Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

16 – 22 March 2015

The first week of the ECB's QE pushed the euro to an 12-year low versus the dollar and caused further falls of the euro zone's bond yields. But the programme failed to deliver strong support for the Polish FX and FI markets. This was probably partly due to a broader trend of growing worries about emerging assets amid the strengthening dollar and the looming Fed interest rate hike. The story will also continue this week as the FOMC meeting on Wednesday may be key for investors' view on the monetary policy outlook in USA.

In the context of the above-mentioned factors, the bunch of macroeconomic data releases due in Poland should recede into the background. Nevertheless, the figures will likely confirm that the shape of the economy is at least satisfactory. We still expect that GDP growth might be below 3%YoY in 1Q15, but our forecasts of production and sales for February are above market consensus. The labour market figures should also confirm the positive picture. Domestic data are less important for the market these days also because of the MPC's clear indication on the monetary policy prospects. The central bank's minutes due this week may shed more light on the arguments used during the meeting in February, especially given the recent comments of the MPC members. We stick to our view that rates will be unchanged for more than a year (with normalisation in 2H 2016).

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 March)					
14:00	**PL**	**Current account**	**Jan**	**€m**	**-920**	**-1194**	**-1005**
14:00	**PL**	**Exports**	**Jan**	**€m**	**12755**	**12611**	**11967**
14:00	**PL**	**Imports**	**Jan**	**€m**	**12956**	**12670**	**12600**
14:00	**PL**	**Core inflation**	**Feb**	**%YoY**	**0.5**	**0.4**	**0.5**
14:15	US	Industrial output	Feb	%MoM	0.3	-	0.2
		TUESDAY (17 March)					
11:00	DE	ZEW index	Mar	pts	48.1	-	45.5
11:00	EZ	HICP	Feb	%YoY	-0.3	-	-0.6
13:30	US	House starts	Feb	k	1040	-	1065
13:30	US	Building permits	Feb	k	1065	-	1053
14:00	**PL**	**Wages in corporate sector**	**Feb**	**%YoY**	**3.2**	**3.1**	**3.6**
14:00	**PL**	**Employment in corporate sector**	**Feb**	**%YoY**	**1.3**	**1.3**	**1.2**
		WEDNESDAY (18 March)					
14:00	**PL**	**Retail sales**	**Feb**	**%YoY**	**0.0**	**1.0**	**0.1**
14:00	**PL**	**Industrial output**	**Feb**	**%YoY**	**4.1**	**5.6**	**1.7**
14:00	**PL**	**Construction and assembly output**	**Feb**	**%YoY**	**-0.3**	**-0.1**	**1.3**
14:00	**PL**	**PPI**	**Feb**	**%YoY**	**-2.7**	**-2.7**	**-2.9**
19:00	US	FOMC decision		%	0.25	-	0.25
		THURSDAY (19 March)					
13:30	US	Initial jobless claims	week	k		-	289
14:00	**PL**	**MPC minutes**					
15:00	US	Philly Fed index	Mar	pts	8.0	-	5.2
		FRIDAY (20 March)					
		No important data releases					

Source: BZ WBK, Reuters, Bloomberg

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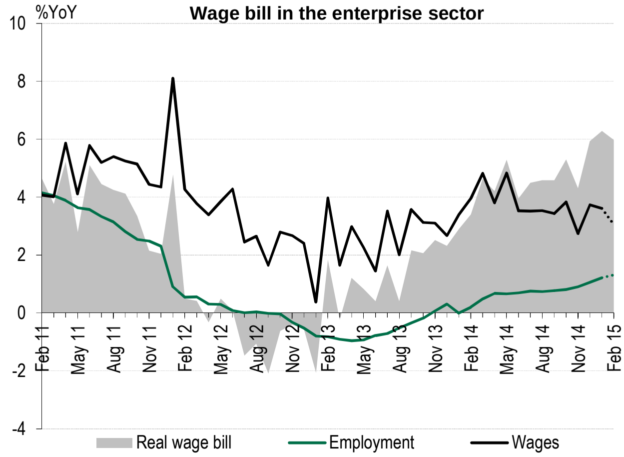
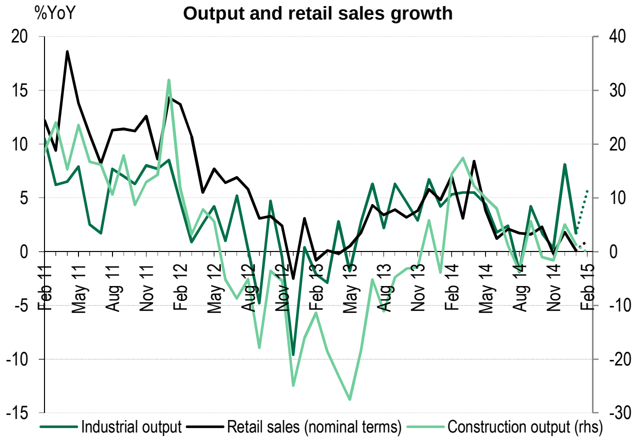
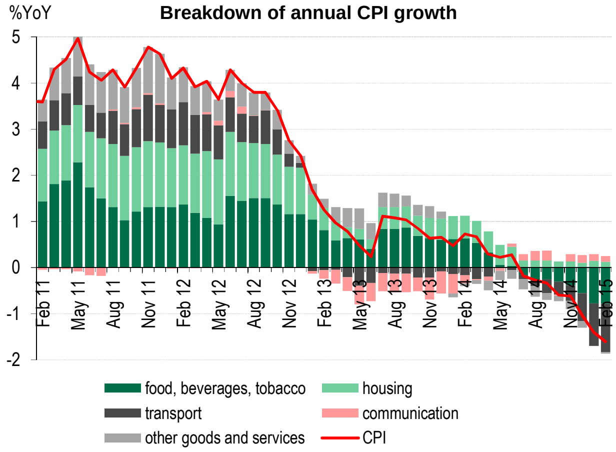
What's hot this week – Domestic data to confirm robust growth





- Foreign trade probably stagnated in January on the back of weak industrial output growth at the start of 2015. Still, we think that both exports and imports are set to improve, given the positive domestic consumption outlook and improving economic growth in the EU. The current account deficit is likely to widen versus December, due to the seasonally lower income balances.
- The labour market has been booming and we expect February's wages and employment in the corporate sector to confirm this trend. According to our forecast, wage growth decelerated, but this was mainly due to the postponed bonus payments in mining. Still, employment growth should remain robust. In general, the positive labour market situation will be supportive of consumption growth in the coming quarters.
- We are quite optimistic about February's industrial output and expect an above-consensus reading. There is a neutral working day effect in February and the weather was more or less similar to what it was a year earlier. So the reading will actually show the underlying trend, which, in our view, is improving thanks to robust internal demand and the reviving euro zone. Strong data on car output support our forecast.
- In our view, retail sales picked up in February. The nominal growth rate of this category is not that informative about private consumption given the deflation and it is better to look at the real growth, which we expect at 4%YoY. New car registrations fell sharply in February, pointing to a considerable downward risk to our forecast. Though it should be noted that changes in car registrations were not exactly very helpful in forecasting retail sales in the last few months.
- We do not expect the MPC's minutes to be surprising, but they may shed more light on the arguments that convinced MPC members to cut rates by 50bp and to conclude the easing cycle.

Last week in the economy – Inflation at the bottom



- CPI declined in February to -1.6%YoY from -1.4%YoY after a revision in January, hitting a new all-time low. The deepening of deflation was mainly due to the fall of transport prices and base effects for tobacco products. The Statistics Office released its new weights' breakdown for the CPI basket. We expect the net impact of the basket's reweighing on the inflation path to be negligible. In our view, the February reading showed the bottom of the CPI falls and from March on, we expect inflation to start gradually rising to c0.6%YoY at the year-end (yet inflation will remain negative probably until the end of Q3). In our view, the data are neutral for the monetary policy outlook.
- According to our estimates, core inflation, excluding food and energy prices, stood at 0.6%YoY in January and 0.4%YoY in February.
- The pace of money supply growth accelerated in February to 8.8% YoY. This was the fastest growth since August 2012.

Quote of the week – This is (conditional) end

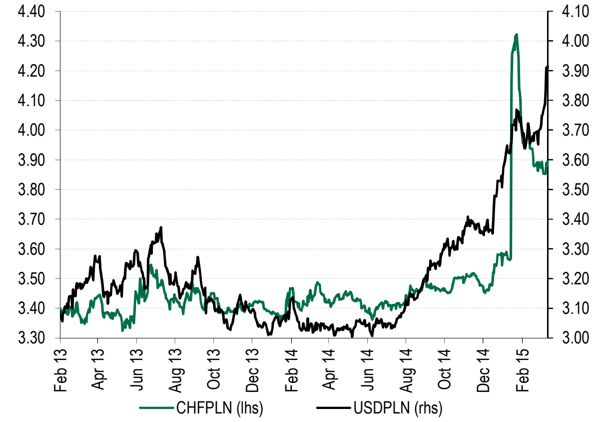
Andrzej Kaźmierczak, MPC member, 13.03.2015, PAP
Further rate cuts could be risky (…) the risk of PLN appreciation is not big.
Jerzy Osiatyński, MPC member, 13.03.2015, Bloomberg
Assuming the MPC has ended the easing cycle once and for all would be an oversimplified interpretation. Changes in the zloty exchange rate could prompt the council to reconsider its policy bias. There may still be room for rate cuts.
Elżbieta Chojna-Duch, MPC member, 11.03.2015, PAP
The MPC's statement is unequivocal and firm. It is not so sure that this (monetary tightening) will be the decision of the next Council.
Anna Zielińska-Głębocka, MPC member, 10.03.2015, PAP
There is no more room for easing. But the MPC still works, it has the possibility to act and we cannot say that there will be no decisions in the next year or so.

The last MPC meeting brought a strong declaration that the easing cycle was over, making most market participants (and us) believe that the Council would not change rates for the rest of its term. But some MPC members have recently challenged this view, reminding us they were still on the watchout and could act if necessary. In our view, it is the zloty exchange rate that may become the key driver in monetary policy in the last months of MPC's term. According to the NBP survey, EURPLN at 3.90 is average profitability threshold for Polish exports. However, the NBP has said many times that it was the pace of change rather than a particular PLN level that could worry the central bank. So far, the stronger dollar and worries about the Fed rate hike are limiting the risk of excessive zloty appreciation.

Foreign exchange market – Stronger dollar hurts emerging market currencies

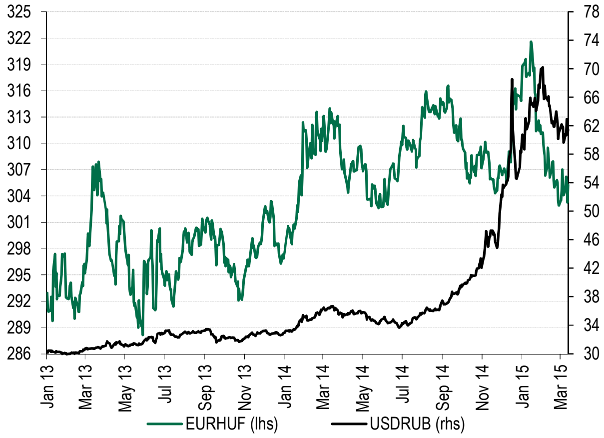
EURPLN

USDPLN and CHFPLN



EURUSD

EURHUF and USDRUB



USD/PLN highest since May 2004

- EUR/PLN hovered in a range of 4.12-4.16 last week. The economic calendar was light and the ECB's QE has so far had little impact on the Polish FX and FI markets. At the same time, USD/PLN remained in its upward trend amid the strengthening dollar. USD/PLN broke its peak from 2009 and rose above 3.96, the highest level since May 2004. Since July 2014, when the zloty's strong depreciation trend vs. the U.S. dollar began, the Polish currency has lost over 20%, making it the 6th weakest EM currency against the USD.
- Many emerging market currencies were under pressure from the looming Fed rate hike and the significant dollar strengthening. Poland, in contrast to some other emerging markets, is not heavily exposed to U.S. dollar appreciation since its USD-denominated debt is relatively small. But it seems that the Polish currency also suffered a bit from the negative sentiment towards EM assets.
- The recent period was very unfavourable for the developing currencies. Exchange rates, such as USD/ZAR, USD/BRL, USD/COP, reached multiyear peaks, while USD/MXN or USD/TRY surged to their fresh all-time highs. In some cases, in addition to pressure from the appreciating dollar, the EM currencies also suffered due to local negative factors. At the same time, the Russian ruble is performing quite well given the significant weakening seen in the EM world. The currency resisted this week's 100bps interest rate cut (to 14%) and some falls in the oil prices. The currency was possibly supported by the slightly higher hopes that the Russia-Ukraine crisis will not deteriorate in the short term.

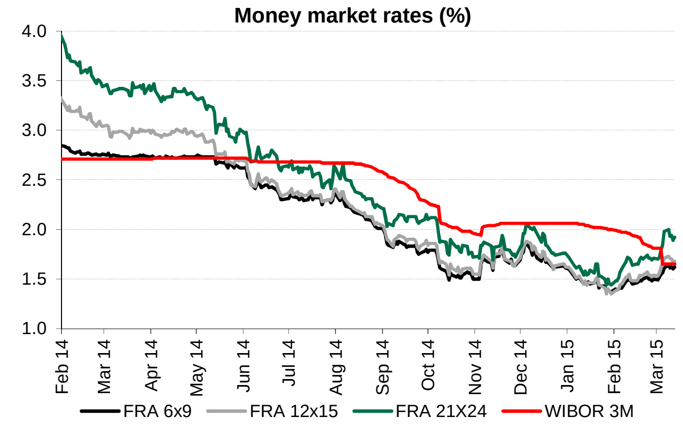
... but we think the zloty may firm

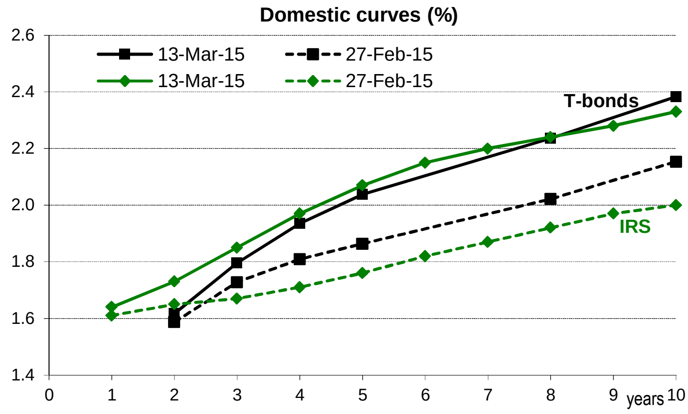
- We still believe the zloty should appreciate against the euro in the coming weeks, supported by the ECB's QE, Poland's relatively high real interest rates and the quite strong macro data (industrial output, retail sales, labour market due this week). However, the pace of its appreciation may be slower due to the negative sentiment towards EM assets, especially if expectations for Fed rate hikes rise and the dollar appreciation continues. In this context, this week's FOMC meeting will be crucial. If the Fed removes the word "patient" from its statement, this could suggest that a rate hike in June is very likely.
- The persisting uncertainty about Greece is another risk factor for the FX market as there seems to be a growing conflict between Greece and Germany. What is more, some sources suggest that the government in Athens may soon run out of cash.

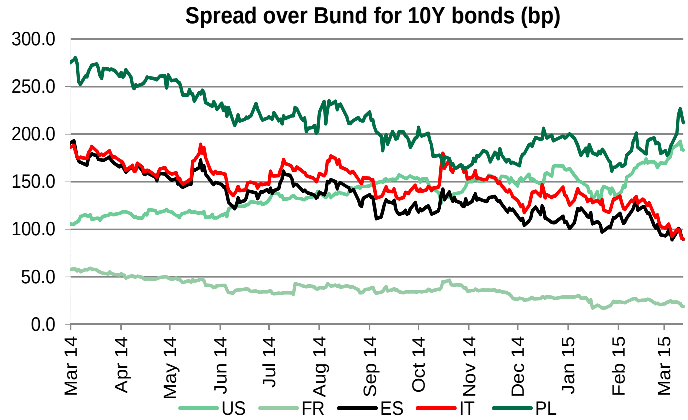
EURUSD still on the downside

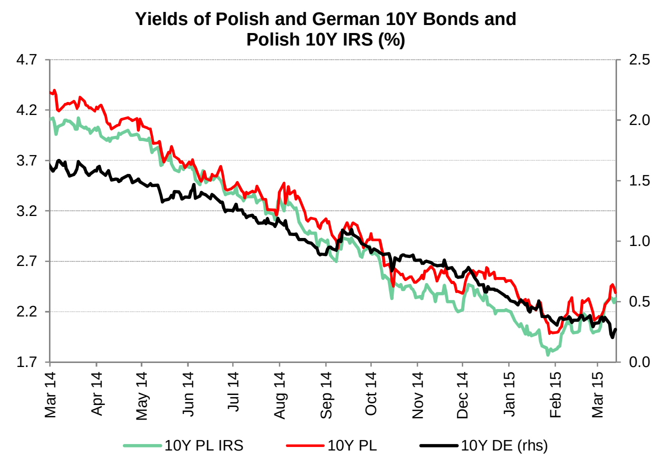
- During the third consecutive week of EUR/USD falls, the exchange rate reached its lowest level since January 2003 – 1.05. The euro remained under pressure due to cash inflows from the ECB's QE programme, while the dollar continued to gain on the back of the strong U.S. nonfarm payrolls data that seem to bring U.S. rate hikes closer.
- Many U.S. macro releases are due this week, but the market is likely to focus on the outcome of the Wednesday evening's FOMC meeting. Investors expect the Fed's statement to be more hawkish than the last one. However, apart from the statement, comments of the Fed governor Janet Yellen at the post-meeting press conference will be important. They could determine whether EUR/USD will continue its downward trend or whether the trend will be reversed.

Interest rate market – Fed meeting more important than Polish data









FRAs point to rate hikes, bonds and IRS volatile

- WIBOR rates remained stable last week, while FRAs fell visibly by 1-9bp across the curve. However, FRAs for the longer tenors (starting from 12x15) stayed above the current level of the 3M WIBOR by 2-24bp. This implies that the market is pricing-in monetary policy normalisation in the second half of 2016, which is also our baseline scenario.
- The T-bond and IRS markets were more volatile over the past week, with huge intraday movements. At the beginning of the week, Poland's assets were under pressure from the strong U.S. labour market data despite the start of the ECB's QE programme. The yield of the 10Y benchmark had several times tested 2.50% (the highest level since the end of 2014), but this level effectively halted any upward move and activated the demand side. Domestic bonds gained quite visibly before the auction, with the yield of the 10Y bonds falling towards 2.35%. However, at the end of the week, it returned above 2.40%. Regarding the IRS, the 10Y rate grew above 2.30% in the first few days of last week, reaching the highest level since mid-December 2014. But the IRS rates rebounded slightly at the end of the week, tracking the bonds.
- The domestic curves became steeper over the past week, in contrast to the core and peripheral debt markets. Moreover, the premium over Bunds widened markedly to well above 220bp in the 10Y sector (the highest level since mid-August 2014). One should notice that the premium over Bunds widened slightly also for some peripheral euro zone countries.
- Poland's Ministry of Finance successfully launched long-term T-bonds (WZ0124, DS0725 and WS0428) despite the vulnerable market conditions. The ministry sold bonds worth more than PLN4.6bn, with PLN4.15bn at the regular auction. We think that both floaters, WZ0124 and the 10Y benchmark DS0725, probably attracted healthy demand from domestic and foreign investors. We estimate that this auction helped cover almost 50% of this year's borrowing needs.

Fed meeting in focus, domestic data in the background

- The domestic macro data calendar is heavy this week, with Poland's statistics office due to release all the main real economic activity indicators. We expect the data to be quite strong, above market consensus (especially industrial production), confirming that economic growth is decent. The releases may exert some upward pressure on rates/yields, in particular at the long-end of the curves. However, the impact of these data should be limited now that the MPC had concluded the monetary easing cycle and signalled it would not change interest rates in the near future. We think that the WIBOR rates and the short-end of the curves are well-anchored near their current levels, supported by the outlook of stable NBP rates in the nearest months.
- We think that global factors will be key for the domestic debt market. This week, apart from the macro data releases in Europe and the U.S., the FOMC meeting will be the most important. If the Fed drops the word 'patient' from its post-meeting statement in March, it may negatively affect bonds, boosting expectations for a rate hike as soon as in June.
- We maintain our view that inflows of portfolio money into the Polish market, due to monetary policy easing in the euro zone, should be positive for the Polish bonds in the short term. We, therefore, do not rule out that the Polish yields/IRS rates could drop slightly further from their current levels, but the balance of risks has changed towards less supportive prospects for debt in the medium to long term.

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.