Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

22 – 28 February 2016

Although sentiment on the global financial markets remains volatile, 'risk on' prevailed last week again, supported by solid economic data from the U.S. and hopes for further policy easing by the ECB. The zloty appreciated and bonds firmed last week, with the spread between the Polish and German 10Y bond yields narrowing towards 270bp. Apart from the better mood abroad, sentiment was also supported by soothing comments from deputy PM Morawiecki. And we do not mean the presentation of his "Responsible Development Plan", but rather the three important issues he mentioned in various interviews and which could have tamed investor worries about the government's policy outlook: (1) the president should not push for implementing his proposal of FX loan conversions, (2) the tax-free income should be increased gradually in order to keep public finances in check, (3) there was never a strong government pledge to lower the retirement age.

President A. Duda appointed two MPC members (Łukasz Hardt and Kamil Zubelewicz) and the Sejm is probably going to approve PiS candidate Jerzy Żyżyński at the nearest session. It is quite likely that we will get see interviews with the new members in the coming days, which will hopefully cast some light on their views on monetary policy. So far, several new MPC members have admitted that although they saw some room for interest rate reductions, they would be very cautious with such decision.

There are many important new data releases abroad due this week, with the domestic publications (unemployment rate, business climate indicators) likely in the background. Market sentiment at the start of the week may be strongly determined by the investors' reaction to the EU-UK talks, which should end during the weekend.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (22 February)					
9:30	DE	Flash PMI – manufacturing	Feb	pts	52.0	-	52.3
10:00	EZ	Flash PMI – manufacturing	Feb	pts	52.0	-	52.3
		TUESDAY (23 February)					
8:00	DE	GDP	Q4	%YoY	1.3	-	1.7
10:00	**PL**	**Unemployment rate**	**Jan**	**%**	**10.3**	**10.3**	**9.8**
10:00	DE	Ifo index	Feb	pts	107.0	-	107.3
14:00	HU	Central bank decision		%	1.35	-	1.35
16:00	US	Consumer confidence index	Feb	pts	97.5	-	98.1
16:00	US	Home sales	Jan	m	5.40	-	5.46
		WEDNESDAY (24 February)					
16:00	US	New home sales	Jan	k	520	-	544
		THURSDAY (25 February)					
11:00	EZ	HICP	Jan	%YoY	0.4	-	0.2
14:30	US	Initial jobless claims	week	k	-	-	262
14:30	US	Durable goods orders	Jan	%MoM	2.5	-	-5.0
		FRIDAY (26 February)					
14:30	US	Preliminary GDP	Q4	%QoQ	0.5	-	0.7
14:30	US	Personal income	Jan	%MoM	0.4	-	0.3
14:30	US	Consumer spending	Jan	%MoM	0.3	-	0.0
16:00	US	Michigan index	Feb	pts	91.0	-	92.0

Source: BZ WBK, Reuters, Bloomberg

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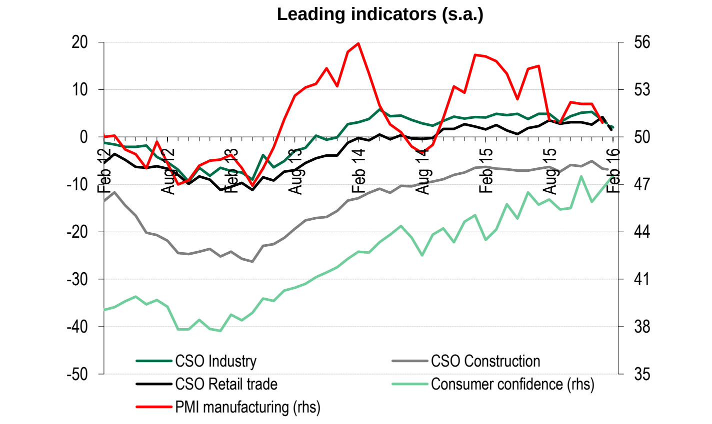
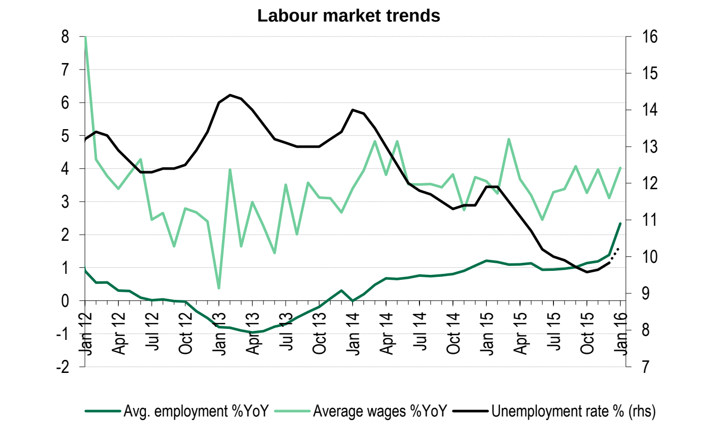
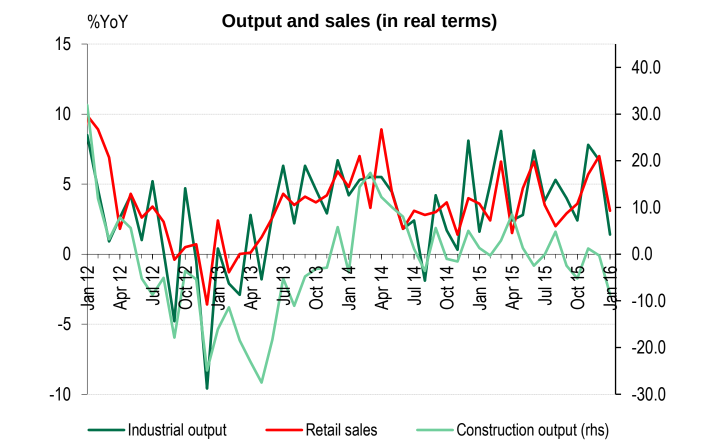
What's hot this week – Business climate, unemployment rate



- January's registered unemployment rate is unlikely to attract much attention since we already know the Labour Ministry's flash estimate (10.3%, in line with our forecast) and a surprise in unlikely. We forecast the seasonally adjusted unemployment rate at 9.8%, the lowest level since 2009.
- On Monday, the statistics office will release its business climate indicators for February. These may prove interesting, given their recent falls coupled with a declining PMI. There may be some one-off effects, as the government's plans to introduce a new retail tax may have weighed on sentiment in retail trade. However, confirmation of the downward trend in business sentiment, especially in manufacturing, would support our forecast of GDP slowdown in1Q16.
- We expect the Statistical Bulletin to show more details about January's strong growth in employment.

Last week in the economy – Positive labour market data, disappointing activity in industry





- Labour market data surprised to the upside, with employment growth accelerating to 2.3% YoY from 1.4% YoY in December. Wages rose 4.0% YoY vs. 3.1% YoY in December. Please keep in mind that every year in January the statistics office updates its sample of the surveyed companies and adds those that started to employ more than 9 workers in the last year. This time around, employment rose by 77k MoM – the best January result since 2011. The pace of wage growth in the corporate sector accelerated and, in our opinion, this stemmed mainly from the fact that the December reading was dragged down by low payments in mining.
- Industrial output growth decelerated in January to 1.4% YoY from 6.8% YoY in December 2015. Poland's industry was negatively affected by a lower number of working days than a year ago, but, even when adjusted for this effect, January's data show some deceleration as the seasonally adjusted output grew 3.3% YoY, its slowest for 10 months.
- Falls in construction and assembly output of 8.6% YoY (7.0% YoY after seasonal adjustment) were a major negative surprise. Supposedly, this may have been due to worse weather conditions, but we cannot rule out that the ongoing slowdown in public investments (visible in data since mid-2015) is one of the culprits as well.
- January's retail sales were weaker than expected, rising3.1% YoY in real terms. We think that consumers could have switched some purchases to December from January and this could explain why the end of 2015 was strong (+7% YoY, highest growth since April 2014) and the start to 2016 weak. The incoming months will be key for verifying this theory.
- In January, producer prices fell 1.2% YoY due to a further decline in commodity prices.

Quote of the week – There is room to cut rates, but MPC should be cautious

Eryk Łon, MPC member, PAP, 15.02
There is room to cut rates in Poland, but it is not significant. A rate cut would not affect the real economic processes. However, it should be considered. But we have to be cautious. If the zloty gains considerably, a rate cut would become more probable than in a case, in which the zloty weakens.

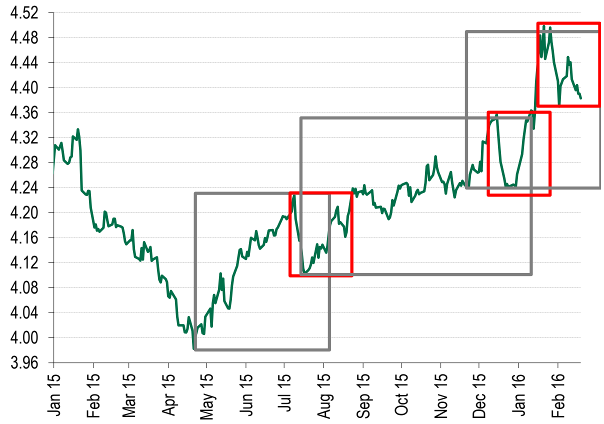
Jerzy Żyżyński, candidate for MPC member, PAP, 16.02
Generally, I am in favour of a rate cut, but there are some counter-arguments. As regards small banks – lower gains. We have to be cautious.

Jerzy Kropiwnicki, MPC member, Dziennik Gazeta Prawna, 17.02
As regards changes in interest rates, we should not rush. We have to remember that deflationary factors are outside the Council's powers. I am also speaking about external factors.

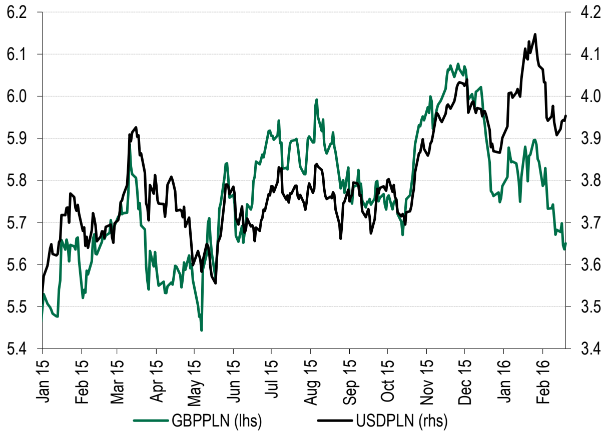
The new MPC is almost complete now that President Andrzej Duda has appointed Łukasz Hardt and Kamil Zubelewicz to the Council. Both are quite young economists but with no monetary policy background. There is only one vacancy, most likely to be filled by Jerzy Żyżyński. Fresh comments of the newest MPC members show that some of them see room to cut rates (Żyżyński seems to be the most dovish), but remain cautious due to the weak zloty and the potentially negative impact of the cut on small banks and credit unions. However, the last MPC minutes from the February meeting showed some central bankers argued that favourable labour market conditions and risk of acceleration in consumer demand may be arguments to consider rate hikes. The February meeting was not attended by the two most hawkish members of the last MPC, i.e. Jan Winiecki and Andrzej Rzońca, so it seems that someone else took their position

Foreign exchange market – Global sentiment remains crucial

EUR/PLN

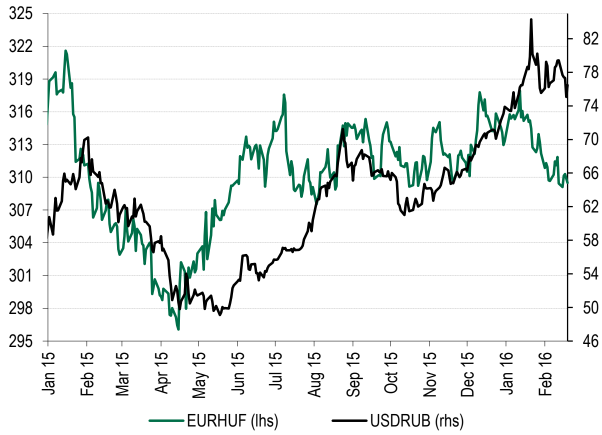


GBP/PLN and USD/PLN



EUR/USD

USD/RUB and EUR/HUF



EUR/PLN near important support

- EUR/PLN was the least volatile this past week since late November 2015 as positive global sentiment persisted for the better part of the week. The zloty gained temporarily to 4.37 per euro mainly thanks to deputy PM Morawiecki who said that President Andrzej Duda would not push for his draft of the FX mortgage conversion bill. At the same time, USD/PLN stayed in its horizontal trend at around 3.93, just above the local low at c3.90.
- EUR/PLN neared the local low from early February and the important support level at 4.36, if broken, would make the current down-wave longer than the previous two corrections (see the first chart). In addition to the domestic factors, the positive sentiment on the global markets was an important driver for the zloty's recent strengthening. Investors' higher risk appetite was fuelled, among others, by decent U.S. macro data. Another bunch of U.S. macro data releases is on the agenda this week.
- Turning to domestic events, the market is likely to ignore the unemployment data release, but we think that interviews with the new MPC members may start appearing. Their view on the room to cut rates has so far been rather cautious, which, together with the market's speculation that the Council could cut the central bank's reserve requirement ratio instead of the main refi rate, could be somewhat supportive for the zloty.
- EUR/PLN is close to its local bottom and breaking 4.36 may open the door to a more persistent zloty recovery.

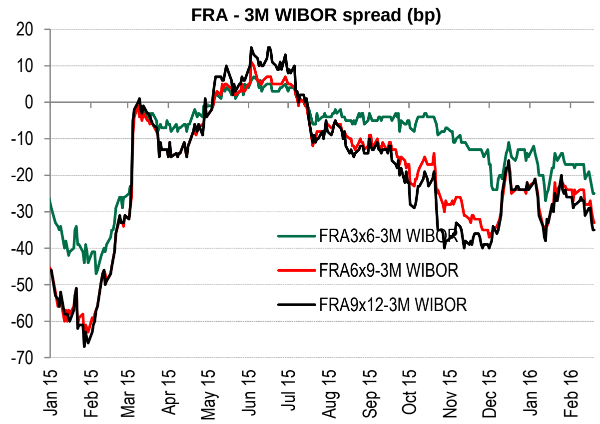
EUR/USD down

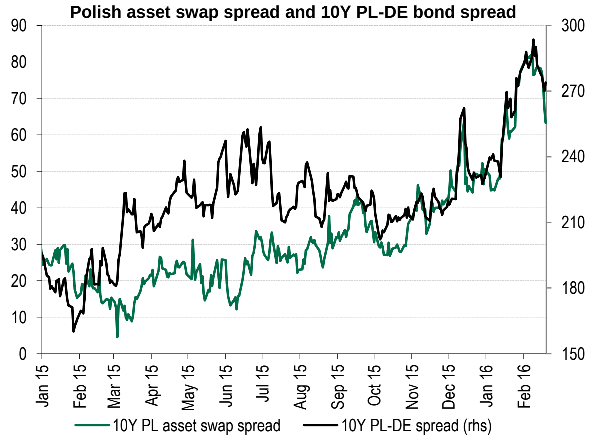
- The dollar recovered slightly after weakening for three consecutive weeks on above-consensus U.S. data releases and rising odds for more ECB action in March. EUR/USD fell below 1.11 and reached its lowest level since early February.
- U.S. data shall continue to have a significant impact on the market this week. The odds for Fed rate hikes this year are already very low, so more positive surprises in macro releases could lead to the market's re-pricing of its view and more dollar gains. At the same time, room for further rises in EUR/USD looks limited due to the possibility of verbal interventions from the ECB officials.

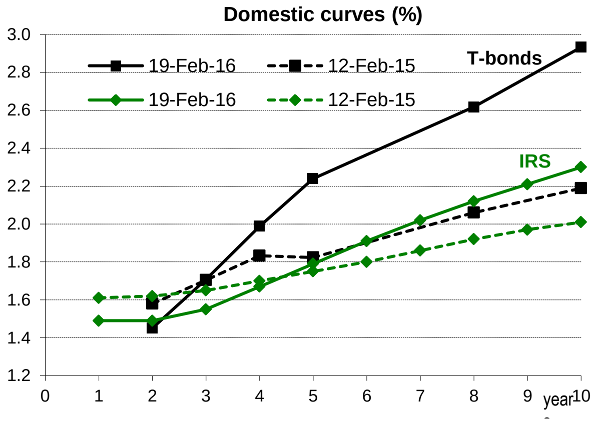
No big changes for HUF and RUB

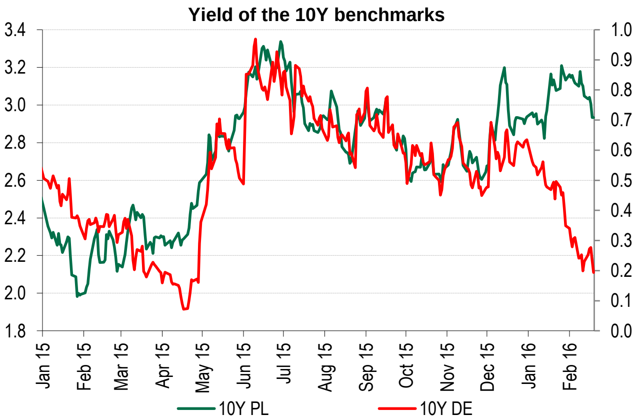
- EUR/HUF remained roughly stable near 310 and just above the local low at c308. The Hungarian currency benefited from the zloty's appreciation, but did not manage to sustain its own gains. This week, the Hungarian central bank meets and its policymakers' recent comments were pretty straightforward. They said more monetary policy easing may be delivered, if needed. Still, this did not stop the forint from gaining 1.5% vs. the euro so far this year. We think that the MNB officials could continue their verbal interventions and we do not expect the bank to take any new action this week.
- USD/RUB fell temporarily to 75 from 79 and established a fresh low in February on the rising Brent oil price. However, the exchange rate did not manage to break below the local bottom from late January at c74.5. Developments on the commodity market are likely to remain the core driver for the ruble in the nearest future.

Interesting rate market – Market should remain strong









Poland's debt stronger and stronger

- The domestic interest rate market saw some relief last week thanks to stronger hopes for ECB action and speculation on the MPC's future decisions. There has been some media speculation that the MPC may consider cutting the mandatory reserve requirement ratio instead of the main interest rate. We think that the domestic macro data (in particular the weaker-than-expected output and retail sales) and favorable bond tender results (details below) also contributed to the debt strengthening. As a result, the 10Y benchmark yield temporarily fell to nearly 2.90%, the lowest this month.
- On a weekly basis, the yield curve shifted down (by 1-11bp) and flattened gradually, echoing core markets. However, bonds outperformed IRS (10Y IRS rate increased by 4bp in weekly terms) and, as a result, the asset swap spread tightened markedly, below 70bp for the 10Y sector (down from c80bp at the end of the previous week). What is more, the spread over Bunds also tightened gradually to c270bp.
- Poland's Ministry of Finance successfully tapped the domestic bond market. It sold the 5Y PS0421 benchmark and WZ0120 floaters worth PLN7.2bn in total (at both the regular and top-up auctions). As we had expected, the auction attracted solid demand that was generated, in our view, mainly by commercial banks and foreign investors. Demand reached cPLN12bn at the regular auction (the bid to cover ratio was at c2, up from 1.5 at the previous auction) and cPLN3.3bn at the top-up. All in all, Poland has covered c40% of this year's gross borrowing needs.
- On the money market, the FRA rates fell 3-10bp across the board. Investors returned to their earlier expectations for a deeper decline in the WIBOR 3M in the upcoming months. The market now expects the rate to fall by nearly 40bp in nine months' time (FRA9x12 at 1.34%).

Interesting week ahead

- This week's domestic macro calendar is light (registered unemployment rate), so all eyes will be on the external macro data releases (including flash PMI, CP in the euro zone countries, and GDP, confidence indices in the U.S.) and global sentiment. Inflation data could be the most important since falling inflationary expectations are the central bankers' key current concern. We believe that the released macro data abroad should support investor expectations for central bank action (further monetary easing by the ECB and Fed on hold in March). Further strengthening on the core markets would be a supportive factor for the domestic curves.
- While the markets have had relief, global sentiment remains fragile and could make a U-turn very quickly. Following the significant strengthening of the last days, the risk of a correction is on the rise, especially since the market is already pricing in aggressive easing from the ECB and even from Poland's MPC. However, we uphold our stance that until the ECB meeting, the domestic debt market should remain quite strong. Notwithstanding, the scope for further southward move of the yield curve seems limited.
- Turning to the domestic factors, the newly appointed MPC members may present their point of view on monetary policy. Their speeches should be closely monitored and could affect investor sentiment. What is more, this will be the week when commercial banks can change their tax base. Thus, there may be greater volatility due to the bank tax in the upcoming days.

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.