Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

15 – 21 February 2016

The Polish economy was in a very solid condition at the end of 2015, which was confirmed by last week's data on GDP exports and corporate loans. We expect these trends to continue (GDP growth at c3.5%) and this week's data on output, sales and the labour market will show the performance at the start of 2016. We expect these numbers to be quite positive. Still, for the Polish financial market the global mood may continue to be more important. The key risk factor for Polish economic growth is the current turmoil abroad and worries that it may result in a slowdown of the economic growth in the euro zone, which could trigger worse exports prospects. Global outlook will remain key for EURPLN, which we still see in a wide range of 4.36-4.51.

Worries about the global growth made the market price-in monetary policy easing of the main central banks (even cuts of the interest rates in the U.S.) and led to a flattening of the yield curves. Under such circumstances, investors may increase their expectations towards a possible interest rate cut also by the Polish MPC. The inflation (actually deflation) is supportive, as January's 12M CPI figure was lower than expected again (0.7% YoY). It seems that deflation may last as long as almost until the year-end. New members of the Polish MPC seem to opt for a continuation of current monetary policy, though they also emphasised the importance of the central bank's new inflation projection as a driver of future decision (to be published in March). This week we will get to know the final PiS's candidate from the Lower House (Sejm) and two candidates to be proposed by the President Duda.

The bond (probably 5Y) auction will take place on Thursday. The last two auctions that were held after the S&P's downgrade were quite successful and the recent performance of the Polish debt suggests no problems selling bonds this time around either.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (15 February)					
		No important data releases					
		TUESDAY (16 February)					
9:00	CZ	Advance GDP	Q4	%YoY	4.5	-	4.7
11:00	DE	ZEW index	Feb	pts	56.5	-	59.7
14:00	**PL**	**Wages in corporate sector**	**Jan**	**%YoY**	**3.4**	**3.8**	**3.1**
14:00	**PL**	**Employment in corporate sector**	**Jan**	**%YoY**	**1.5**	**1.6**	**1.4**
		WEDNESDAY (17 February)					
14:00	**PL**	**Industrial output**	**Jan**	**%YoY**	**2.9**	**1.7**	**6.7**
14:00	**PL**	**Construction and assembly output**	**Jan**	**%YoY**	**-3.2**	**-5.4**	**-0.3**
14:00	**PL**	**Real retail sales**	**Jan**	**%YoY**	**5.4**	**6.9**	**7.0**
14:00	**PL**	**PPI**	**Jan**	**%YoY**	**-0.7**	**-0.5**	**-0.8**
14:30	US	House starts	Jan	k	1175	-	1149
14:30	US	Building permits	Jan	k	1205	-	1204
15:15	US	Industrial output	Jan	%MoM	0.4	-	-0.4
20:00	US	FOMC minutes					
		THURSDAY (18 February)					
11:00	**PL**	**Bond auction**					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	-	-	269
14:30	US	Philly Fed index	Feb	pts	-2.9	-	-3.5
		FRIDAY (19 February)					
14:30	US	CPI	Jan	%MoM	-0.1	-	-0.1

Source: BZ WBK, Reuters, Bloomberg

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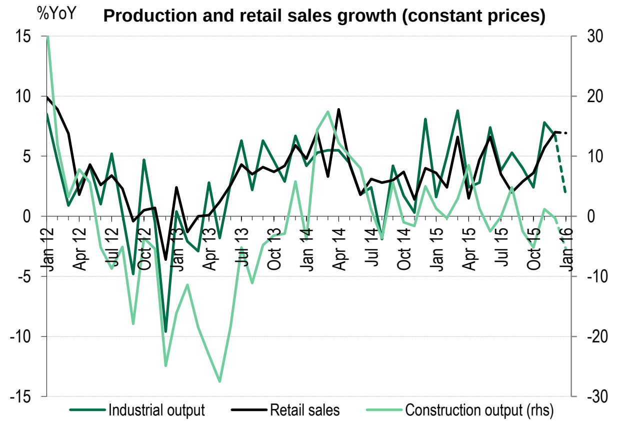
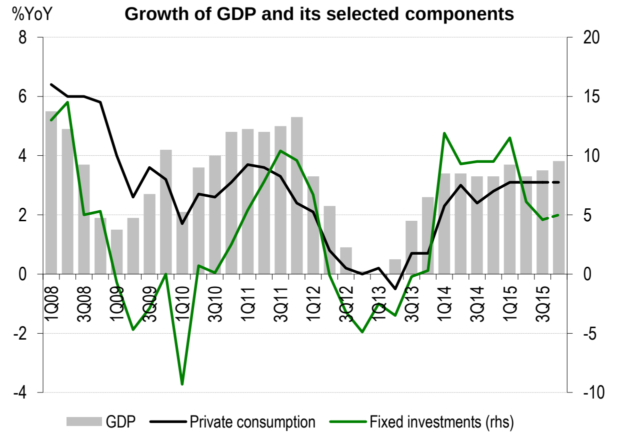
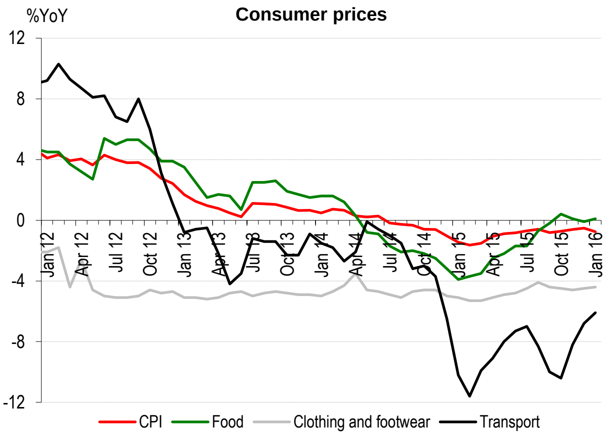
What's hot this week – Industrial output, retail sales, labour market statistics



- A strong set of Polish data for January is scheduled for this week, which should help assess the economic climate at the start of 2016.
- January's PMI surprised to the downside, so industrial output will be eyed closely in search of any signs of a slowdown. This number will indeed be lower than in December, but, due to the working-day effect and with the underlying trends, should remain strong, in our view. We also expect retail sales to stay robust and construction output to show a negative reading, given the weak trends in this sector and severe weather conditions in January.
- Labour market data will be under strong impact of January's revision of the statistical sample. We expect employment growth to rise on this. Wages will continue to rise moderately.

Last week in the economy – GDP up, deeper and longer deflation, strong foreign trade





- Polish GDP grew 3.9%YoY in 4Q15, slightly better than estimated, while the seasonally adjusted quarterly growth reached 1.1%, the strongest since 4Q14. In general, the data confirmed that Poland's economy remained strong at the end of 2015, despite the uncertain global environment. We expect GDP growth to be at 3.5%YoY on average in 2016. Private consumption is likely to accelerate due to the strong labour market and the government's subsidies for kids (500+ programme), while investment growth may slow (mainly in the public sector).
- Once again, the inflation reading surprised to the downside. In January, prices of consumer goods and services were by 0.7% lower than last year (the market consensus and our forecast were at -0.5% YoY). We were surprised by the scale of the decline in healthcare (-1.9% MoM, presumably due to changes to the list of reimbursed medications) and transport (-4.2% MoM; in addition to the significant falls in fuel prices, transport service prices also went down). The January data will be revised next month, adjusted by the new CPI basket weights, so a slightly different final reading cannot be ruled out. According to our estimates, core inflation ex food and energy prices fell to zero in January (the lowest level since 2006).
- The C/A deficit in December 2015 amounted to €410mn, i.e. the gap was significantly lower than we had expected (€1144mn). Exports surprised to the upside, reaching €13.8bn (up 12.1%YoY), while imports were below expectations and amounted to €13.5bn (3.8%YoY). As a result, foreign trade showed a surplus of €373mn. The services' balance showed a surplus of €835mn, roughly in line with our expectations. Overall, the December balance of payments looks quite positive thanks to the strong performance of foreign trade, supported by the weak zloty and low commodity prices.

Quote of the week – Current level of rates supports the macroeconomic balance

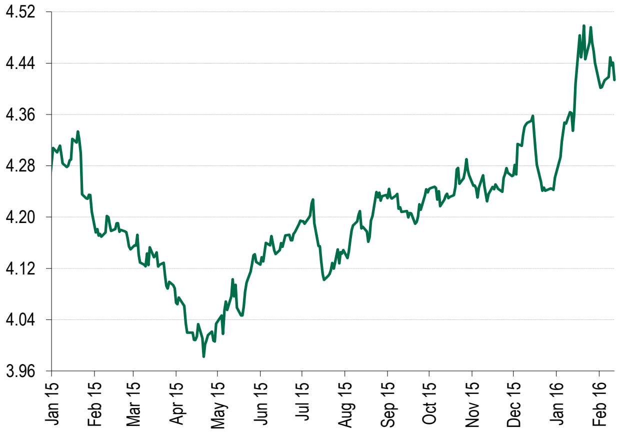
Marek Chrzanowski, MPC member, Reuters, 08.02
The current level of interest rates supports the macroeconomic balance and stability of the Polish economy. Changing rates or the inflation target would negatively affect this balance We should continue the current monetary policy.

Eugeniusz Gatnar, MPC member, Bloomberg, 08.02
A decision on changing the level of rates will depend on the inflation and GDP outlook published in March, as well as on how the economy reacts to the government's new economic policy. After all, the effects will be seen in only a few months. (…) The "supply-side nature" of Poland's long-lasting deflation means it isn't harming the economy, while indicators from retail sales to credit growth and manufacturing add to the evidence that the cost of money is appropriate. There is no need to use the central bank to "artificially boost" demand for lending.

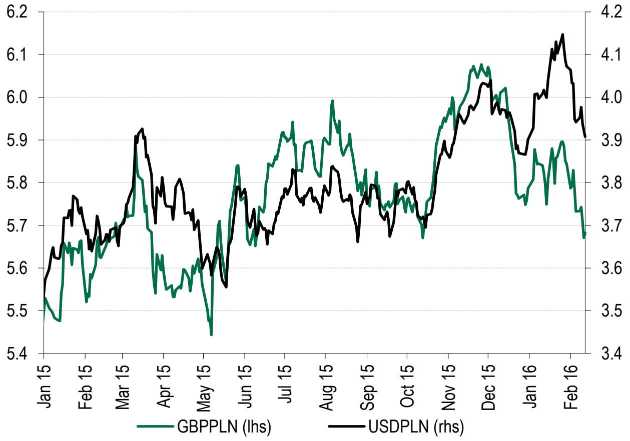
Three new MPC members – Marek Chrzanowski, Eugeniusz Gatnar and Jerzy Kropiwnicki (appointed by the Senate) – attended the meeting in February. The other two new members – Grażyna Ancyparowicz and Eryk Łon (appointed by the Sejm) – were sworn in after this meeting. The third Sejm nominee was expected to be appointed before the end of Anna Zielińska-Głębocka's term on February 9, but, surprisingly, PiS deputies decided to withdraw their support for Henryk Wnorowski. The new candidate will be most likely Jerzy Żyżyński (a PiS member of parliament). We have no news yet of the two new candidates to be appointed by President Duda (the deadline is February 19). All eight new members should be in place by the March meeting. Chrzanowski and Gatnar seem to agree that monetary policy in Poland should be managed as it was by the previous council (no reason to change the inflation target, rates are at an appropriate level). They also emphasised the importance of the central bank's new inflation projection as a driver of future decisions.

Foreign exchange market – High volatility persists

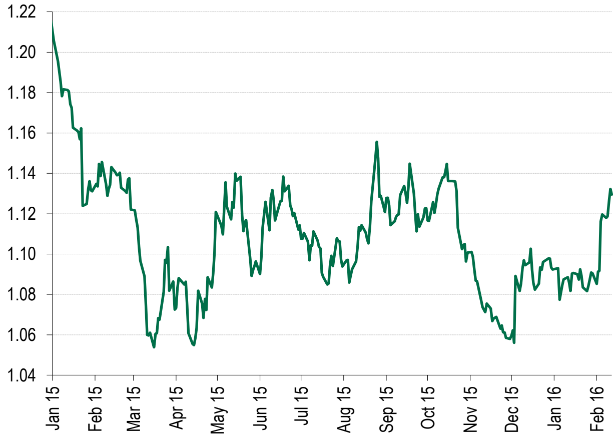
EUR/PLN



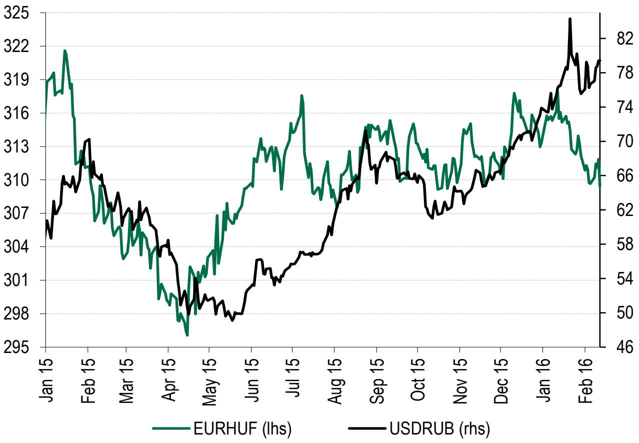
GBP/PLN and USD/PLN



EUR/USD



USD/RUB and EUR/HUF



The zloty remains vulnerable to global factors

▪ The zloty remained highly volatile against the main currencies over the past week. The currency weakened due to a higher global risk aversion and concerns about the government's policies (such as the bank tax, conversion of CHF mortgage loans), especially in light of the negative opinion of NBP. Domestic macro data had little effect on the zloty. As a consequence, on a weekly basis, EURPLN fluctuated in quite a wide range of 4.398-4.472 and ended the week slightly above 4.40 (more or less near the previous week's close), supported by improvement in global sentiment. At the same time, USDPLN remained below 4.00. The rate reached a local minimum at c3.88, for the first time since end–December.

▪ Looking at technical analysis, EURPLN did not change much over the past week and the rate stayed between 4.36-4.51. This week is filled with domestic and U.S. macro data releases, with the latter likely having the biggest impact on the zloty. We think that PLN might react asymmetrically to the news flow. We think that the zloty could lose more from the continued risk-off mood and due to uncertainty related to the Polish government's policy than strengthen if the global mood improves. The aforementioned consolidation channel is, therefore, still valid.

EURUSD continues its upward trend

▪ Last week, EURUSD rose markedly thanks to further weakening of the probability that the Fed will raise rates in the upcoming months despite the Fed chair Yellen's testimony. The rate temporarily exceeded 1.137, the highest level since mid-October. The U.S. dollar also significantly weakened against JPY over the past week as the Japanese currency gained thanks to its safe haven status.

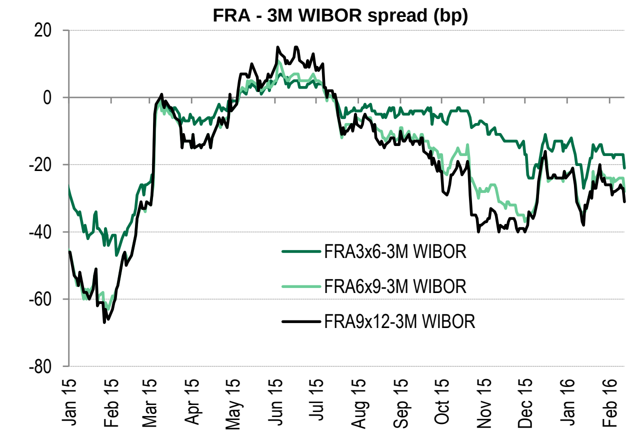
▪ The U.S. macro data releases (including CPI) and events (FOMC minutes) that are due this week will dominate the market. We expect the data to be rather mixed. We also expect the FOMC to take quite a dovish stance as regards its monetary policy normalisation. We think that data from Germany (ZEW index) will also be in the spotlight this week. All in all, we expect EURUSD to stay in the range of 1.108-1.14.

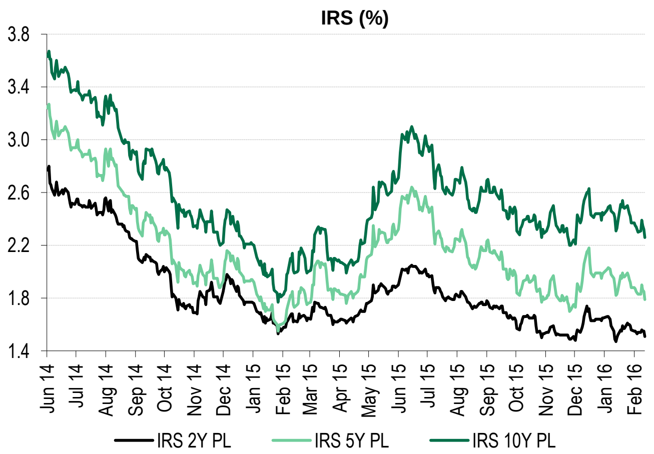
Mixed picture for CEE currencies

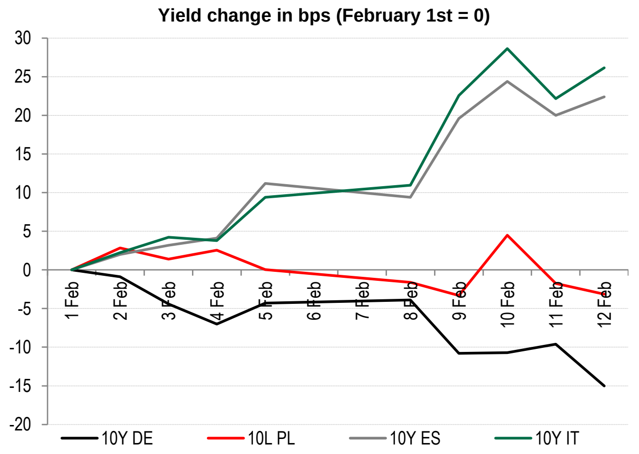
▪ Last week, the Russian ruble depreciated sharply against the U.S. dollar due to a fall in oil prices and the risk-off mood. USDRUB rose to nearly 80, but the rate ended the week close to 79. The Hungarian currency suffered from the dovish minutes of NBH, suggesting that more easing was likely, if needed. This, together with the risk aversion mood, pushed EURHUF up towards 313. But it was only temporary as the rate fell below 310 at the end of the week. At the same time, EURCZK, as in the previous weeks, was more immune to the global risk-off mood due to CZK's safe haven status in the CEE region. As a result, EURCZK stayed in a narrow range of 27.0-27.06.

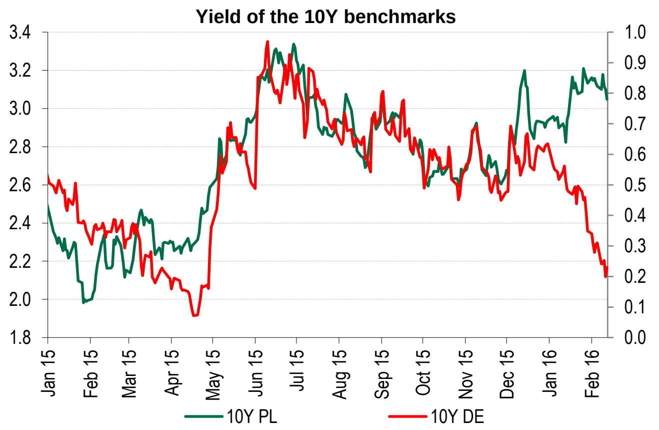
▪ We think that global factors will still play the main role among the CEE currencies. Therefore, volatility on HUF and RUB should remain high. What is more, the Czech GDP data for 4Q15 might affect EURCZK in the short term.

Interest rate market – (Not overly high) risk aversion could help









Rates lower after a volatile week

▪ The past week was quite volatile for Polish IRS and yields. The market was under pressure from high tensions worldwide, but bonds were quick to recover (partly thanks to the CPI data) and their yields fell even below the previous week's closing. The same was true of the IRS. The 2Y rate ended the week close to 1.50%, the 5Y at around 1.80% and the 10Y near 2.25%. WIBORs also changed last week, with the 6M, 9M and 12M rates falling 1bp.

(Not overly high) risk aversion could help

▪ DAX has lost so far in February 11% and S&P500 7%. The odds for a 25bp Fed rate hike are now down, according to Bloomberg, to 0% from 18% for March and to 11% from more than 60% for December. As the third chart shows, the euro zone's peripheries have lost quite substantially already this month on rising concerns about the global banking sector and economic growth. At the same time, the 10Y Bund yield neared its c.0.05% all-time low from April 2015 and it seems that gains of the German debt were more important for the Polish bonds than the sell-off in Spain or Italy.

▪ Several important U.S. data are on the agenda this week, including the FOMC minutes' release. The German yields are close to their record lows, which might suggest that a strong trigger is needed to push them much lower. However, it looks like there is still room for weaker equities and if the Chinese stock market opens lower on Monday (to catch up with the recent rout in the European and U.S. markets), Bunds could remain well-bid. For the Polish market, the scale of the potential risk aversion is key – an overly high risk aversion could spur demand for safe assets and push the domestic IRS/yields up. But only slight market sentiment deterioration could prove supportive for the Polish debt. We also think that room for strengthening is smaller than room for some profit-taking on the domestic market.

▪ We expect Poland's data releases to be a rather mixed bag. January's industrial output could disappoint, but our forecast for real retail sales is above the market consensus. On balance, this week's domestic macro releases are rather unlikely to change the market's view on monetary policy. Investor focus could rather shift to the process of appointing new MPC members as the ruling PiS party needs to propose a new candidate following the withdrawal of its support for Wnorowski. President Andrzej Duda may also name his two candidates. The market is pricing in only 50% odds for a 25bp cut in 3 months' time and a full 25bp cut in 6 months. We think that the longer FRAs could move up if more neutral comments emerged this week.

▪ The Finance Ministry will hold a bond auction on Thursday. It already placed 2Y and 10Y bonds this month and we now expect 5Y debt and/or a floater to be offered. At the end of December, domestic investors held c.75% of the outstanding PS0421, of which banks had 70%. The last two auctions that were held after the S&P's downgrade were quite successful and the Polish debt's recent performance suggests the ministry should not have problems selling its bonds this time around either.

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.