show growth slowing to 3.1%YoY from 3.3% in 3Q14. Market reaction should be moderate, however, because the flash will include no further details and the figure has already been implied by earlier data publications showing 3.3% GDP growth in the entire 2014.
- Inflation data is likely to be more important. According to our estimate, CPI inflation fell to -1.4%YoY in January, which is below market consensus. The drop was mainly caused by a sharp collapse in fuel prices (by more than 7%MoM) and a lower than usual (season-wise) rise in food prices at the start of the year. Such low reading could reinforce hopes for a rate cut in March.
- The balance of payments' data for December may show a wider current account deficit, but, at the same time, faster export growth (suggested by the industrial production's rebound, especially in the export-oriented sectors).

Last week in the economy – PMI surges, MPC stays on hold





- The Monetary Policy Council kept interest rates unchanged in February, but its message, both in the statement and at the press conference, clearly pointed to a high probability of a rate cut in March. What is more, the NBP governor did not rule out that the scale of the monetary policy adjustment could be larger than 25bp and we also think that the probability of this scenario materialising is growing. We expect the Council to cut rates by 50bp this year and think that that this could even happen in just one move, if financial markets stabilise, the zloty continues to gain and activity data surprise to the downside.
- The latter is not so obvious, however. The Polish manufacturing PMI Index jumped in January to 55.2 from 52.8, well above expectations. This was the fourth positive surprise in the last five months and this time around it also was the highest since February 2014. The rise was driven by improvement in all the main constituents. Rising orders (mainly domestic, with export orders improving less) pushed companies to increase production and hire more people. Pressure from the higher demand on the Polish companies was also reflected by the jump in backlogs (of the work sub-index), which reached its highest level in four years. At the same time, prices of finished goods fell for the 26th month in a row despite the rising demand. This was, among others, due to high market competition.
- The PMI report implies an upward risk to our industrial production forecast for January (which was at -0.5%YoY, much below the market consensus). Moreover, recent news about car sales suggest an upward risk to our retail sales' forecast – January saw a small rise in the number of newly registered cars, both in MoM and YoY terms, which is striking, given the seasonality (January is usually weaker than December) and the fact that last year car sales were artificially boosted by temporary tax allowances.

Quote of the week – We are nearing rate cuts

Marek Belka, NBP governor, 4.02.2015, MPC press conference

Yes [the MPC is now closer to rate cuts].

What I can say today is that there is a sufficient number of factors that could convince the Council to cut rates and there is sufficient number of MPC members that lean towards such decision.

I won't get into speculation "what if", but assuming the situation does not change dramatically, we have to take into account the possibility that a majority [for a rate cut] will be mustered in March.

Yes [the scale of the monetary policy adjustment may be bigger than 25bps].

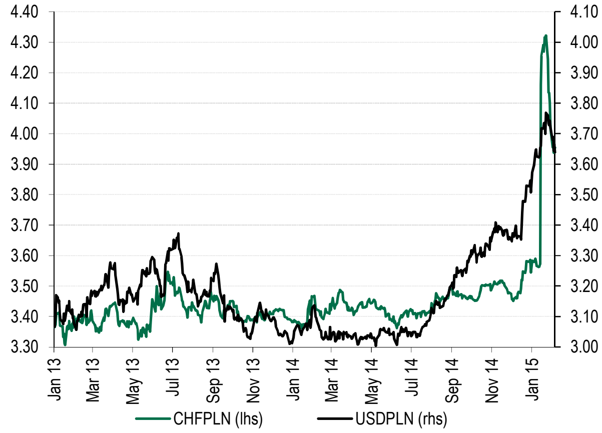
The MPC has signalled very clearly that a rate cut was getting closer and that instability on the financial markets was the main reason why the central bank did not cut rates in February.

Marek Belka was quite straightforward during the press conference and said that only a dramatic change of the situation could stop the central bank from adjusting its monetary policy in March. Moreover, he explicitly suggested that the scale of the adjustment could be bigger than 25bp. While a 50bp rate cut (in one move) cannot be ruled out completely, we think that two cuts of 25bp each are more likely, unless uncertainty over Greece and Ukraine fades significantly and economic data surprise to the downside.

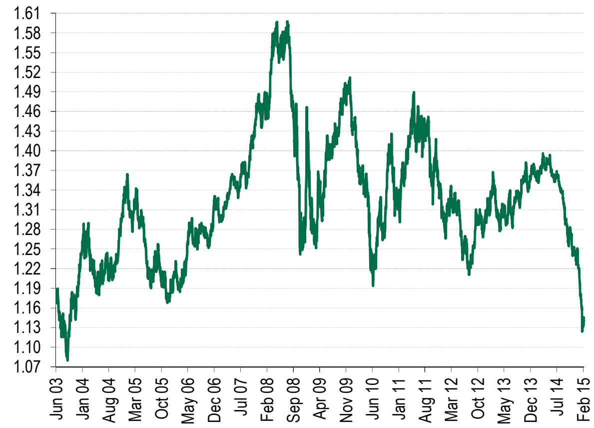
Foreign exchange market – Zloty awaiting Polish data

EURPLN

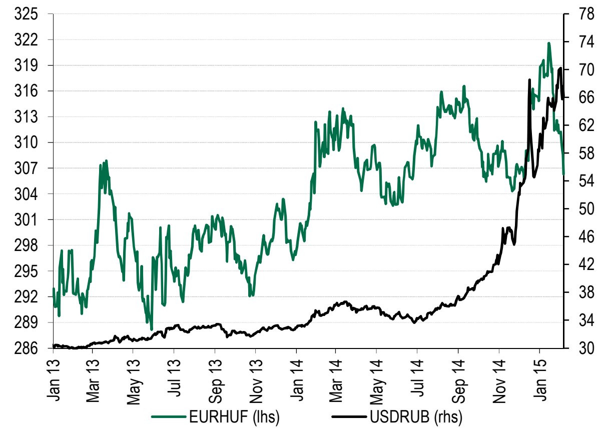
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



ECB, MPC and US data supported the zloty

- The past week was already the third in a row, when EURPLN was trending down. In line with what we had expected last week, the exchange rate broke 4.20 and touched its weekly low at 4.15. The zloty, therefore, trimmed all the losses it had suffered vs. the euro in the second half of December. The currency continued to benefit from the ECB's latest decision and the yet another set of weak US data that the market believes could delay the Fed's first rate hike. The domestic currency also gained from the Polish MPC's decision to keep rates on hold. However, the scale of the weekly appreciation was the smallest that we have seen over the past three weeks as EURPLN failed to continue its downward path on quite a clear hint that monetary easing was likely in Poland soon and amid worries over Greece.
- The zloty also firmed noticeably vs. the dollar as USDPLN temporarily fell near 3.60 from 3.70. This was the second consecutive week of a falling USDPLN. Holders of CHF-denominated loans also felt relief as CHFPLN eased below 4.0.
- This week is rather light in global releases, but there are several important publications due in Poland. First, January's CPI is on the agenda and we expect it had dropped significantly last month. Should our forecast prove correct, expectations for monetary policy easing in Poland could strengthen and weigh on the zloty. The zloty's appreciation trend vs. the euro stopped after the MPC's press conference and a very dovish (CPI) release could hit the domestic currency. We assume, however, that Poland's GDP growth stayed above 3% in 4Q and, together with the strong PMI for January, could offer some support for the zloty.
- The weekly pace of the EURPLN's decline is fading and we think the exchange rate could stay close to 4.17-4.18 in the coming weeks as the outlook for more rate cuts in Poland and worries over Greece could neutralise the positive impact from monetary policy easing in the euro zone.

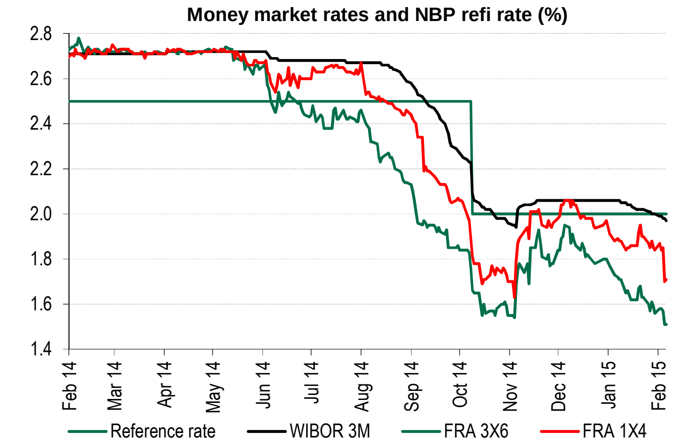
Large fluctuations of EURUSD

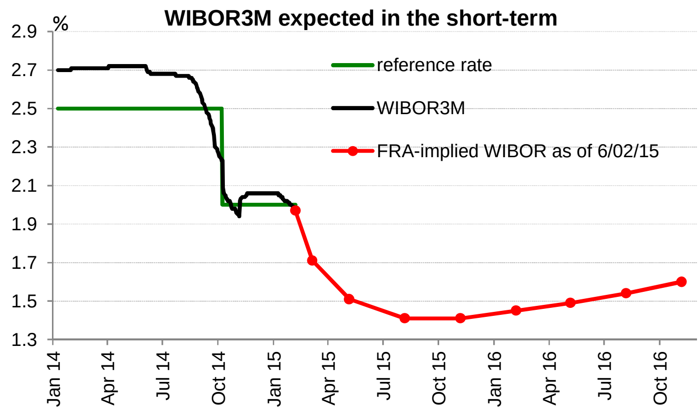
- The euro continued to recover vs. the dollar amid more below-consensus US macro data and thanks to the rise in EURCHF on the back of speculation that SNB was intervening on the market. Just like we had expected, the exchange rate rose to reach 1.153, its highest since the ECB's January decision to extend the asset purchase programme. Uncertainty over Greece did not stop the single currency from rising, but after the strong US nonfarm payrolls EURUSD trimmed nearly all earlier increase.
- The US and euro zone macro calendar is rather light in the coming days, so investors are likely to focus more on Greece and its negotiations with the EU. The recent talks were rather inconclusive and time is running out since the review of the Greek bailout programme should be completed by the end of this month. It is still unknown if Troika will agree to some of the reforms that have been proposed by the Greek government. Important levels are 1,108 and 1,166.

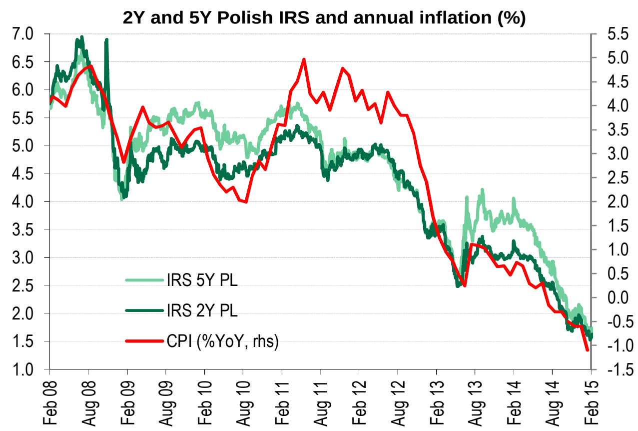
27.0 floor for EURCZK still in place, forint gains vs. euro

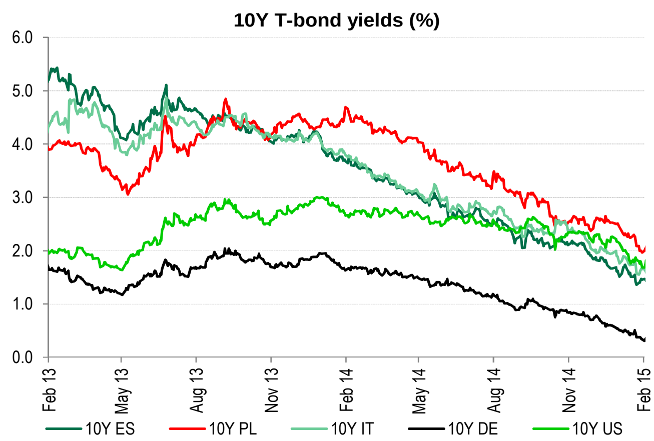
- The Czech central bank also refrained from changes in its monetary policy. It kept the EURCZK floor at 27.0 and said it would be left in place longer - until 2H16 (vs. 1Q16 previously). CNB stressed that it may adjust the floor upward if deflationary pressures strengthen in the long term. January's CPI is due this week and the market expects it had fallen below zero for the first time since October 2009. Low CPI could fuel speculations that the EURCZK floor could be raised and hit the koruna.
- EURHUF plunged quite sharply to 305 from 312 as the forint continued to benefit from the ECB's monetary policy easing. The Hungarian CPI is due this week and it could trigger a move up in EURHUF if it surprises to the downside

Interest rate market – Focus on domestic macro data and bond auction









WIBOR rates slightly down, bond rally loses steam

- There was no significant reaction on the money market to the MPC's clear signal that rate cuts were likely in the coming months. WIBOR rates fell slightly by 1-3bps across the curve, while FRAs on the longer tenors (starting from 6 months) were 2-14bps higher than at the end of January. The latter was mainly caused by the upward move on the IRS market. Despite some correction, the market is still pricing-in rate cuts of 50bps in three months' time, which is also our baseline scenario now.
- In the first week of February, the rally on both bonds and the IRS lost some steam. This was mainly due to the gradual rise in yields on the core markets. Moreover, the MPC's decision to keep rates unchanged in February brought some profit-taking as some investors felt disappointed. The fresh supply of T-bonds at the auction (more below) also added to the higher yields. All factors mentioned above together with much stronger the US labour market data resulted in the 10Y benchmark yield rising temporarily towards 2.20%, the highest level over two weeks.
- The front end of the curves performed better than the belly and the long ends over the past week. Consequently, both curves steepened quite visibly, with the 2-10Y spread widening slightly above 60bps for the T-bonds and to 36 for the IRS. Moreover, the spread over Bunds widened due to concerns over Greece.
- Poland's Ministry of Finance sold more than it had originally planned - cPLN5.9bn (vs. the PLN3.0-5.0bn offer) of WZ0124, DS0725 and WS0428 - at the first auction in February. As expected, demand was solid and amounted to PLN11.4bn in total (including the top-up tender). Over half the cash collected came from the sale of the 10Y DS0725 benchmark (c.PLN3.5bn) at a yield of 2.09%, well below the level (2.295%) recorded at the first auction this year. We estimate that the Ministry has covered c.44% of its 2015 borrowing needs after this auction.

CPI inflation should support lower yields/rates

- CPI and the flash 4Q GDP data will be in the center of investors' attention this coming week. Our forecasts point to a sharp deepening of deflation in January, which is likely to fuel hopes for additional monetary easing in March and may lead to further falls of the money market rates. We decided to revise down our path of the WIBORs as we believe that the MPC will cut rates by 50bps in total in upcoming months. All in all, we expect a more visible decline in the WIBOR rates once the rate cut is delivered by the Council, assuming the 3M WIBOR sits at 1.60% (on average) in June.
- We perceive the recent curve steepening as a temporary phenomenon and expect it to flatten should the situation in the global markets stabilise. We expect the 5Y and 10Y tenors to recover thanks to the expected cash inflows from the ECB. At the same time, the short end should remain roughly stable as expectations for monetary policy easing in Poland remain alive.
- Poland's Ministry of Finance will announce this week details on its second (and last) auction this month. According to the monthly issuance plan, the choice of the series will depend on market conditions, but it should exclude bonds that were offered at the first auction. We think that the Ministry is likely to offer new 2Y and 5Y series (OK0717 and PS0420) worth roughly PLN3-5bn. We think that the auction will attract much attention of both the domestic and foreign investors. In our view, the Finance Ministry should have no problems with the debt placement.

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.