Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

February 23 – March 1 2015

Global sentiment was driven last week by the mixed news-flow on Greece but no conclusive agreement was reached so far. At the end of the week, Greece put in a request to extend its bailout by six months, but reaction from Germany and especially its finance minister, was rather cold. The market rebounded slightly on the softer FOMC minutes, but this was only short-lived. On the domestic side, there was a series of Polish macroeconomic data but they failed to affect the overall economic picture. As is generally expected at the beginning of the year, economic activity was subdued with no signs of inflationary pressure. Overall, January's set of economic data justifies further monetary easing and supports our view for a 25bp cut in March.

The euro zone's finance ministers will be discussing the Greek request to extend its bailout plan exactly one week before it expires. This issue has been driving the market ever since Syriza won the parliamentary election in late January. If talks fail again and, as a result, risk of Grexit increases, demand for risky assets should be limited in the short to medium term, which could lead to some zloty weakening and a sell-off on the bond market. However, if the talks lead to an agreement, then concerns that have been hovering over the market for the last four weeks should fade, allowing other global factors or local issues to start playing the main roles again. The last set of domestic macro data will be released this week. In our view, the detailed 4Q 2014 GDP data shall not surprise and trigger any noticeable move on the zloty. The odds for rate cuts in Poland in the coming months are quite high and this could slow the pace of the zloty's appreciation and support the front end of the curves.

Economic calendar

CET TIME	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (23 February)					
10:00	DE	Ifo index	Feb	pts	107.2	-	106.7
16:00	US	Home sales	Jan	m	5.0	-	5.04
		TUESDAY (24 February)					
8:00	DE	GDP	Q4	%YoY	1.6	-	1.2
10:00	**PL**	**Unemployment rate**	**Jan**	**%**	**11.9**	**12.1**	**11.5**
11:00	EZ	HICP	Jan	%YoY	-0.6	-	-0.2
14:00	HU	Central bank decision		%	2.10	-	2.1
16:00	US	Consumer confidence index	Fed	pts	99.5	-	102.9
		WEDNESDAY (25 February)					
16:00	US	New home sales	Jan	k	475	-	481
		THURSDAY (26 February)					
14:30	US	CPI	Jan	%MoM	-0.6	-	-0.4
14:30	US	Initial jobless claims	week	k	-	-	283
14:30	US	Durable goods orders	Jan	%MoM	1.6	-	-3.3
		FRIDAY (27 February)					
9:00	CZ	GDP	Q4	%YoY	1.3	-	2.4
10:00	**PL**	**GDP**	**Q4**	**%YoY**	**3.0**	**3.0**	**3.3**
10:00	**PL**	**Fixed investments**	**Q4**	**%YoY**	**8.8**	**8.8**	**9.9**
10:00	**PL**	**Private consumption**	**Q4**	**%YoY**	**3.0**	**3.0**	**3.2**
14:00	**PL**	**Inflation expectations**	**Feb**	**%YoY**	**-**	**-**	**0.2**
14:30	US	Preliminary GDP	Q4	%YoY	2.1	-	5.0
16:00	US	Pending home sales	Jan	%MoM	2.4	-	-3.7
16:00	US	Michigan index	Feb	pts	94.0	-	98.1

Source: BZ WBK, Reuters, Bloomberg

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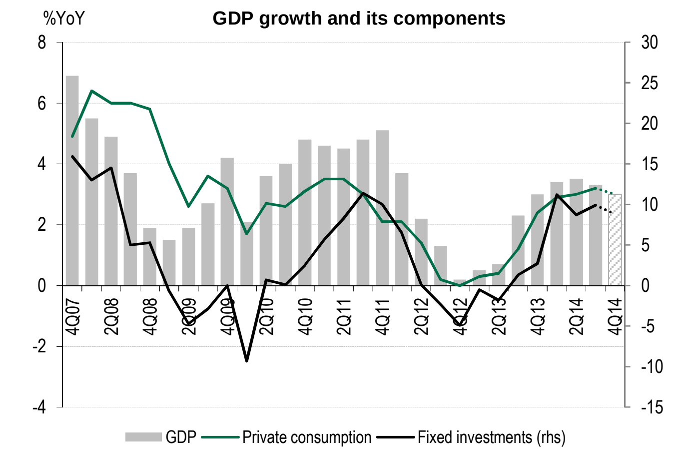
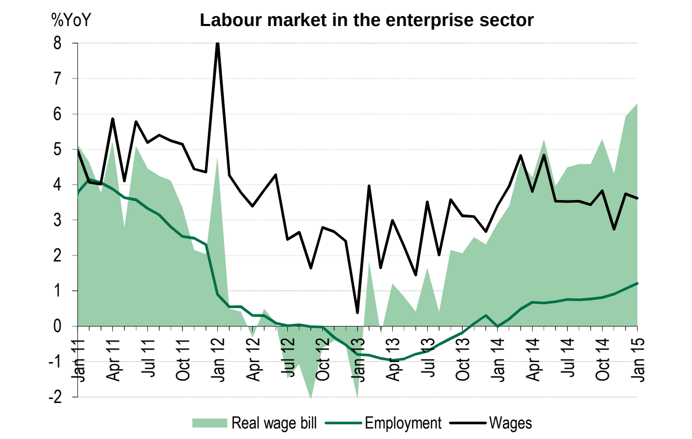
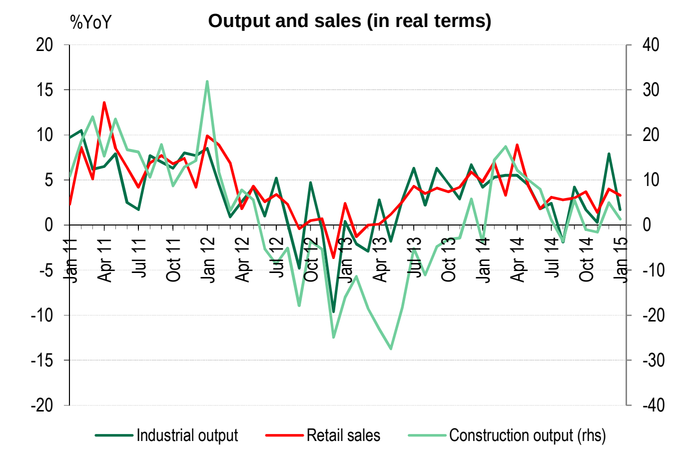
What's hot this week – Unemployment rate in January and detailed GDP for Q4



- The registered unemployment rate most probably climbed in January to 12.1% from 11.5% in December. Higher unemployment in the first month of the year is a typically seasonal phenomenon, though before the Ministry of Labour had presented its estimate, our forecast was a bit lower (11.9%). On an annual basis, the unemployment rate likely decreased by 1.8pp (1.9pp a month earlier). We think that the pace of decline of the unemployment rate may be slowing down, as it has reached historically low levels.
- On Friday we will see detailed GDP data for Q4. These numbers are not likely to change the macro picture, given the fact that we have already seen data for the whole 2014, including the headline figure for Q4. We expect a moderate deceleration in both consumption and fixed investment growth, in line with the market. Still, we hope to see some improvement in consumer demand in the following quarters.

Last week in the economy – A lot of new data, but picture barely changed





- Average employment growth in the corporate sector accelerated in January to 1.2%YoY, less than expected, while average wages rose 3.6%YoY, above forecasts. The real wage growth reached 5%YoY, the fastest since early 2009. The real wage bill soared 6.3%YoY, the most since November 2008.
- Industrial output rose in January 1.7%YoY, roughly in line with the market consensus. Adjusted seasonally, it grew 4%YoY, that is only marginally less than in the previous month (this year in January there was one working day less than in January 2014). Construction output expanded by 1.3%YoY.
- Sales surprised significantly to the downside, showing a mere 0.1%YoY growth in nominal terms in January, compared to 1.8% in December. In real terms, however, sales increased by 3.3%YoY (4% last month). The slowdown in nominal terms was more significant, which implies that the deflator played a key role. We estimate that the sales deflator fell by one percentage point to -3.1%YoY in January.
- The sales figure was driven, to a large extent, by the category of fuel, which fell by as much as 16.5%YoY (the lowest result in over 15 years). This was mostly due to the lower fuel prices, which dropped at a similar scale.
- Despite the weak nominal number, the real pace of sales' growth still remains moderate and this supports our forecast for private consumption growth at c3%YoY in 1Q15. The employment and wage data confirm that the labour market is still in full swing, which also supports robust consumption growth. On the other hand, consumer confidence indicators for February deteriorated markedly. This may be a one-off effect due to rise of CHFPLN exchange rate, but we have to see more data to confirm or reject this view.

Quote of the week – Is there a room for a rate cut?

Adam Glapiński, MPC member, 19.02.2015, Reuters
I maintain my stance that there is no need to cut interest rates any further.

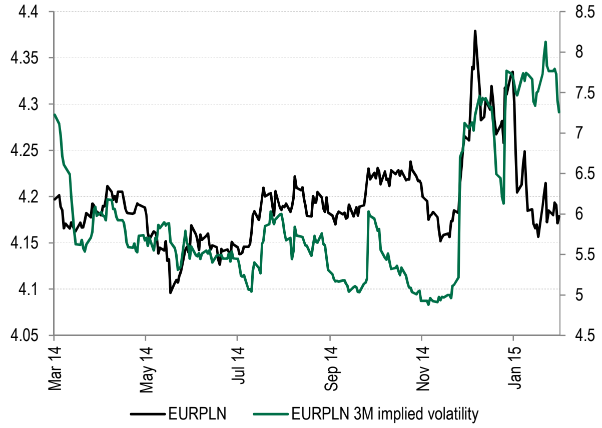
Marek Belka, NBP president, 19.02.2015, Reuters
Latest data show there is still some room for interest rate cuts.

Minutes from the February's MPC meeting, NBP
(…) However, some Council members judged that due to the significant volatility in the financial markets in the recent period, it was justified to leave interest rates unchanged at the current meeting. Yet, these members did not rule out an adjustment of monetary policy in the nearest future, when evaluation of inflation prospects in the medium-term would be possible, taking into account NBP's March projection.

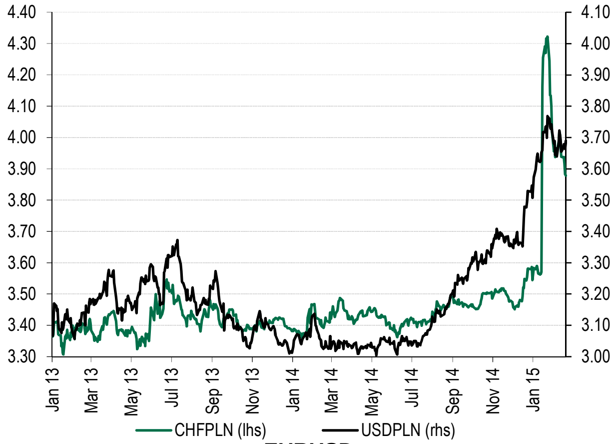
The central bank's minutes from the MPC's meeting in February showed that the Council is rather sceptical about GDP growth in Poland's main trading partners. GDP growth in Poland is seen to be close to the potential and accelerating, but, on the other hand, the risk is skewed downwards and the output gap remains negative. Additionally, real interest rates are high and deflation is expected to last longer. However, the heightened volatility in the financial markets encouraged the MPC to leave rates unchanged, despite a motion for a 25bps cut. We expect the MPC to cut rates by 25bps in March, given the rather weak macro data, deeper deflation and calmer situation in the FX market.

Foreign exchange market – EURPLN to soon leave its narrow trading range behind?

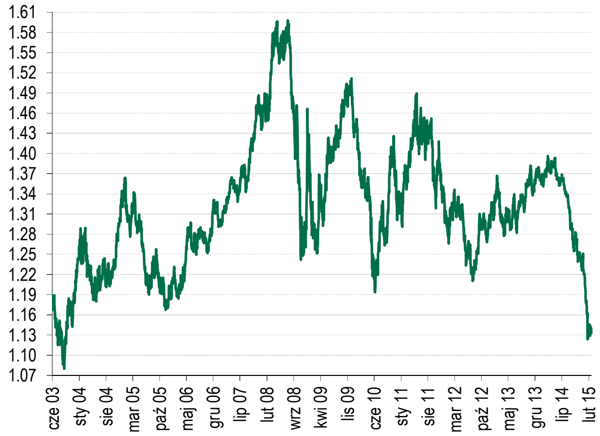
EURPLN and 3M implied volatility



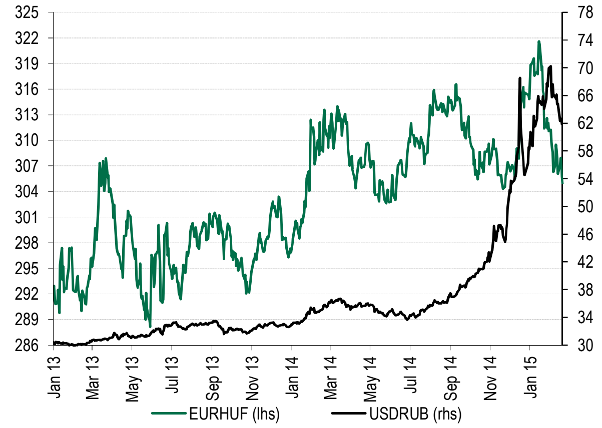
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



EURPLN low, but volatility remains high

- EUR/PLN remained somewhat above the local lows as it hovered around 4.18 during the past week. Global sentiment was driven by the mixed news-flow on Greece, which still had no conclusive agreement. This is why the exchange rate stayed in a horizontal trend. EUR/PLN tested 4.16 on NBP's Marek Belka, who said that the domestic currency was undervalued. But the attempt proved unsuccessful just one day before the Eurogroup's meeting on Greece on Friday.
- Note that even though the zloty managed to recover all of its losses, it suffered vs. the euro in the second half of December 2014, the implied volatilities pulled back only partly. This seems to be quite a good indication that high uncertainty persists in the market and a signal that investors are still not excluding that there are chances for a sharp change (for EM currencies this usually means a depreciation risk).
- The euro zone's finance ministers will be discussing the Greek proposal to extend its current bailout programme exactly one week before it ends. This issue has been the main driver on the market since Syriza had won the parliamentary elections in late January.
- If talks break up again and, as a result, the risk of Greece leaving the euro zone increases, demand for risky assets should be limited in the short to medium term due to uncertainty over how this process will be implemented. If the talks lead to an agreement, then concerns that have been hanging over the market for the last four weeks should naturally fade, allowing for other global factors or local issues to start playing the main roles again. The odds for rate cuts in Poland in the coming months are quite high and this could slow the pace of the zloty's appreciation. At the same time, detailed GDP data that are due this week shall not surprise and trigger any big move.

EUR/USD waiting for an impulse

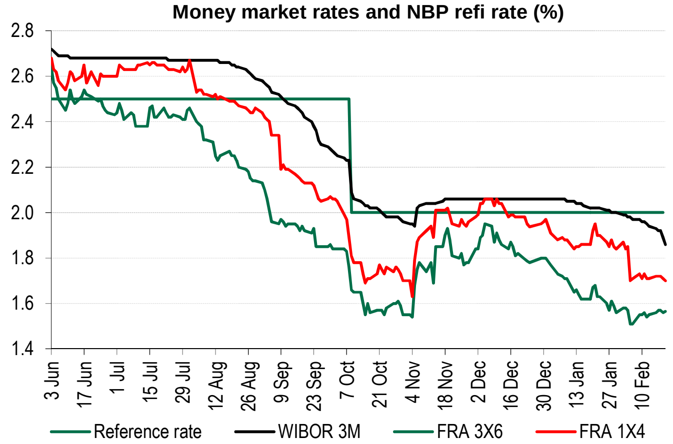
- EUR/USD stayed in its horizontal trend around 1.14 last week as investors were still waiting for the final conclusions on Greece. Interestingly, despite the market uncertainty, EUR/CHF rose gradually to nearly 1.08 from 1.055 during the past week. This might have been due to the verbal interventions of the SNB's Governor Thomas Jordan who said that the central bank was ready to enter the market in order to depreciate the Swiss currency, which he said was still overvalued. Further falls in the negative interest rates might finally also lead to the desired effect.
- Before the Greek talks started at the end of this week, the weekly EUR/USD trading range was the narrowest since the Christmas week in December 2014. This period of such miniscule changes is likely to end since the current Greek bailout programme is also about to end. EURUSD has been in the down trend already since May 2014 and reached the local low at c.1.1 just after the January's ECB easing decision. Since then, there has been no significant reaction to worries over the future of the euro zone, so another plunge cannot be excluded if there is no happy end to the Greek case.

Hungarian CB decision key in the CEE region

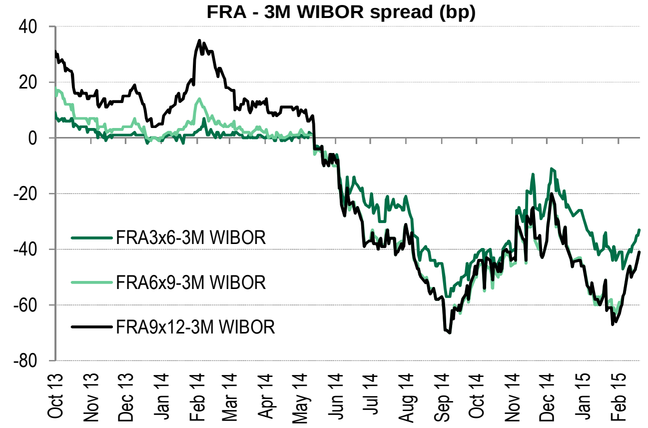
- The Hungarian central bank will decide on its interest rates this week. Given the recent decline in inflation, there has been some speculation that monetary policy easing is now more likely. There has also been some suggestion that rates could be reduced, also by the MBN last month. If rates are cut already this week, then this could raise pressure on the forint or limit the potential for its appreciation, depending on the outcome of the Greek talks. Just like in the case of EUR/PLN, EUR/HUF is now close to the local low (c.303 from November) and the coming days may be decisive on whether the exchange rate breaks its support (and heads towards 300 or lower) or rebounds to 321 or higher.

Interest rate market – Greek headlines and Yellen's testimony important for market mood

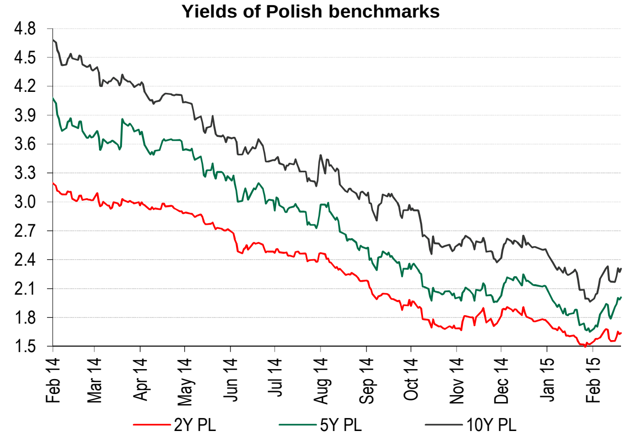
Money market rates and NBP refi rate (%)



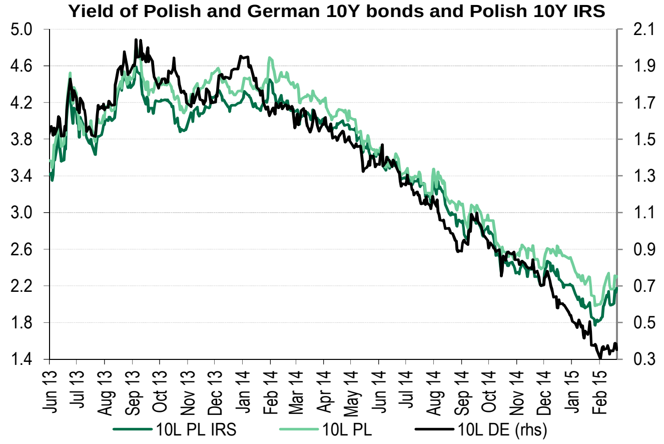
FRA - 3M WIBOR spread (bp)



Yields of Polish benchmarks



Yield of Polish and German 10Y bonds and Polish 10Y IRS



The market awaits rate cuts in the near future

- WIBORs continued to fall and the decline in rates even intensified in the past week. In weekly terms, WIBORs dropped by 6-9bp (vs. the 1-3 bp decline in the previous week). At the same time, FRAs rose across the board, most strongly in the longest-dated rates. Nevertheless, the FRA3x6 is still around 30bp below the current WIBOR 3M, which clearly indicates that the market still expects at least a 25bps cut at the nearest MPC meeting.
- In our view, macro data releases this week (unemployment rate, detailed 4Q GDP growth) should not change our general outlook for economic growth or monetary policy in the upcoming months. We, therefore, still expect WIBORs to continue their downward trend ahead of the MPC meeting in the following week.

High volatility due to the uncertain situation in Greece

- Volatility on the domestic debt market stayed high last week. On the one hand, domestic macro data releases point to a rate cut by the MPC, supporting the front-end of the curves. On the other hand, the uncertain situation in Greece adds to market volatility, especially on the belly and long-end of the curves. The rise in yields/IRS rates also resulted from a gradual increase in yields on the core market (in weekly terms, the yield of the 10Y Bund climbed by 5bp). Despite the fact that the Greek government requested a bailout extension by six months, there are still huge differences to be overcome. As a consequence, risk-off remains dominant on the market, pushing the yield of the 10Y benchmark above 2.30%. However, the FOMC minutes were seen as slightly dovish and helped the domestic interest rate market rest a bit in the short-term. Notwithstanding, yields of both T-bonds and the IRS rates were higher by 10bp (on average) than a week ago.
- Since the front ends of the curves remain well-anchored by expectations for MPC's rate cuts, and the long ends remain under pressure, there was bear-steepening in the IRS and bond markets. The 2-10Y spreads widened, in particular for the IRS (to 52bp from 36bp in the previous week).

Busy week for the debt market

- This week will remain busy due to the many important events and macro data releases. First, investors are still waiting for news on Greece. The outcome of the Eurogroup's meeting on Friday may set the direction on the financial markets. However, we believe that the market will rebound if there is a positive solution to the Greek problem. Second, the market will await the Fed's governor congressional testimony on 24 February. Fears of a less dovish statement (as compared to minutes) may result in higher U.S. yields. Consequently, this could be a negative factor for the domestic long-term assets. Third, the last set of domestic macro data should be neutral for the market. On the other side, further improvement in the euro zone macroeconomic data might result in core market weakening, which could negatively affect the domestic curves.
- Poland's Ministry of Finance will announce its issuance plans for March. Based on the quarterly plan, the Ministry plans two normal auctions and one switch tender. Taking into account the uncertain market situation, it is likely that only one standard auction and a switch tender will be set for March. We would like to recall that after February's auction, the 2015 borrowing needs are already covered in 47%. There is, therefore, no need to flood the market with a high supply. Any news on the possibly limited supply could also be supportive for the domestic debt securities.

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