Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

29 February – 6 March 2016

Global market sentiment remained very volatile last week, but Poland's zloty and bonds managed to gain on rising hopes for more ECB easing, fading concerns about the Polish internal situation and despite another set of poor German economic activity indicators. EUR/PLN tested 4.36, while the 10Y benchmark yield stayed comfortably below 3%.

U.S. releases are likely to be the main global sentiment drivers. Odds for a Fed rate hike have grown in the last couple of weeks thanks to the somewhat more upbeat U.S. macro data and less concern about China. January's nonfarm payrolls and the manufacturing ISM are likely to be most closely watched this week. We think that room for a more significant and persistent bond weakening is limited by strong expectations for more action to be announced by the ECB next week. This might be particularly the case if the euro zone's flash HICP for February surprises to the downside. Turning to Polish data, we do not expect much impact from the release of detailed GDP numbers, but we think that the PMI release could affect the front end of the curve, particularly if it proves disappointing again, making monetary policy easing somewhat more likely. At the same time, EUR/PLN is close to an important support level and a fall below 4.36 may mean that a more sustainable zloty recovery is underway.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (29 February)					
10:00	**PL**	**GDP**	**Q4**	**%YoY**	**3.9**	**3.9**	**3.5**
10:00	**PL**	**Private consumption**	**Q4**	**%YoY**	**3.2**	**3.2**	**3.1**
10:00	**PL**	**Investments**	**Q4**	**%YoY**	**4.9**	**5.0**	**4.6**
11:00	EZ	Flash HICP	Feb	%YoY	0.0	-	0.3
14:00	**PL**	**Inflation expectations**	**Feb**	**%YoY**	**0.2**	**0.2**	**0.2**
16:00	US	Pending home sales	Jan	%MoM	0.6	-	0.1
		TUESDAY (1 March)					
2:45	CN	PMI – manufacturing	Feb	pts	48.4	-	48.4
9:00	**PL**	**PMI – manufacturing**	**Feb**	**pts**	**50.5**	**50.6**	**50.9**
9:55	DE	PMI – manufacturing	Feb	pts	50.2	-	52.3
10:00	EZ	PMI – manufacturing	Feb	pts	51.0	-	52.3
16:00	US	ISM – manufacturing	Feb	pts	48.5	-	48.2
		WEDNESDAY (2 March)					
14:15	US	ADP report	Feb	k	180	-	205
20:00	US	Fed Beige Book					
		THURSDAY (3 March)					
9:55	DE	PMI – services	Feb	pts	55.1	-	55.0
10:00	EZ	PMI – services	Feb	pts	53.0	-	53.6
11:00	**PL**	**Bond auction**					
14:30	US	Initial jobless claims	week	k	-	-	272
16:00	US	Industrial orders	Jan	%MoM	2.0	-	-2.9
16:00	US	ISM – services	Feb	pts	53.0	-	53.5
		FRIDAY (4 March)					
9:00	CZ	GDP	Q4	%YoY	3.9	-	4.7
14:30	US	Non-farm payrolls	Feb	k	188	-	151
14:30	US	Unemployment rate	Feb	%	4.9	-	4.9

Source: BZ WBK, Reuters, Bloomberg

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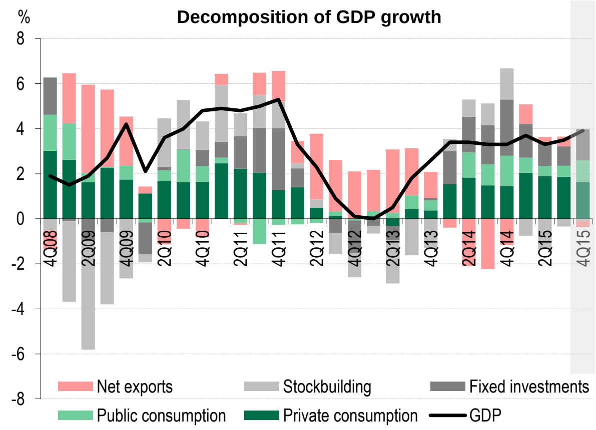
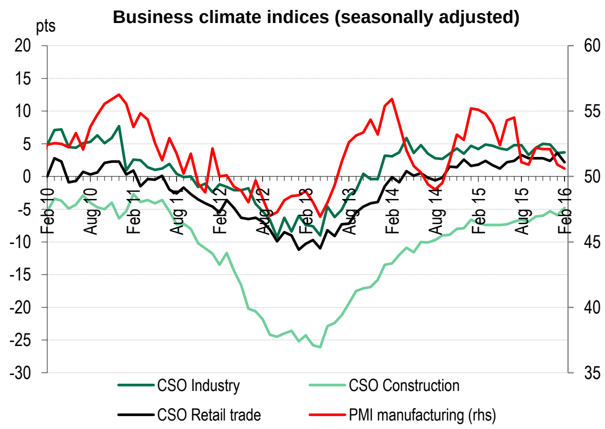
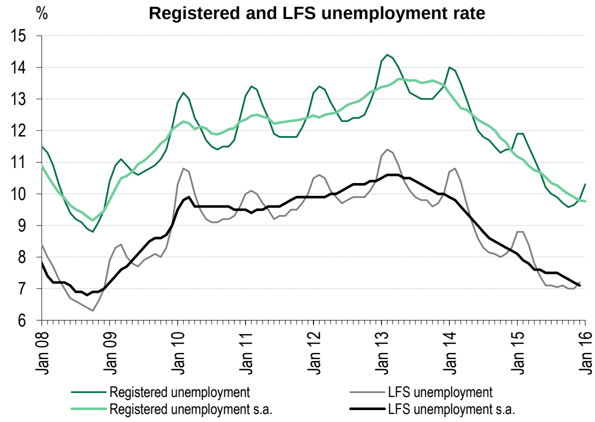
What's hot this week – GDP and PMI





- The statistics office will publish detailed GDP breakdown for Q4 on Monday. We expect the headline number to be the same as the already released 3.9% flash estimate. In our view, the growth breakdown was roughly similar to that in Q3, with slightly higher growth rates of private consumption, fixed investment, and a lower contribution of net exports.
- In the upcoming quarters, we expect GDP growth to remain close to 3.5% YoY, the growth rate that was seen throughout 2015. We believe that private consumption growth will accelerate, driven by favourable labour market developments and higher social benefits (the government's 500+ child benefit programme). On the other hand, fixed investments are likely to decelerate due to lower public outlays and a worse business climate caused by an unstable regulatory environment.
- Booming private consumption is likely to fuel imports. In our base scenario, we expect the ongoing recovery in the euro zone to strongly support Polish exports. However, recent data from Europe has cast some doubt on this. In general, we expect a negative contribution of net exports.
- We expect PMI to fall further in February because rising uncertainty about the regulatory and political environment is likely to weigh on sentiment. Our forecast also draws support from the falling PMI indices in Germany and the euro zone. However, the underlying trends remain quite positive and this was recently reflected by improvement of the consumer confidence indicator (which reached the highest level since 2008), rebound in the statistics office's business climate indices for manufacturing and construction, as well as the European Commission's ESI for Poland.

Last week in the economy – Labour market offers good news



- Poland's registered unemployment rose to 10.3% in January (and fell to a seasonally adjusted 9.8%, according to our estimate), the lowest reading in January since 1991. Demand for labour remained strong. The number of the newly registered unemployed reached 224k, the lowest January level since 1998. What is more, the number of people removed from the unemployment rolls due to taking up of a job was higher than a year before. We expect further declines in the unemployment rate this year, though at a slower pace than in 2015.
- LFS data on the labour market showed a fall in the unemployment rate to 6.9% in 4Q2015. According to LFS, employment rose 1.6% YoY to reach 16.3mn, the highest level ever.

Quote of the week – We should keep some room for manoeuvre

Łukasz Hardt, MPC member, Bloomberg, 23.02

I see absolutely no reason to cut interest rates at the moment. They should stay at the current, stable level. We should keep some room for manoeuvre in case it is needed in the future, keeping in mind that space for cuts has shrunk a lot and is quite tiny.

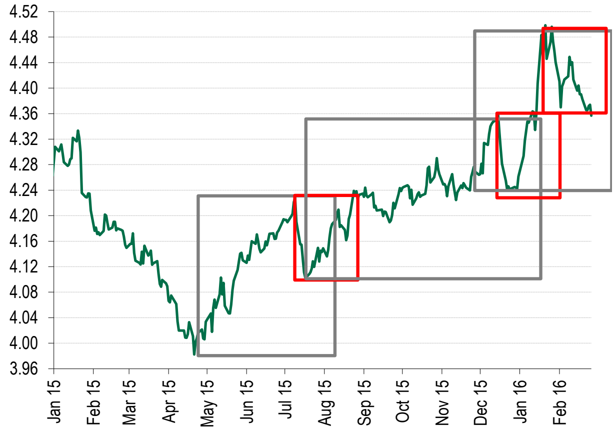
Eryk Łon, MPC member, Reuters, 23.02

Polish monetary policy is currently expansionary and should remain so in the upcoming months. Further falls in stock prices in the developed economies can weigh on the global growth outlook. The stock market will be one of the factors affecting my views on monetary policy.

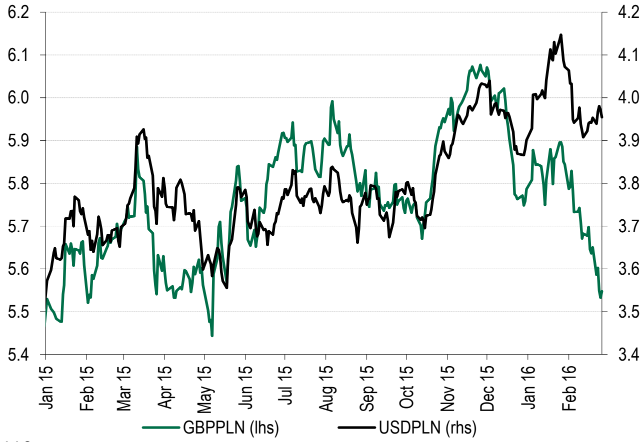
Łukasz Hardt, appointed to the MPC by President Andrzej Duda, was clearly sceptical about interest rate cuts in Poland, making monetary policy easing in March less probable. MPC's Eryk Łon listed the stock market as one of the factors that could affect his views on interest rates. Let us keep in mind that his earlier comments about future rate cuts were also rather cautious, but he did not rule them out then. In general, the new MPC is clearly less dovish than expected. A rate cut of 25bps in March still remains our base-case scenario because we expect the central bank to revise down its inflation path majorly (most probably showing inflation running below the MPC's target until 2018). More easing in the euro zone (the market expects something really huge) may also change the environment and encourage central bankers to cut. In our view, even if the MPC does not to cut the reference rate, it may lower the reserve requirement ratio.

Foreign exchange market – The zloty could firm further

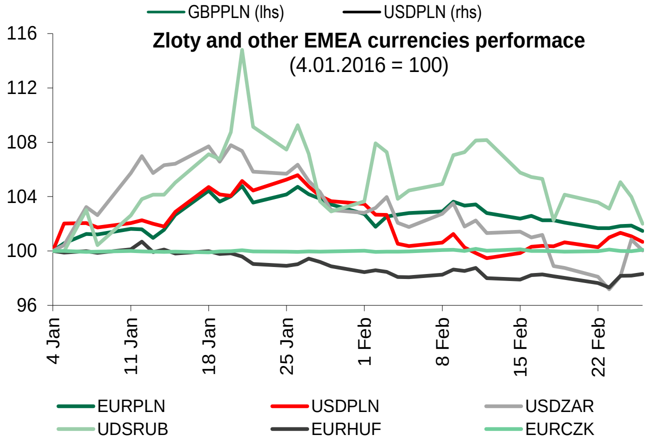
EUR/PLN



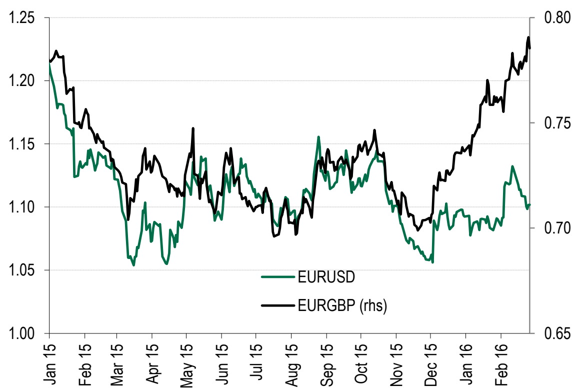
GBP/PLN and USD/PLN



Zloty and other EMEA currencies performace (4.01.2016 = 100)



EUR/USD and EUR/GBP



Zloty gains on improved global sentiment …

- Poland's zloty gained visibly last week, with EUR/PLN testing 4.35, the lowest level since the start of January. This was generally caused by improvement of the global sentiment. Poland's market response to significant falls on the Chinese stock exchange was only short lived, with EUR/PLN temporarily rising a tad above 4.38. The zloty also gained against the U.S. dollar. USD/PLN stabilised slightly above 3.98, after reaching a weekly minimum close to 3.93 (due to a rise of EUR/USD slightly above 1.114). At the same time, CHF/PLN fell below 4, after reaching week's maximum at 4.03. All in all, this was the 6th consecutive week of zloty strengthening against the euro.
- The zloty took a breather last week as tensions related to the FX mortgage conversion bill faded. Investors are currently waiting for the Financial Supervision Authority's (KNF) estimate of the potential losses for banks if the FX mortgage conversion plan presented by the president was implemented in its current shape. KNF plans to release its calculations in March, which means that this will unlikely be an issue this week. Thus, the zloty will be under the influence of domestic (GDP, PMI index) and global macro (PMIs for both the euro zone and China, non-farm payrolls in the U.S.) factors. EUR/PLN is flirting with its strong support level of 4.36 and we think that investors are waiting for an additional impulse to break through this level permanently. In the short run, incoming macro data should be supportive (with EUR/PLN moving towards 4.34), while concerns about the banking system may limit the scope for zloty gains until the situation is clarified.

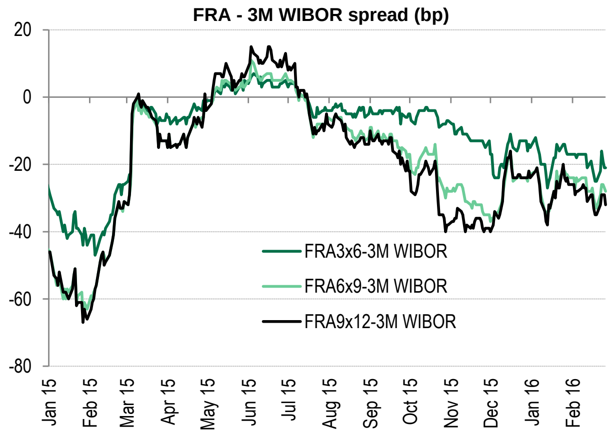
… and outperforms other CEE currencies

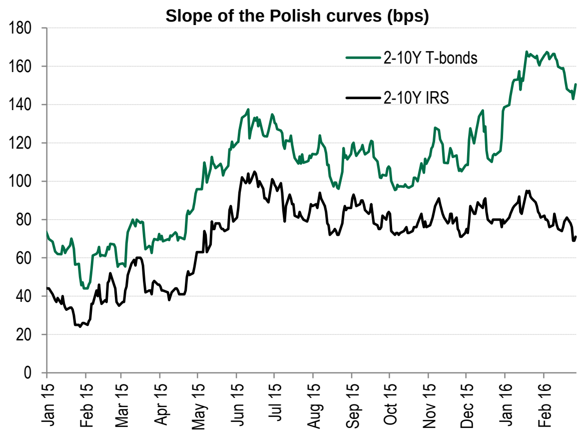
- On a weekly basis, the zloty outperformed its CEE peers. But the currency is an underperformer when it is compared to the region's other units at the start of 2016. The Hungarian forint and Russian ruble were highly volatile this past week, while the Czech koruna moved sideways. EUR/HUF rose above 311 as a result of, among others, dovish rhetoric of the Hungarian central bank. At the same time, USD/RUB dropped towards 75 (after a brief increase to as high as 78) due to rising oil prices.
- CEE currencies, similarly to PLN, will be under the influence of domestic factors and global sentiment. We expect EUR/CZK to remain more or less stable, just above the central bank's floor of 27. At the same time, HUF and RUB will be more volatile, especially the Russian currency, which may quickly rise if oil prices return to their downward trend.

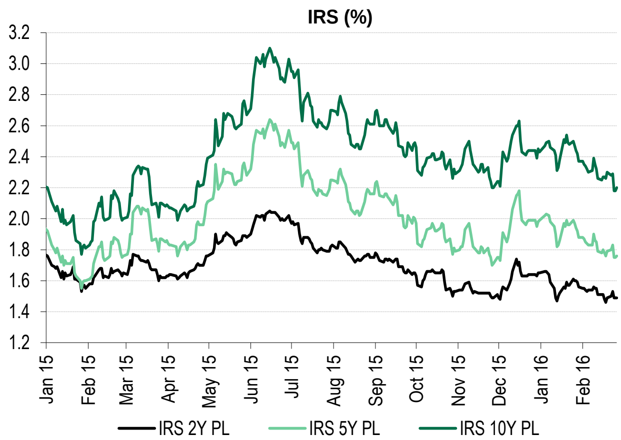
GBP under pressure from growing "Brexit" risk

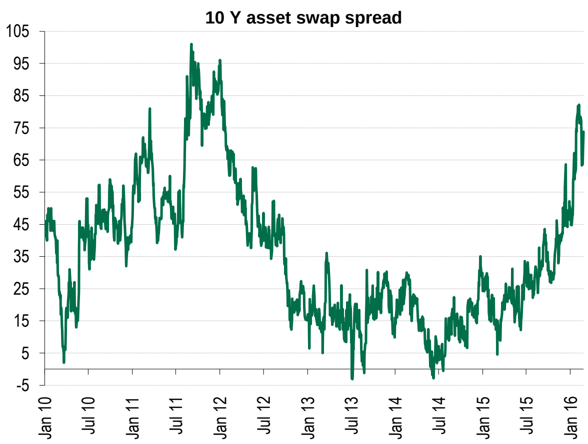
- The British pound weakened sharply over the past week due to the rising risk of a "Brexit". As a result, EUR/GBP rose above 0.79, the highest level since December 2014, while GBP was at its weakest level in seven years against the U.S. dollar (1.393). At the same time, EUR/USD moved downwards due to more calls for deeper monetary easing in the euro area. The rate reached a local minimum near 1.096, down from the local maximum at 1.114 at the start of the week.
- This week's macro calendar is quite heavy, with the main focus on the leading indicators (PMI, ISM), flash inflation rate for the euro zone and labour market data in the U.S. The growing risk of deflation in the euro zone (suggested by inflation data in Germany) might strengthen expectations that the ECB will deliver a more substantial easing package in March.

Interest rate market – Rates should remain low









Rates down, curves less steep

- Last week was good for bonds. Polish yields fell 2-5bp and the IRS by even up to 10bp on a weekly basis. The domestic 10Y benchmark yield reached temporarily c2.90% and the 5Y yield neared 2.15% for a while, their lowest since mid-January. At the same time, the 10Y IRS fell below 2.20%, its lowest since April 2015, while the 5Y rate fell to 1.75%, just above the local bottom at 1.70% seen in late November 2015. Both curves flattened with the 2-10 spreads falling 2bp for the bonds and 10bp for the IRS. The 10Y asset swap spread fell 10bp to c.70bp, but remained relatively high, near 80bp, its highest level since late 2012.
- 1M and 3M WIBORs fell 1bp last week despite cautious comments of the new MPC members.

Rates should stay low ahead of ECB

- Important events are on the agenda this week. We think that the Polish PMI can affect the front end of the curve, particularly if it proves disappointing again, making monetary policy easing somewhat more likely. FRAs are discounting less than a 25bp cut in 1 month and 3 months, and there may be some room for the market rates to fall if February's economic activity falls short of expectations. We will also get to see detailed 4Q GDP data, but we do not expect them to have much impact on the market
- U.S. releases are likely to be the main drivers for the belly and long ends of the curves. Odds for a Fed rate hike have grown in the last couple of weeks thanks to the somewhat more upbeat U.S. macro data and less concern about China. The market now sees a c.25% probability for a 25bp hike in July (vs. less than 10% that was priced in mid-February). January's nonfarm payrolls disappointed after surprising positively for three consecutive months, but the manufacturing ISM rose at the beginning of the year for the first time since May 2015. These numbers are likely to be most closely watched this week. We think that room for a more significant and persistent bond weakening is limited by strong expectations for more action to be announced by the ECB next week. This might be particularly the case if the euro zone's flash HICP for February surprises to the downside.
- On Monday, the Finance Ministry will announce its monthly bond supply plan. Deputy Finance Minister Piotr Nowak said that the ministry's last bond auction helped cover 39% of this year's gross borrowing needs. Nowak believes that reaching the 50% mark at the end of 1Q is likely, but the ministry will not aim for this at any price. In its original 1Q plan, the ministry planned to sell bonds worth PLN28-38bn. It has already issued debt for c.PLN29bn, so we think its supply in March should not be higher than PLN10bn. There are also no significant coupon payments/maturities in March, so liquidity will not favour an ambitious supply plan.

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.