

WEEKLY ECONOMIC UPDATE

23 – 29 March 2015

Last week's main event, the FOMC meeting, surprised investors by its more dovish message than had been expected. Even though the Fed withdrew its pledge that it would be 'patient', it introduced several other changes in its statement. It cut its GDP and inflation forecasts, it also trimmed its estimates of the equilibrium unemployment rate, which, on balance, cooled down expectations of the timing of the first rate hike in the U.S. The latter triggered a sharp (yet temporary) dollar depreciation and a significant (and more persistent) strengthening of the debt market. Apart from the more distant rate hike outlook presented by the Fed, the Polish currency also drew support from the relatively strong local macro data, in particular the balance of payments, which showed solid export growth and a record-high surplus in foreign trade in January. The other monthly indicators released last week were also quite decent, confirming that industrial and construction activity was growing and that the labour market was still improving. Retail sales' growth disappointed a bit, but we think that in all probability it did not properly reflect the real trend in consumption demand of the recent months. The growing employment and wages, as well as the continuously positive consumer sentiment, suggest that growth in household spending is accelerating. The recent business climate indicator in retail trade seems to confirm this, as well.

The registered unemployment rate will be Poland's sole headline data release this week and it should also confirm that the situation on the labour market keeps on improving. The statistics office will additionally release its monthly bulletin, including some interesting details on the state of the economy. However, the market will be focused on publications abroad, which will include some of the most important leading indicators from the euro zone (flash PMIs, business and consumer confidence indicators). A number of Fed members will also speak in public.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (23 March)							
15:00	US	Home sales	Feb	m	4.94	-	4.82
TUESDAY (24 March)							
2:45	CN	Flash PMI – manufacturing	Mar	pts	50.4	-	50.7
9:30	DE	Flash PMI – manufacturing	Mar	pts	51.5	-	51.1
10:00	EZ	Flash PMI – manufacturing	Mar	pts	51.5	-	51.0
10:00	PL	Unemployment rate	Feb	%	12.0	12.0	12.0
13:30	US	CPI	Feb	%MoM	0.2	-	-0.7
14:00	HU	Central bank decision		%	1.95	-	2.1
15:00	US	New home sales	Feb	k	475	-	481
WEDNESDAY (25 March)							
10:00	DE	Ifo index	Mar	pts	107.2	-	106.8
13:30	US	Durable goods orders	Feb	%MoM	0.5	-	2.8
THURSDAY (26 March)							
	PL	Bond switch auction					
13:00	CZ	Central bank decision		%	0.05	-	0.05
13:30	US	Initial jobless claims	week	k		-	291
FRIDAY (27 March)							
13:30	US	Final GDP	Q4	%QoQ	2.4	-	5.0
15:00	US	Michigan index	Mat	pts	91.8	-	91.2

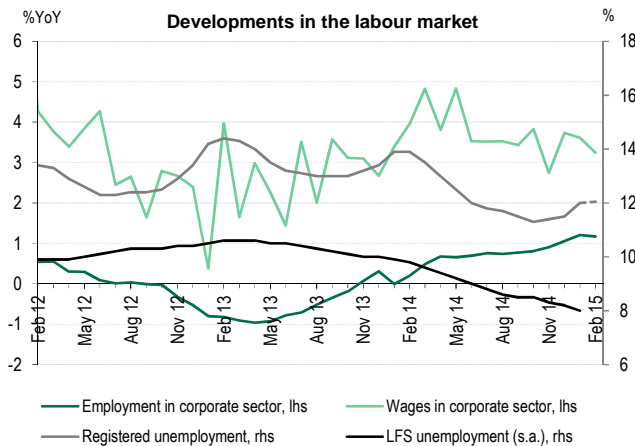
Source: BZ WBK, Reuters, Bloomberg

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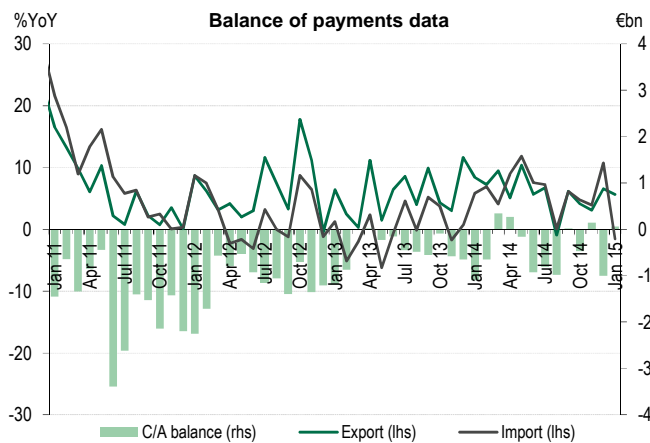
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What's hot this week – More positive news on unemployment

■ According to our estimates, the registered unemployment rate stayed at 12.0% in February, while the seasonally adjusted rate fell to 11.3% from 11.4% in January, its lowest level since August 2009.

■ The labour market has been improving since mid-2013 and we expect the unemployment rate to fall further in the short- and medium-term. In the short term, strong domestic demand and a reviving foreign demand will most likely translate into higher demand for labour. In the medium term, falls in the unemployment rate will be fuelled by the shrinking working-age population (although this should be limited by growing economic activity in older demographic groups).

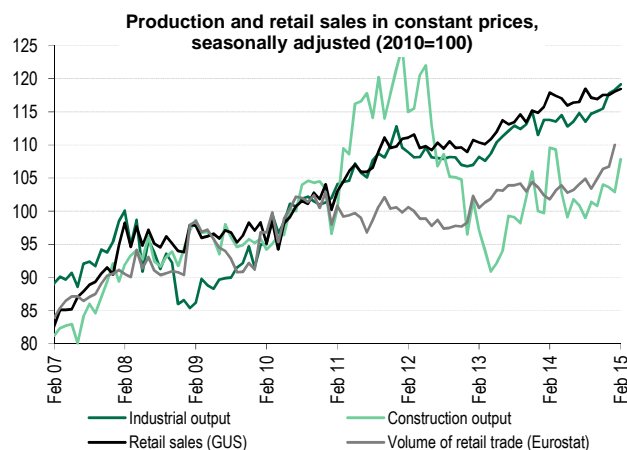
■ According to an NBP report on the labour market, the immobile-age cohorts are now doing considerably better than their earlier counterparts. They are more active and face a lower risk of unemployment.

Last week in the economy – Strong output and exports, weaker retail sales and wages

■ The current account recorded a €56mn surplus in January, driven by surprisingly strong exports and lower-than-expected imports. The improvement in exports was probably driven by the euro zone's economic rebound, while the weaker imports probably stemmed from lower commodity prices rather than struggling domestic demand. These data, therefore, build optimism regarding Poland's growth in the coming quarters.

■ Average wage growth in the corporate sector eased in February to 3.2%YoY (from 3.6% in January). At the same time, employment growth reached 1.2%YoY (same as in January). The slower wage growth was probably mainly the effect of lower bonus payments in the mining industry. We think that wage growth remained decent in other sectors though, as well. The employment figure was slightly disappointing, but it is hard to draw any strong conclusions at this point as most business climate surveys recently showed that companies' demand for employees remained strong. The corporate sector's total wage bill continues to rise quickly (6.2%YoY in February vs. 6.4%YoY in January, supporting healthy private consumption growth).

■ Industrial output grew 4.9% YoY in February, while construction and assembly output contracted 0.3% YoY. It is worth noting that the total industrial output was negatively affected by a significant drop of production in mining (-11.3% YoY). In contrast, output in the manufacturing sector expanded by 6.6% YoY. In construction, the annual growth rate was pushed lower by a very high base effect, though the seasonally adjusted index recorded a noticeable rebound. All in all, we find the production data to be quite positive, indicating that recovery is well on track. Real retail sales rose 2.4% YoY, but contracted 1.3% YoY in nominal terms amid a further drop in prices (-3.6% YoY). The retail sales' data certainly do not look impressive, but we have some doubts whether they properly reflect the current trends in the private consumption demand.

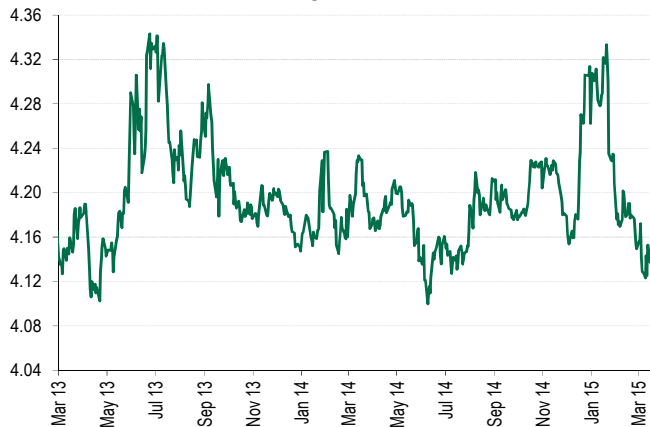
**Quote of the week – Interest rate adjustments in the event of an unexpected shock are possible****Minutes from the March's MPC meeting, NBP**

While discussing the scale of interest rate reduction and their desired level in the current cycle, the majority of Council members judged that interest rates should be adjusted on a single occasion so that the scale of the reduction would be significant and enough to contain the uncertainty about future monetary policy. These members were also of the opinion that a significant one-off reduction in interest rates should come along with an announcement that this decision concluded the monetary policy easing cycle. The majority of Council members judged that such an announcement would not prevent an adjustment in interest rates in an event of unexpected strong shocks in the Polish economy or its environment.

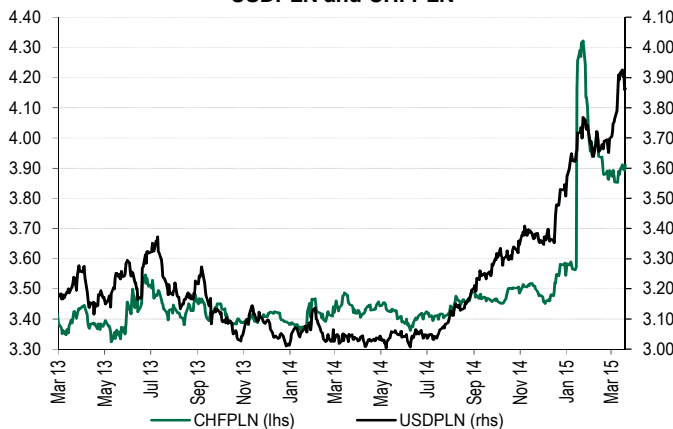
Minutes from the MPC's meeting in March showed that most Council members supported the single but significant rate cut in order to reduce uncertainty about future monetary policy. Moreover, they agreed that such a decision should be accompanied by a statement that the monetary easing cycle was over. However, their statement did not fully shut the door to further rate cuts – the MPC members agreed they should react in case of strong unexpected shocks in the Polish economy or its surroundings. We think that a considerable zloty appreciation, e.g. due to the ECB's monetary easing, could be such a shock. However, this is not our base-case scenario – we only expect a gradual appreciation of PLN. Considering this, we expect interest rates to remain unchanged for at least a year with the first hikes in 2H2016.

Foreign exchange market – Horizontal trend still likely

EURPLN



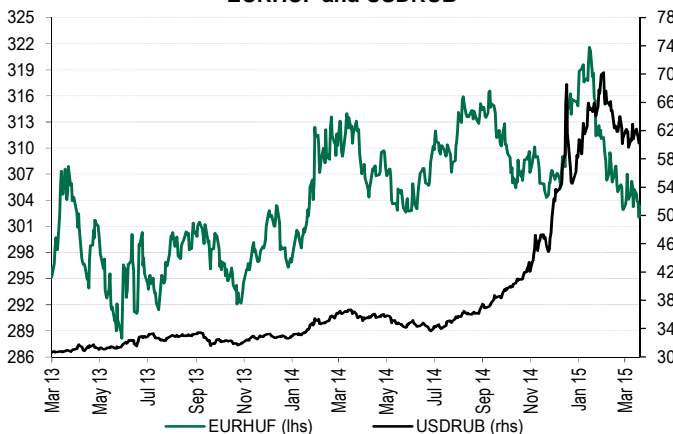
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



Good week for the zloty ...

▪ The Polish zloty gained significantly over the past week, drawing support from the strong export data and the Fed, which had quite a dovish message for the markets despite the fact that it withdrew its previous assurance that it was “patient”. Consequently, EURPLN fell temporarily to 4.109 (its lowest level since June 2014) compared with 4.15 recorded before the FOMC meeting. The zloty’s appreciation against the U.S. dollar was even more significant. USDPLN temporarily fell below 3.75, but quickly returned above 3.85. In weekly terms, the zloty gained the most against the British pound (2.1%) and the U.S. dollar (1.3%).

▪ The positive impulse from the Fed eased slightly toward the end of the week. However, the first rate hike in the U.S. now seems to be more distant and this should – together with ECB’s monetary expansion, the end of the MPC’s monetary policy easing, and the decent domestic macro data – support the zloty in the coming weeks. From the technical point of view, the EURPLN chart did not change significantly. The strong support level remains at 4.11, while the resistance zone is between 4.16 - 4.18. We think that EURPLN will stay in this range. Strong data from the U.S. economy could provide a strong impulse, pushing EURPLN towards the resistance zone.

... and for the other CEE currencies

▪ The other CEE currencies also benefited from the relatively dovish Fed. EURHUF temporarily fell towards 301 (a 14-month low), also supported by hopes for a possibly positive outcome of a S&P rating review (it is expected that the agency may change Hungary’s rating outlook to positive in the near future). Last week, the Czech koruna had firmed and was as strong as 27.14 against the euro, nearing the EURCZK floor. Meanwhile, the Russian ruble strengthened against the U.S. dollar, with USDRUB falling to 58.8. However, the exchange rate shifted upwards to 61 later as exporters sold foreign currency in preparation for tax payments to the state budget.

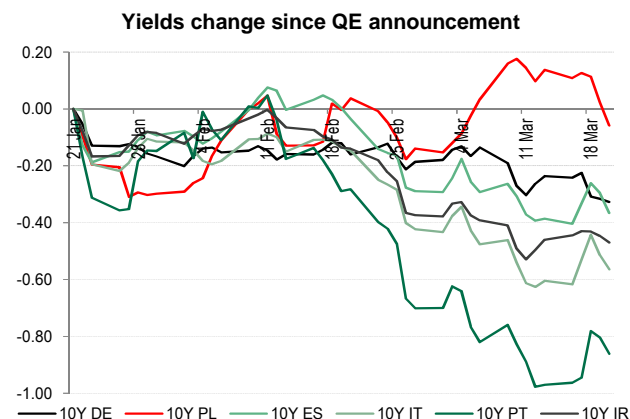
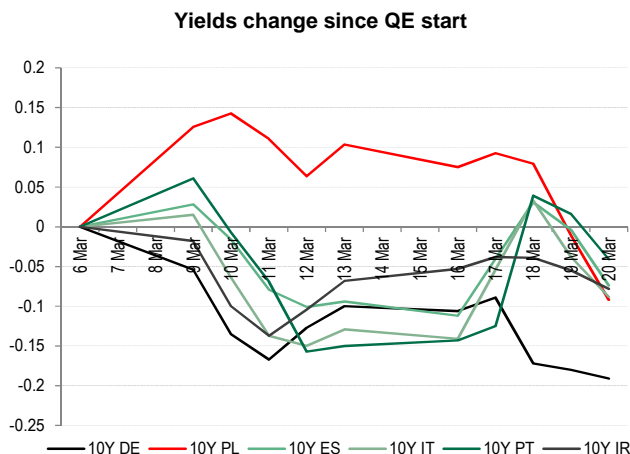
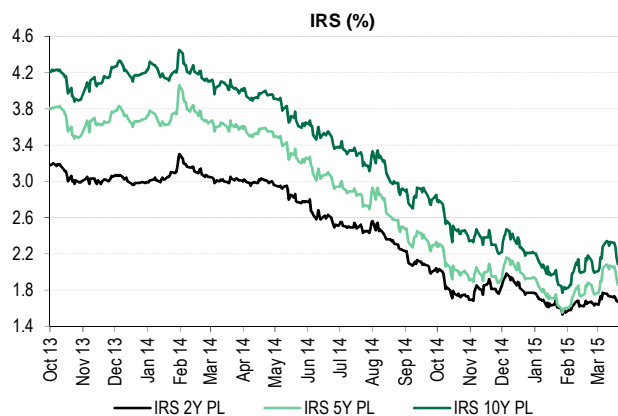
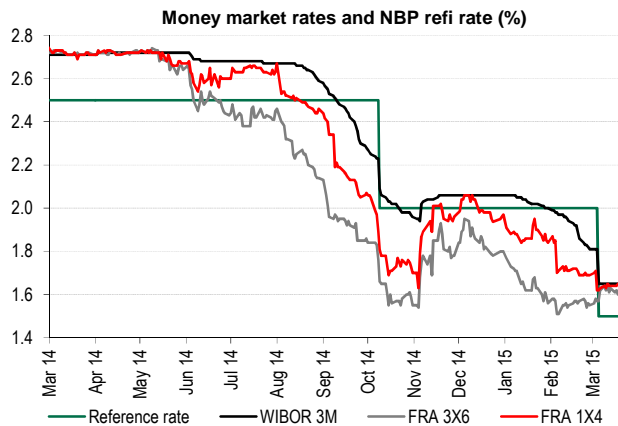
▪ This week investor sentiment will likely remain under the influence of external factors, though some local factors in the CEE region may also play a role, especially the expected central bank decision. We cannot rule out that the Hungarian central bank will cut rates, which would add volatility on the market and push EURHUF towards 305. Regarding the Czech koruna, the CNB meeting later this week should not bring any significant changes in its monetary policy, allowing EURCZK to stabilise slightly below 27.5.

Sharp jump of EURUSD on the Fed only short-lived

▪ The dovish message from the FOMC meeting pushed EURUSD rapidly up to almost 1.10. This was the sharpest one-session upward move in exactly 6 years. On March 18, 2009, the Fed also surprised markets by announcing higher-than-expected asset purchases, which then undermined the dollar. The move this time around was very short-lived, however. The dollar quickly trimmed some of its losses and, at the end of the week, EURUSD was close to 1.08.

▪ This week investors will get to see more macroeconomic data from Europe and the U.S., including the key leading indicators. We expect these data to confirm the current positive trends in both the economies. We, therefore, expect EURUSD to be in a horizontal trend, between 1.047 and 1.10, awaiting labour market data and the final PMI readings, due for release next week.

Interest rate market – Polish bonds stronger but still behind bonds on the European markets



Money market stable, IRS and yields lower after the FOMC...

Polish data were rather mixed last week and, as such, failed to trigger any directional trend. The money market remained stable and the 1-12M WIBOR rates were unchanged. The FRA rates moved sideways.

The outcome of the FOMC meeting was the most important for the Polish IRS and debt markets last week. And even though the Fed dropped the word “patient” from the statement, the overall tone and comments of governor Janet Yellen at the press conference were much less hawkish than the market had expected. Now that the first rate hike in the U.S. seems to have been postponed (in the view of investors), global bond yields plunged and this was also the case in Poland. The yield of the 10Y benchmark finally managed to break the support at 2.40%, reaching c2.25%, the lowest level since the MPC’s last meeting in early March. The 5Y yield dropped 20bp, while the short-end gained 5bp. The scale of the IRS curve’s fall was similar, with the 2Y rate reaching 1.68%, the 5Y 1.85% and the 10Y roughly 2.10%.

... but still lagging the European markets

The past week was already the second that saw the ECB buying debt of the euro zone countries. In that time, yields of the core bonds fell the most, while those in the peripheries gained only marginally. However, the cautious market response to the start of the ECB’s QE may stem from the aggressive strengthening of the debt market that took place earlier, when the programme had been announced.

The fourth chart on the left clearly shows that the Polish 10Y benchmark is lagging changes seen in the euro zone market. It suggests that the impact of the ECB’s QE on the Polish bonds will be delayed as European investors will be buying euro zone’s treasuries in the first place, and only when yields of the European bonds will near or reach zero, foreign capital will start looking for alternative assets to buy. This is when we may see more significant buying of the Polish debt by non-residents.

It should be noted, however, that the share of the Polish PLN-denominated and marketable bonds held by non-residents, the biggest group of investors on the Polish debt market, is already quite high – at 40% at the end of January. If we excluded the WZ/IZ bonds (foreigners used to hold roughly 5% of these series in the recent years), the average share of each series held by non-residents is 45%. Out of 22 fixed coupon series, foreigners held over 50% of the outstanding debt in 9 of them at the end of January. In the case of DS0725, the non-residents’ share is at nearly 80%. This factor may somehow limit the willingness of foreign investors to increase their exposure to the Polish debt market, due to, for example, liquidity concerns in case of a potential exit.

The switch tender will be held this week, at which the Finance Ministry will buy back OK0715, PS0415 and DS1015 bonds. According to the latest available data from the end of January, non-residents held nearly PLN24bn of these bonds’ nominal value. We think that given the recently less hawkish (than expected) signals from the FOMC and the monetary policy easing of the ECB, foreign investors will rather reinvest the cash from whatever they will sell at the switch. The fact that Poland’s bonds have finally recorded some significant gains of late could encourage investors to bet that this trend could continue amid the quite positive market circumstances mentioned above.

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