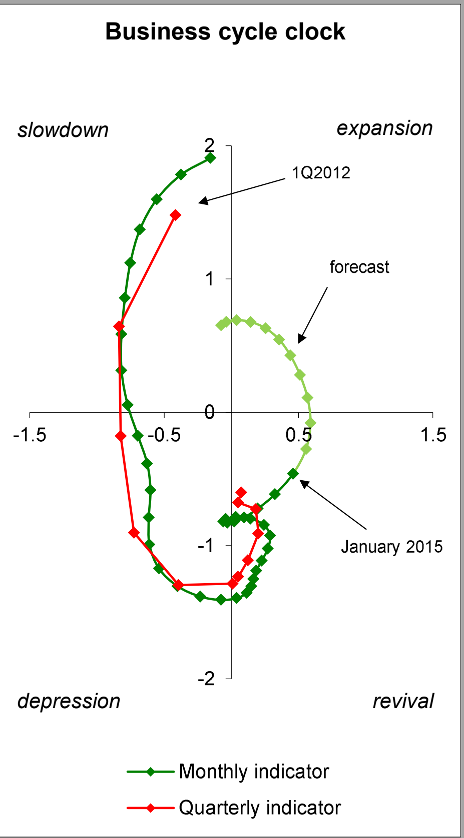
Bank Zachodni WBK
Grupa Santander

MACROscope

Polish Economy and Financial Markets

March 2015

The Tide Is Turning



In this issue:

- We seem to be at a key moment in the economy, making March not only the turn of winter and spring but also a major turning point for the financial markets.

- **Expectations for economic growth in Europe have started to improve and we think we may soon see a series of upward revisions to GDP growth forecasts for both the Euro zone and Poland.** The ECB has already raised its economic growth forecasts for the Euro zone quite substantially and we see growing upward risk to our forecasts for Poland. Data show economic activity is robust and, from 2Q15, GDP growth should accelerate again, driven by healthy domestic demand and the improving external outlook.

- **Poland's Monetary Policy Council cut interest rates by 50bp and concluded the easing cycle with main refi rate at 1.50%.** The decision came as a surprise (as the market expected a 25bp cut) but we cannot say that it was not justified. We think interest rates will remain unchanged in 2015 and the first hikes could be expected in 2H16. Deflation probably hit its lowest point in February (at -1.5%YoY, according to our forecast), and we think it will edge up again in the coming quarters. Reaching the 2.5% inflation target is still a way off, but we think it will take place sooner than predicted in the central bank's last inflation projection (which does not foresee it happening until the end of 2017).

- **The MPC's pledge that this marked the end of easing cycle had a positive impact on the zloty, which appreciated to 4.11 per euro, the strongest level since June 2014.** It seems that the horizontal trend in EUR/PLN observed since August might have just ended and the zloty could start gaining in the coming months as one negative factor (rate cuts in Poland) is no longer an issue. Additional support for the zloty could be provided by the ECB's extended asset purchase program that started in March. We expect some bigger portfolio inflows to Polish assets, which could help the zloty. One of the elements that may attract foreign capital is the recent weakening of the Polish bond market – triggered by the MPC ending its easing cycle and strong US employment data – which could be seen as a good buying opportunity. Our forecasts for economic data due this month assume a relatively good performance and this may also support the zloty, but, at the same time, limit the scope for bonds to recover.

- **US monetary policy is also important.** The market thinks the word 'patient' may be dropped from the FOMC's statement as soon as March, bringing a Fed rate hike even closer. Should this happen, upward pressure on global bond yields could strengthen, but we do not think this is likely to hurt the zloty significantly as a more hawkish attitude would be a sign of trust in the positive outlook for the US (and global) economy, which, in turn, would support risk appetite.

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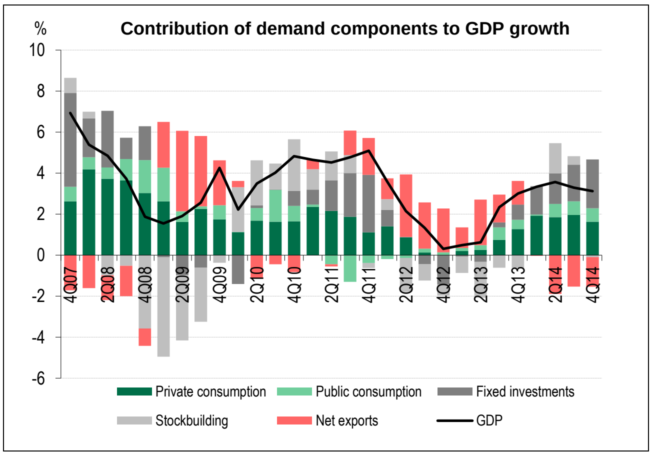
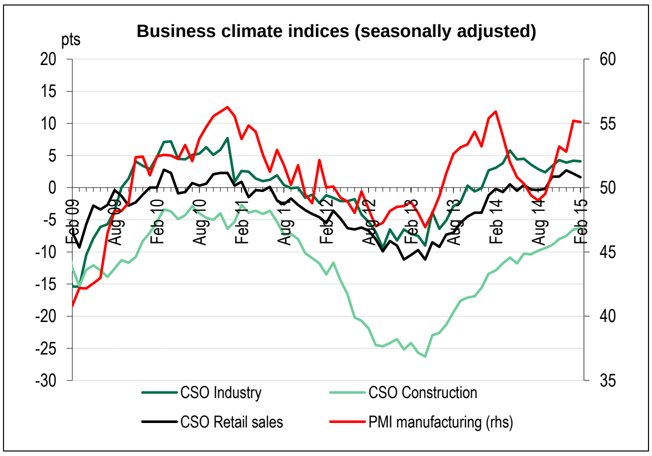
Financial market on 11 March 2015:

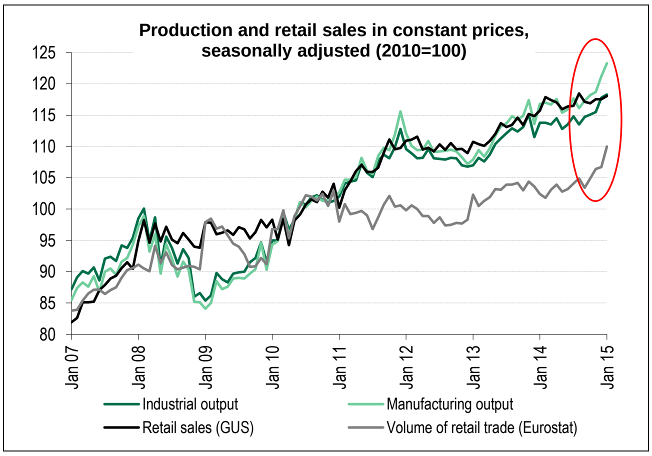
NBP deposit rate	0.50	WIBOR 3M	1.65	EURPLN	4.1435
NBP reference rate	1.50	Yield on 2-year T-bond	1.65	USDPLN	3.9091
NBP lombard rate	2.50	Yield on 5-year T-bond	2.09	CHFPLN	3.8888

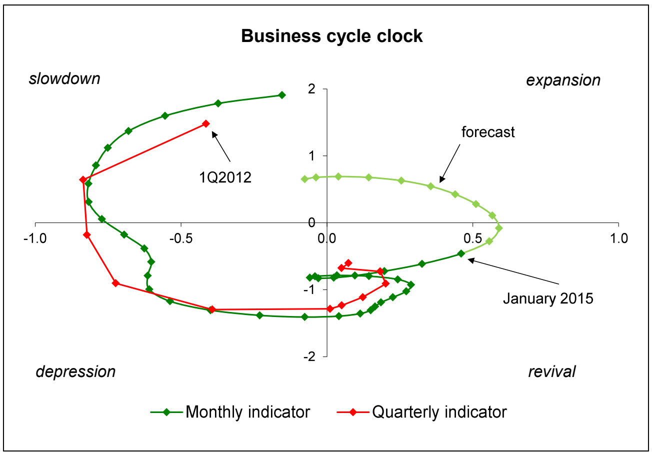
This report is based on information available until 11.03.2015.

Economic update









Source: CSO, Markit, BZ WBK.

GDP growth was stronger than expected at the end of 2014

- Poland's GDP data for 4Q14 surprised positively again, with a slight upward revision to 3.1%YoY from the 3.0% flash estimate released two weeks earlier. Seasonally-adjusted growth reached 0.7%QoQ (vs flash 0.6%). Admittedly, the Polish economy slowed a bit at the end of 2014, but, in general, the deceleration appeared to be very mild and fundamentals still look healthy.
- Domestic demand rose 4.6%YoY in 4Q14, with private consumption up 3.1%YoY and fixed investment growth at 9.0%YoY. The lion's share of investment growth was in machinery and equipment with a decreasing share in buildings and structures.
- Net exports negatively affected GDP growth, subtracting 1.5pp, but we note that real export growth accelerated to 6.9%YoY in 4Q from 3.8% in 3Q. Import growth accelerated even more, to 10.7%YoY (its fastest pace since 1Q11).

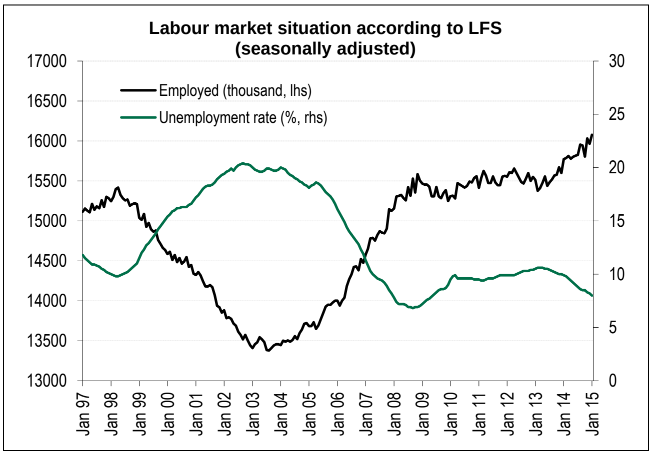
There is growing evidence that activity is accelerating again

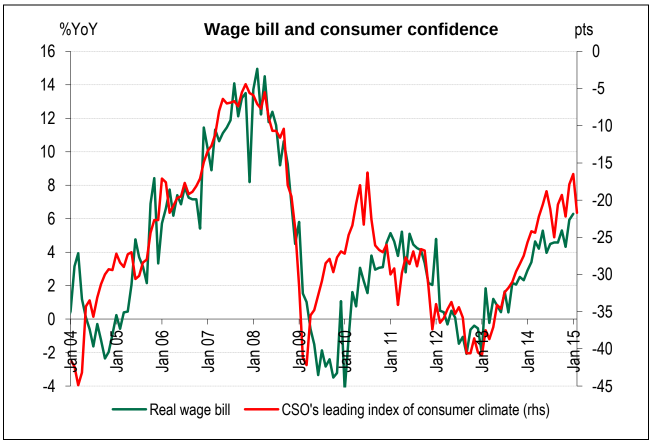
- We think the trend is gradually changing: we see growing evidence that economic activity, after slowing in the second half of 2014, is starting to accelerate again in early 2015.
- Most of the leading indicators and economic climate surveys show that entrepreneurs were optimistic and business activity in the main sectors was rising at the start of the year. Manufacturing PMI surged to 55.2 in January and dropped back only slightly in February, with all the main sub-components still in the expansion zone. The EC's Economic Sentiment Index edged up in February, staying at level compatible with above-3% GDP growth. The CSO business climate index for manufacturing stabilised, while the index for construction increased and retail trade decreased slightly. All three indicators were close to their highest levels in four years.
- Annual growth rates for industrial production and retail sales for January did not look very impressive at the first glance. However, this was partly due to high base and working days effects. The seasonally- and working-days-adjusted indices not only continued their upward trend in January, but signalled rising momentum (especially in manufacturing output and the volume of retail trade, i.e. the Eurostat measure that includes sales in smaller shops, but excludes vehicles).
- Foreign trade data still confirm a gradual rebound in Polish exports to the biggest Euro zone countries. Strengthening signals of a recovery in EU economies suggest this will continue.

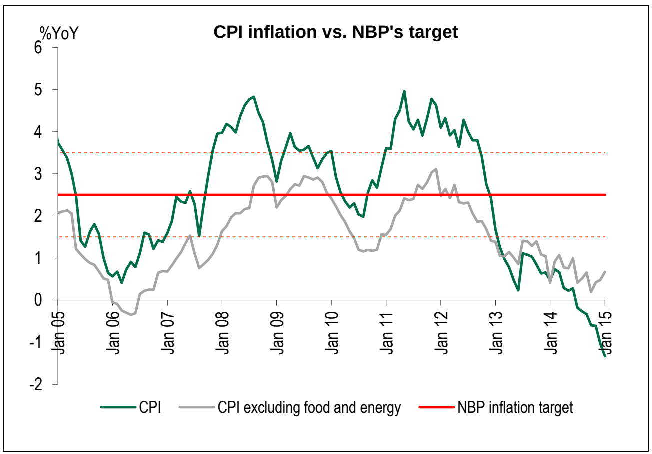
Business cycle clock confirms recovery

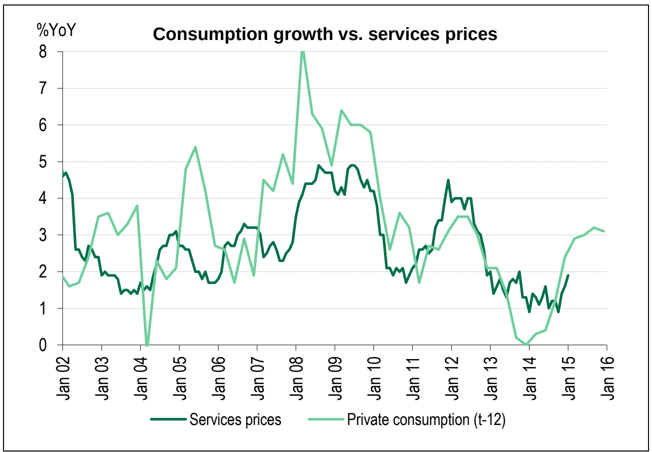
- We have updated and adjusted our business cycle clock – the measure that provides a simple graphical presentation of where the economy currently is in the cycle. The quarterly indicator is based on smoothed and de-trended GDP, while the monthly indicator is based on a number of macroeconomic variables, weighted to bring them in line with the quarterly indicator.
- The index shows that, after a slight and short-lived recovery, the economy stagnated in mid-2014. However, in the last few months the situation has improved again. Forecasts for the coming months suggest we may enter an expansion phase soon.
- We think that GDP growth may slow down a bit more in 1Q15, at least in year-on-year terms, due to a high-base effect in fixed investments (caused mainly by a temporary tax breaks for corporate car purchases in 2014, as there was exceptionally mild winter weather at the start of both years). We predict 1Q15 GDP growth only slightly below 3%YoY. However, the following quarters should see a fresh acceleration. Private consumption should remain strong, supported by a lower cost of living, lower interest rates and a continuing improvement in the labour market (see more on this topic on the next page). Meanwhile, Polish firms should benefit from the Euro zone recovery gathering pace and from cheaper energy and financing costs.

Economic update









Source: CSO, NBP, Eurostat, BZ WBK.

Booming labour market spurs consumer confidence

▪ Even though economic growth decelerated slightly, trends in the labour market remain very positive. Data from the Labour Force Survey (LFS) show that the seasonally-adjusted unemployment rate fell in January to 8.0%, the lowest level since May 2009. The jobless rate has dropped by nearly 2pp in the last 12 months and is fast approaching its all-time low (6.8% in September 2008).

▪ According to our estimate, based on LFS data, the number of people in work has already exceeded 16 million, its highest level in Poland's post-transition history, after growing at c2%YoY. Analysis of historical data shows a strong positive correlation between the LFS employment number and fixed investment growth. Thus, if investments keep expanding at a decent pace in the coming quarters, in line with our base-case scenario, then a solid pace of job creation should be maintained, driving the unemployment rate even lower.

▪ Wage growth in the corporate sector remains moderate in nominal terms (3.6%YoY in January), but – given deepening deflation – real growth of salaries is already quite decent (5%YoY, the fastest since mid-2008). Additionally, if unemployment keeps decreasing, the pressure on real wage growth may intensify. As we signalled in our '2015 Outlook', we expect a gradual increase of unit labour costs this year, albeit from a very low level.

▪ Both growing employment and rising household real incomes are positively influencing social moods. According to a recent CBOS survey, for the first time since Poland's transition more than 50% of Poles said they were satisfied with their living conditions. The CSO's indicators of consumer confidence have improved sharply over the last few quarters (they dropped quite substantially in February, but we think this was connected with the earlier sharp depreciation of the zloty versus the Swiss franc, and the decline may be temporary).

▪ We think that all these factors will support robust consumption growth in the coming quarters.

Deflation near the bottom?

▪ Inflation fell to -1.3%YoY in January, and – according to our estimates – it may drop to a new record low of -1.5%YoY in February. We think it will be the lowest point that we will see this year and we expect the CPI to gradually rebound in the months to come. Since mid-February, fuel prices have risen thanks to the increase in crude oil and we think they will climb gradually until the end of the year. The 12M drop of food prices is also unlikely to deepen much further, in our view.

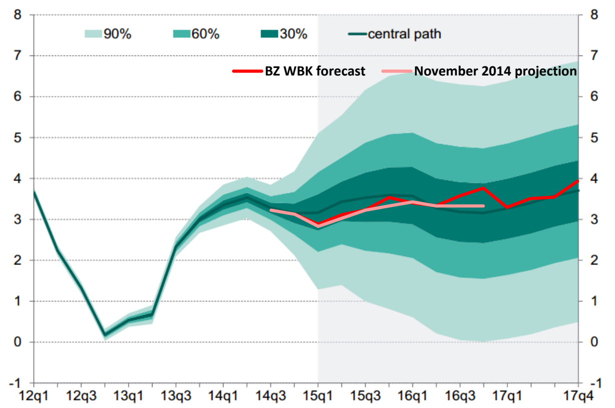
▪ The supply-side factors may stop pushing the CPI lower, but the truth is that demand-side pressure on prices still seems to be very weak. This is reflected by, among other things, the January retail sales deflator falling to an all-time low of -3.1%YoY. That said, strong consumption demand should start to gradually affect average price growth. We can already see a slight uptick in price growth in some CPI categories (restaurants, education, communication, health, other products and services), while, according to HICP data, services prices are already rising 2%YoY.

▪ As every year, the statistics office will revise the weights of the CPI basket (to coincide with CPI figure for February), based on the structure of last year's household expenditure. The impact of these changes is hard to estimate, but, in our view, it should only slightly increase this year's inflation (< 0.01pp).

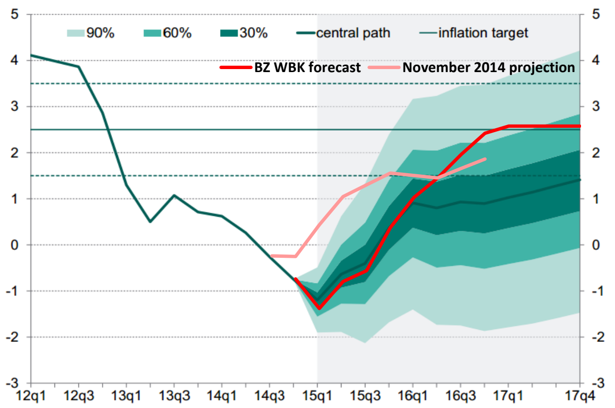
Monetary policy watch

Excerpts from the MPC's communiqué after its March meeting
Since the previous Council meeting, oil prices have increased slightly, but remained far lower than in previous years. At the same time, the prices for other commodities, including agricultural products, continued to decrease. The fall in commodity prices amid moderate global economic growth has been adding to a deceleration in price growth in many countries, and has been deepening deflation in most European countries. At the same time, the fall in commodity prices is supporting economic growth in countries that are net commodity importers.
Major central banks have kept their interest rates at historical lows. The European Central Bank is starting to purchase government bonds, while the majority of non-euro area central banks have eased their monetary policies, also by lowering interest rates.
In Poland, the pace of economic growth in 2014 Q4 slowed down slightly, but stayed close to 3%. GDP growth remained stable due to further rise in consumer demand and still high, despite some deceleration, investment growth. Meanwhile, lending growth was stable and labour market conditions continued to improve. The seasonally-adjusted unemployment rate has been declining driven to a large extent by rising employment. At the same time, the uncertainty about demand outlook continues to contain economic activity in Poland.
Despite improving labour market, wage growth in the economy remains moderate which indicates low wage pressure. Moderate wage growth, the fall in global commodity prices and no demand pressure, all contribute to deepening deflation, both in terms of consumer and producer prices. Inflation expectations of enterprises and households remain very low.
Taking into account prolonging deflation and a significant increase in risk of inflation remaining below the target in the medium term, as indicated by the March projection, the Council decided to decrease NBP interest rates. Decision to lower the interest rates at the current meeting concludes the monetary easing cycle.

NBP projection: GDP growth (%YoY)



NBP projection: CPI growth (%YoY)



Sources: NBP, Reuters, BZ WBK.

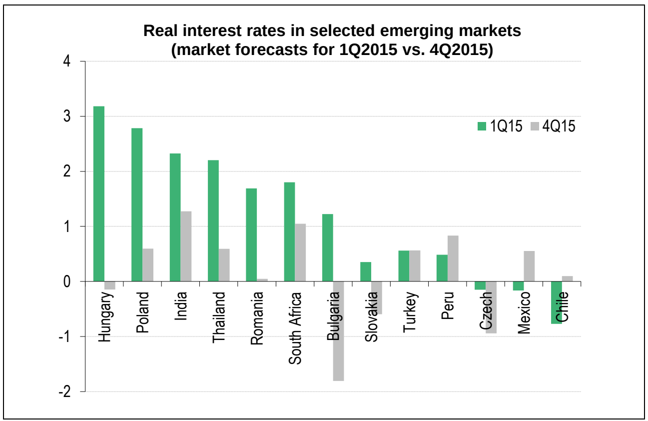
Last action heroes

- The Polish Monetary Policy Council cut interest rates by 50bp in a surprise move, reducing the reference rate to 1.5%, the lombard rate to 2.5% and the deposit rate to 0.5%. The lombard rate is very important for the banking sector (and consumers), as it is used as a reference for the maximum interest that banks can charge on loans to households (four times the lombard). As a result, the maximum rate on consumer credits will now be 10%.
- It looks as if the MPC preferred to concentrate monetary easing in a single move to adjust rates to the new environment (deeper deflation), new forecasts (the bank's new inflation projection points to CPI at c1% in 2016-17, see details below) and taking into account actions of other central banks. The MPC communiqué said explicitly that the monetary easing cycle had been concluded, so this looks like the last change in interest rates by this MPC (whose tenure expires at the end of the year).
- Probably the biggest threat to the central banks' pledge now is the risk of a sharp zloty appreciation. The ECB started its large-scale asset purchases on Monday March 9 and, if this triggers a more substantial drop of EURPLN, it could significantly complicate the Polish central bank's job. However, this is not our base-case scenario and we see only a gradual strengthening of the Polish currency.

NBP projection shows very low CPI

- The new National Bank of Poland staff projection is roughly consistent with November's projection and our forecasts for GDP growth. The NBP expects economic growth to stay more or less stable at 3.4% in 2015, 3.3% in 2016 and 3.5% in 2017. The slight slowdown in 2016 will be due to a smaller inflow of EU funds. In general, growth will be driven by consumption and investment, with a negative contribution from net exports during the projection period. The NBP sees risks to growth as balanced.
- The potential growth rate is expected by the NBP to accelerate on the back of higher total factor productivity growth and favourable labour market conditions, yet to remain below the expected GDP growth. Thus, the output gap will narrow, but remain negative within the horizon of the projection, i.e. until the end of 2017.
- The projection showed a considerable decline in the CPI path, with CPI averaging -0.5% in 2015, 0.9% in 2016 and 1.2% in 2017 and not reaching the target of 2.5% within the projection period. The NBP revision is primarily due to lower energy prices, as a result of a decline of global crude oil prices. Core inflation is expected to stay flattish at 0%-1% due to the negative output gap. We are more optimistic about inflation (see graph) and expect the CPI to reach its target at the turn of 2016 and 2017, as, in our view, strong consumer demand will have more impact on prices than the NBP expects. Moreover, we are expecting a stronger rise in employment, causing higher wage pressure. The NBP's assessment is that risks to inflation are skewed to the downside, mainly due to possible longer-lasting deflation in the Euro zone.
- NBP Governor Marek Belka revealed during the MPC press conference that the Council had asked the NBP to simulate the effects of a 50bp cut on the inflation path and it turned out not to change the situation significantly. In fact, the deputy head of the NBP's research institute, Jacek Kotłowski, who presented the new *Inflation report* said that if they assumed interest rates at the market-implied levels during the forecast period (markets had been pricing in at least a 50bp rate cut), the central bank's model predicted CPI inflation c0.3pp higher and GDP growth c0.4pp higher than in the base-case scenario.

Restrictiveness of the Monetary Policy (Council)



Polish real interest rates still high

- Polish real interest rates (reference rates deflated by the current CPI) were higher than those of other emerging markets before the 50bp March cut. After the move, they are still high relative to peers.
- We expect inflation to start bottoming out from March and, as a result, Polish real interest rates are likely to decrease gradually (to below 1% at year-end from almost 3% currently). However, they will still be among the highest in the emerging market world.
- Even though domestic demand does not seem to need further stimulus, the high level of real rates may attract inflows of portfolio capital, raising the risk of excessive currency appreciation, especially while the ECB's QE is going on.

Rzońca (1.12)

Winiecki (1.11)

Kaźmierczak (1.10)

Glapiński (1.09)

Hausner (1.06)

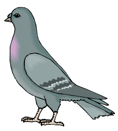
Chojna-Duch (0.83)

Belka (0.86)

Zielińska-Głębocka (0.82)

Osiatyński (0.50)

Bratkowski (0.26)



The index runs from 0 to 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights, more distant – lower.

Numbers directly by the name are values of the index for period since the beginning of current term of office of the current MPC and NBP governor.

Direction of the restrictiveness axis reflects our expectations regarding direction of interest rate changes in the nearest 12 months.

Easing cycle concludes even though NBP sees inflation staying below target

The MPC decided to conclude the easing cycle even though the NBP projections indicate that inflation will not return to target in the next three years. Marek Belka admitted that the Council had asked the NBP to project the impact of a possible 50bp rate cut and it turned out that it did not affect the projection too much. Thus, either the MPC did not fully believe in the projection's results (which used to happen in the past) or it simply gave up and decided to leave it up to the next MPC to try to bring CPI back to its target. It is possible that both interpretations are partly true – some Council members are not fully convinced that inflation will be as low as predicted by the NBP, and, at the same time, their willingness to act is reduced by the approaching end of their term. Marek Belka admitted that 'the Council is aware that it is the last year of its functioning'. He added that the MPC is going to 'clear the foreground' for the new Council. Members are going to analyse ways of communicating with markets, but leave the conclusions of this analysis to their successors.

What about FX interventions?

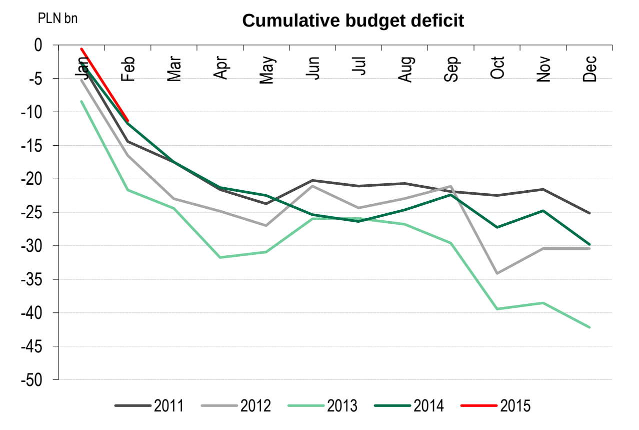
During the press conference Belka stressed that the bank was not targeting any FX rate and that he could not even remember what FX intervention was. In our view, that was unfortunate as a sharp zloty appreciation is potentially exactly what could complicate monetary policy most in the nearest months. Although Belka's words seem to have caused some appreciation of PLN, we believe that FX intervention remains part of the NBP's toolbox. We recall that NBP representatives usually reiterate that the Polish central bank does not target any specific level of exchange rate, but intervenes when volatility on the Polish FX market is excessive. Thus, the NBP can (or even should) try to stop appreciation if it thinks it is happening too fast.

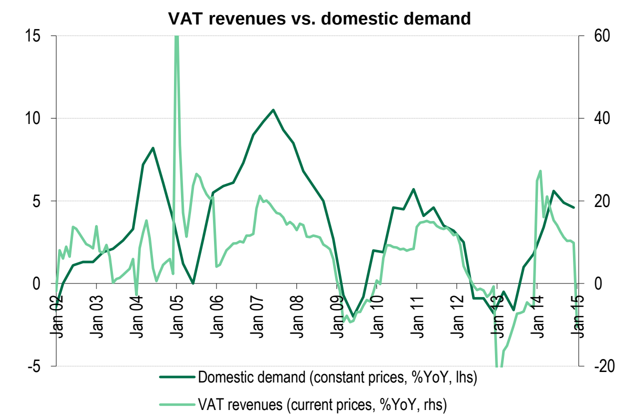
Is this the end?

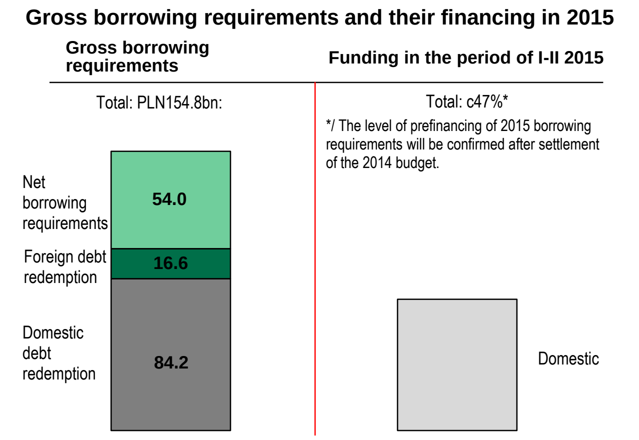
The conclusion after the last meeting is that the MPC wanted to adjust rates to the new economic situation and outlook and preferred to do that in one shot. Therefore, any additional changes in monetary policy would require a further significant change in the situation. We do not think it is likely, as we assume 12M CPI will bottom out soon (February's level of -1.5% - our forecast is below consensus - may be the lowest point this year). We see inflation in the medium-term exceeding the new NBP projection and we expect relatively strong GDP growth to continue in the coming quarters. Of course, given this outlook we might ask whether the latest move was pro-cyclical. We would argue that it was not. Simply, the very low starting point in terms of inflation (4pp below target) and the negative output gap justified an additional adjustment. This is particularly the case if we take into account the action of other central banks since the beginning of the year. We think that the main factor for future MPC decisions will be the exchange rate (the impact of the monetary easing spree in Europe is uncertain), even if the NBP governor rejected (rightly) any FX targeting. Still, in our baseline scenario, rates remain unchanged until mid-2016, so we have shifted the direction of our monetary policy restrictiveness axis to neutral.

Source: NBP, Reuters, BZ WBK.

Fiscal policy watch







	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	11.03	change since 11.02.15	change since 31.12.14	11.03	change since 11.02.15	change since 31.12.14
Poland	223	25	27	60	-6	-11
Czech	32	11	11	48	-1	-6
Hungary	338	42	23	132	-7	-46
Greece	1055	2	149	208	12	29
Spain	98	-29	-10	73	-20	-14
Ireland	52	-37	-19	44	-2	-7
Portugal	144	-78	-71	106	-63	-94
Italy	95	-37	-39	89	-20	-49
France	22	-5	-7	35	-7	-11
Germany				15	-1	-3

Source: Finance Ministry, Reuters, CSO, BZ WBK.

Budget deficit in line with plan at end February, Ministry says

- The budget deficit at the end of January was cPLN0.6bn, or 1.3% of the annual plan, well below the level assumed at this point under the 2015 schedule (PLN1.7bn). The much better-than-expected result mainly came from lower expenditures, due to the fall in the cost of domestic debt servicing, and a lower subsidy to the Social Security Fund (FUS). In both cases, savings were linked to changes in the pension system introduced in early 2014. All in all, budget spending amounted to PLN28.7bn in January (or 8.4% of the annual target) and was nearly PLN2bn lower than predicted. On the revenue side, the first month was roughly in line with expectations. However, we would point out that indirect taxes fell nearly 10%YoY, with VAT receipts down 10.5%YoY.
- Poland's Finance Ministry expects that at the end of February budget deficit will have surged to PLN11.3bn, or 24.5% of the full-year target. That would be in line with the schedule. In our view, such growth is fairly typical of the beginning of the year.
- Finance Minister Mateusz Szczurek said that it is very likely that the final general government deficit for 2014 will be higher than previously expected and even above 3.3%. Szczurek also said that after Poland leaves the excessive debt procedure – which should happen in mid-2016 – VAT rate hikes could be reversed. We forecast a general government deficit of c3% of GDP at the end of this year.

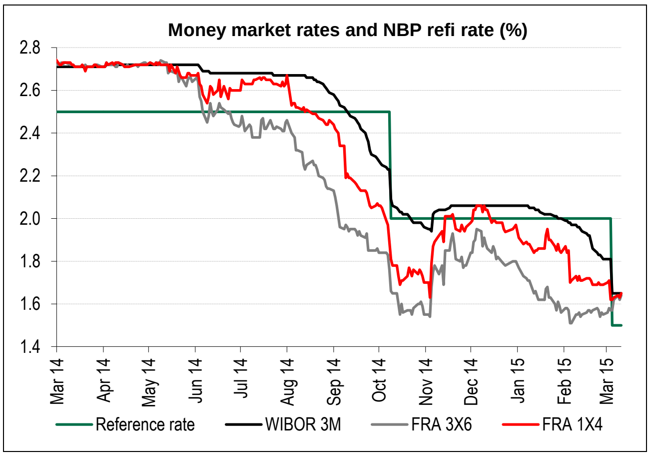
2015 borrowing needs are well secured

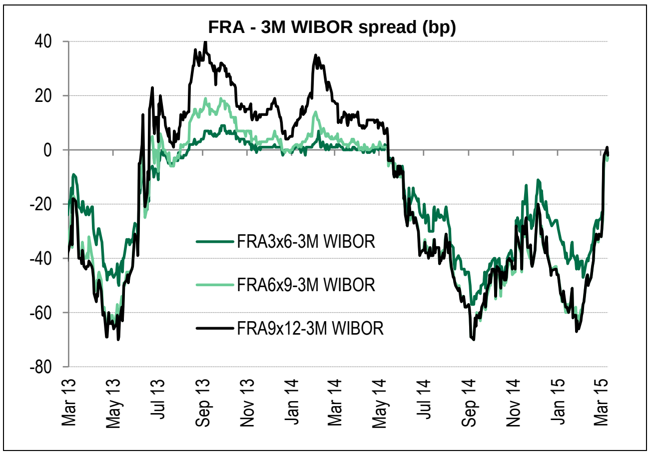
- Poland's Ministry of Finance had completed 47% of its 2015 gross borrowing requirements at the end of February. Compared with last year, Poland has issued less in T-bonds YTD, with the total around 13pp short of last year's numbers at this stage.
- In March, the ministry plans to hold one regular auction, with supply of long-term bonds (floater WZ0124, 10Y fixed-rate benchmark DS0725 and WS0428) worth PLN3-4bn and a switch tender. During the tender, the ministry will bid for bonds maturing in April, July and October 2015. A repurchase auction for a USD-denominated bond (maturing in July and October 2015) is also set for March. The ministry redeemed bonds worth up to US$400.6mn.
- March's offer of T-bonds is quite limited and we expect auctions to attract solid demand. In our view, after 1Q15, the ministry will have covered more than 50% of its 2015 borrowing requirements.

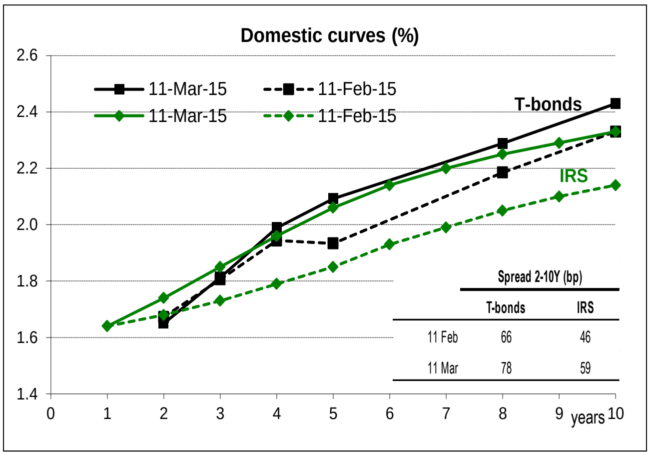
Start of the ECB's QE pushes yields down

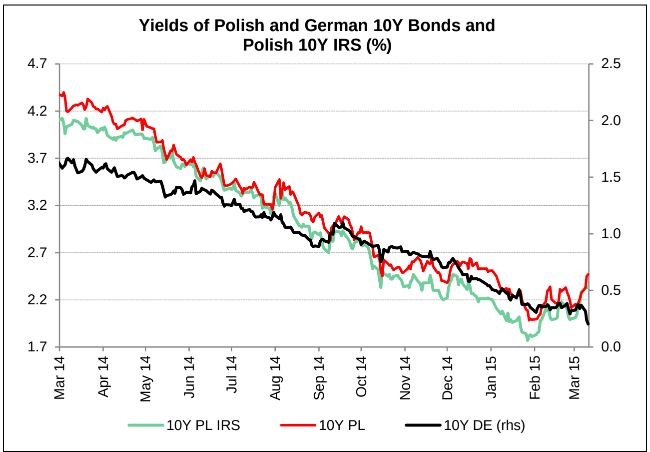
- In February, core and peripheral debt markets gained in anticipation of the upcoming launch of the ECB's QE programme and 10Y spreads over Bunds narrowed quite visibly. Moreover, US Treasuries underperformed European assets on the back of a growing risk of earlier Fed rate hikes.
- As expected, the ECB pushed the QE button in March. Euro zone yields declined considerably, with the 10Y Bund yield falling to a new record low of 0.23%. Despite the ECB's purchases, the spread between peripheral and German debt widened slightly at the beginning of the month.
- We expect a further gradual decline in yields on both core and peripheral markets in the coming months. The divergence in monetary policy between the ECB and the Fed could fuel a further outperformance of German vs US bonds. In the medium to long term, we still think yields will start rising, in particular at the long end, as the global growth picture should improve noticeably and inflation should rise. While the 2Y Bund yield is likely to remain negative until the year end, the 10Y should be above 0.5% by the end of December 2015E.

Interest rate market









Source: Finance Ministry, Reuters, Bloomberg, BZ WBK.

WIBORs fell sharply before and after the 50bp cut in March

- WIBOR rates fell sharply in February, in anticipation of an interest rate cut in March. Rates dropped 12-18bp across the board, which was the biggest monthly decline since September 2014. At the same time, FRAs moved in the opposite direction, climbing 1-27bp (starting from the 3x6 rate) over the past month.
- The MPC's decision to trim rates by 50bp in March caused the WIBOR curve to drop 11-22bp in the 1M-12M segment, with the biggest move at the short-end and the smallest at the long-end. The curve is now normal again, i.e. the shortest rate is the lowest (1.64%) and the longest is the highest (1.68%). By contrast, the MPC's decision did not trigger any noticeable moves in FRAs, as rates had already priced in the 50bp cut. What is more, for the first time since June 2014, the FRA market even sees some room for rate hikes – the FRA18x21and 21x24 are above 3M WIBOR.
- Given the MPC's pledge that the March cut was the last in the cycle, we expect WIBOR rates to stay close to their current levels in the coming months and to start rising gradually in 2016, when rate hikes should be closer. In our view, FRA rates will be more vulnerable – a further increase in IRS rates could drive long term FRAs higher.

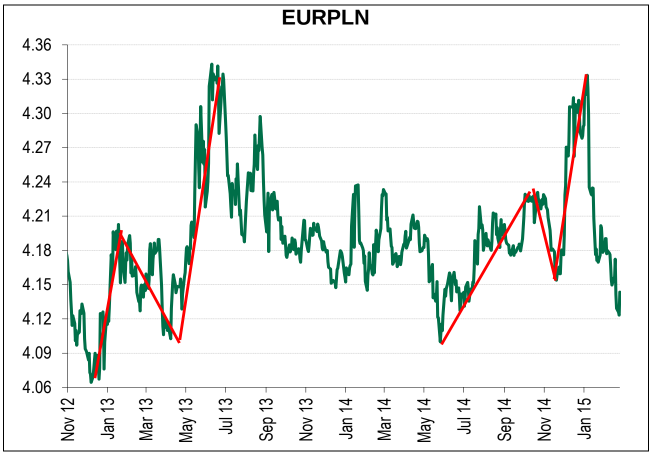
T-bonds and IRS curves steepen

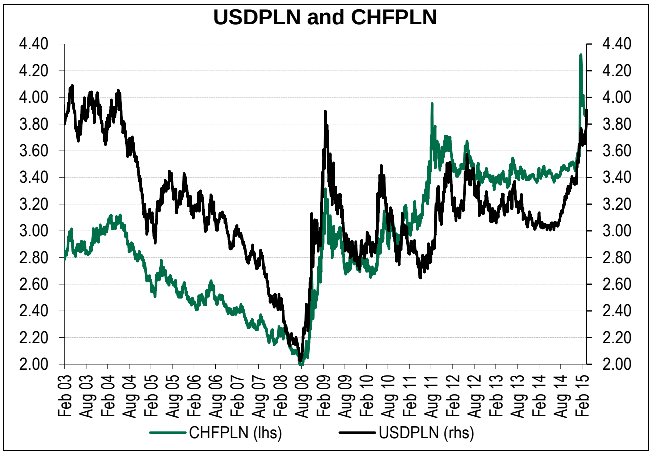
- Bond yields and IRS rates were under pressure in February, due to a risk-off mood and uncertainty about Greece, Ukraine and the timing of the Fed's rate hikes. However, strong expectations of a rate cut in March, the Eurogroup's approval of the Greek bailout and dovish Fed rhetoric (FOMC minutes, Yellen's testimony) helped the domestic fixed income market rebound, trimming a significant part of earlier losses.
- The IRS and bond curves steepened noticeably in the first week of March as rates at the short ends increased less (c10bp) after the MPC's rate cut than in the belly and long ends (25-30bp). The Polish market was also under the pressure from weakening Bunds and strong US non-farm payrolls data. As a result, the 10Y benchmark yield climbed to 2.50%, its highest level since the end of December 2014.

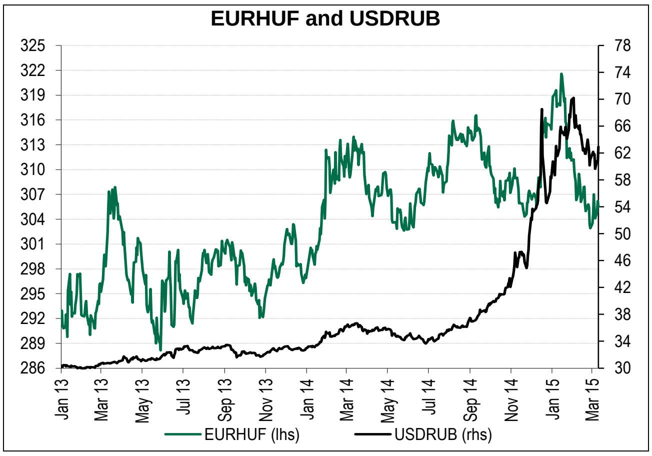
Will the ECB's QE push yields lower?

- Now that the MPC has concluded the easing cycle, we think that domestic factors will no longer support gains in the fixed income market. Our February CPI forecast is below consensus, but we do not think the number will have much impact on the FI market as the MPC has already announced the end of the easing cycle. Moreover, we expect quite favourable data from the real economy, which could exert upward pressure on rates/yields, in particular at the long-end of the curves.
- Global issues should have more of an effect on Polish debt, but in contradictory directions. On the bearish side, the Euro zone recovery, improving domestic fundamentals and the upcoming Fed tightening may contribute to higher yields and this should eventually make curves steeper, in our view. Although we think that the first interest rate hike in the US could be delayed until September, if the Fed drops the word 'patient' from its statement in March, it may negatively affect bonds.
- On the bullish side is the ECB's large-scale buying of sovereign debt that started in early March. The initial days of asset purchases did not produce gains for Polish debt (yields/ rates were roughly stable). In our view, an inflow of portfolio money to the Polish market, due to monetary policy easing in the Euro zone, should be positive for Polish bonds in the short term. We do not rule out Polish yields dropping slightly further from current levels, but the balance of risks has changed towards being less supportive for debt. Therefore, we have raised our forecasts of yields/IRS rates between now and year end.

Foreign exchange market







Sources: Reuters, Bloomberg, BZ WBK.

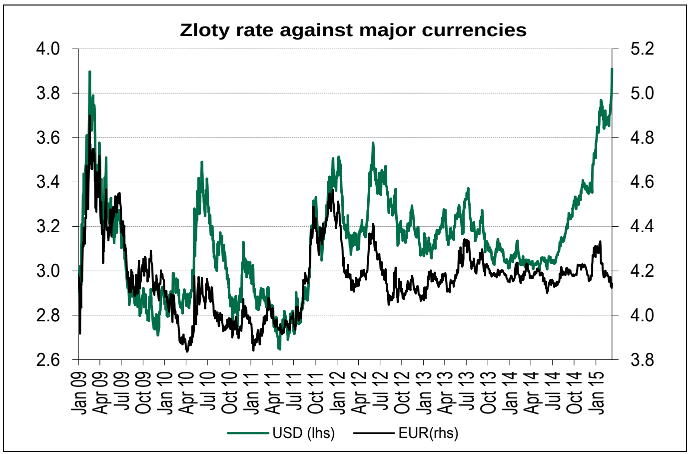
EUR/PLN at its lowest since June 2014 . . .

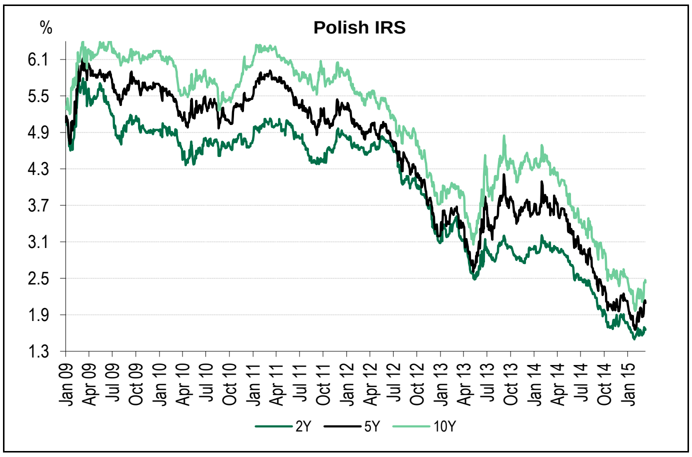
- EUR/PLN continued the decline initiated after the January ECB extension of the asset purchase programme. In early March, the downtrend accelerated after the decision of the Polish MPC. The bigger-than-expected rate cut weighed on the domestic currency, but the depreciation was temporary because the MPC's firm declaration that the easing cycle was over proved more important. The zloty also drew support from the NBP governor saying at the post-meeting press conference that there may be 'appreciation pressure' on the zloty from the ECB's easing and that the NBP 'had already forgotten' what FX intervention was (suggesting the bank would not respond to a substantial rise in its currency). Consequently, EUR/PLN broke its support at 4.14 and reached 4.11 (the lowest since June 2014).
- The zloty continued to appreciate vs the Swiss franc too. As EUR/CHF increased gradually, CHF/PLN eased to 3.85 from c4.0. At the same time, USD/PLN continued to climb, amid the falling EURUSD. It broke the 2009 peak reached during the US financial crisis (c3.915) and reached nearly 3.93.
- Before this month's rate cut, the market had expected that policy easing in Poland would total slightly more than 50bp. The EUR/PLN reaction to the 50bp cut shows that the announcement of the end of the cycle was the most important thing to come out of the MPC meeting. We had expected EUR/PLN to move sideways until April due to the outlook for interest rate cuts in Poland, among other factors. **But now that expectations of further easing have dissipated, we have cut our forecasts for average EURPLN to 4.11 from 4.15 for April and to 4.08 from 4.14 for June.**
- We have already seen the impact of one negative factor fading in importance and March may show the consequences of one that was expected to support the zloty. The ECB has just started injecting cash into the European market and we expect bigger portfolio inflows into Polish assets to support the zloty. The first month of ECB buying could provide some evidence of the overall impact on the Polish currency. We think it could gain from the extra liquidity inflow, but the scale of the effect is uncertain. One of the conditions that may attract foreign capital is the recent weakening of the Polish bond market, which could be seen as a good buying opportunity. Our forecasts of economic activity data due this month point to quite a good performance and this may also support the zloty.
- The remaining risks – the situation in Ukraine and Greek talks on the conditions for financial aid – remain in place and may trigger some sharp profit taking in the Polish FX market if they deteriorate.

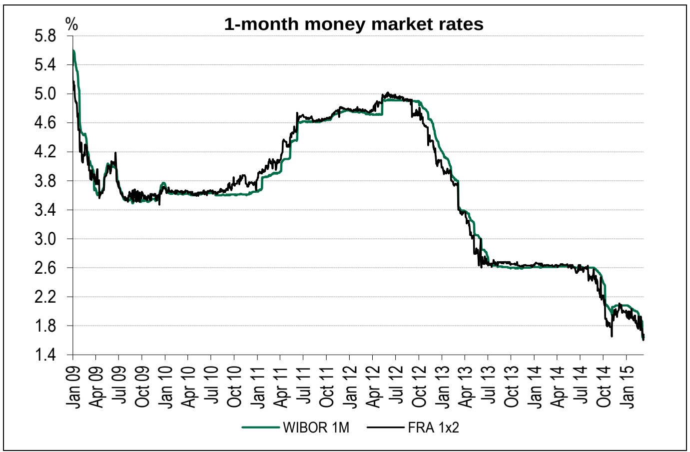
. . . and EUR/USD at its lowest since January 2003

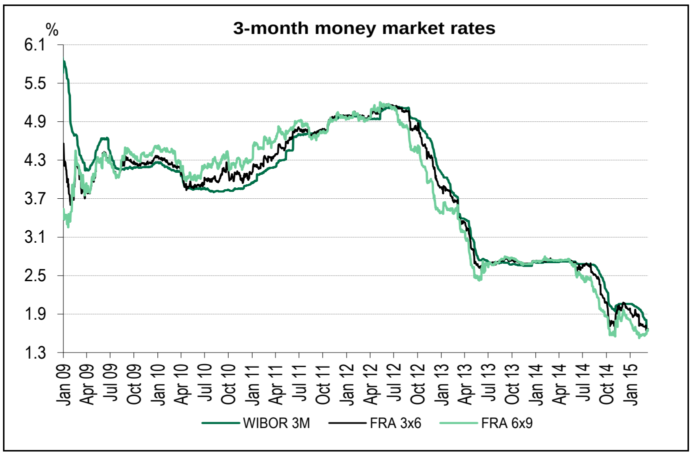
- After eight consecutive months of decline, EUR/USD fell further at the beginning of March, reaching 1.05, its lowest level since January 2003. The dollar continued to appreciate on the back of the clear divergence in the monetary policies of the Euro zone and the U.S., the start of the ECB's QE this month and the much better-than-expected US February non-farm payroll data.
- So far, the EUR/USD's downward trend has been largely driven by expectations for monetary easing by the ECB. The euro's recovery after the extended QE was announced in January was only temporary and was soon followed by a return to its downward trend. The ECB has just started buying Euro zone debt in amounts that exceed the net monthly supply of bonds. Much of the expected impact of QE might have already been priced in, but the coming weeks should show how the market will react to the actual inflow of cash and the negative deposit rate.

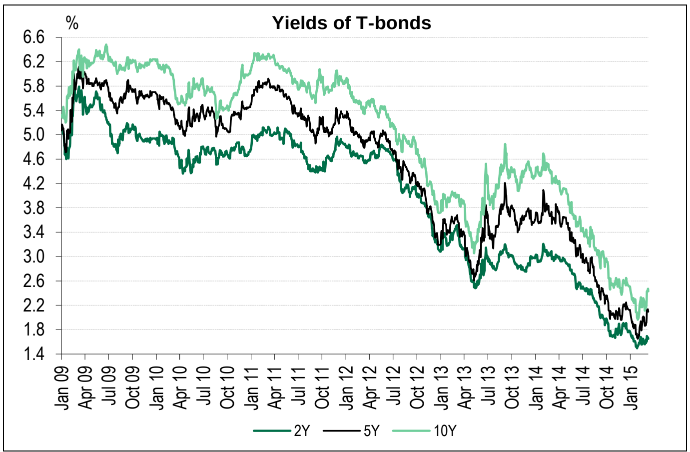
Market monitor

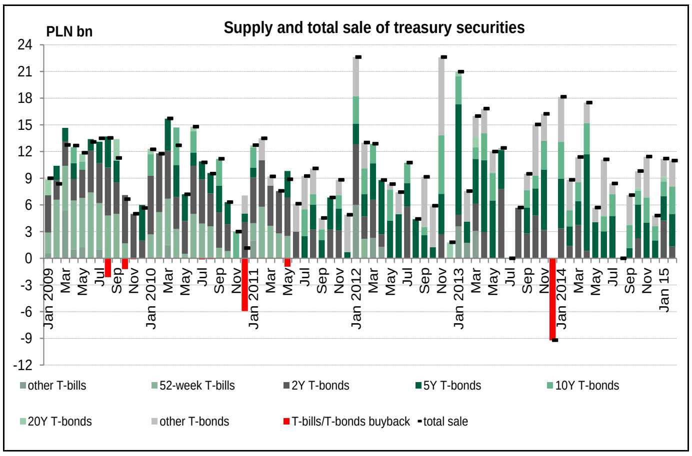












Treasury bond auctions in 2014/2015 (PLN mn)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
March'14	6.03	OK0716/WZ0119	2500-5500	6573.0					20.03	PS0414/OK0714	PS0718/DS1023
April	3.04	DS1023/WZ0119	3000-5000	5781.0	23.04	OK0716/PS1016/PS0718	5000-10000	11722.3			
May	8.05	PS0719/WZ0119	3000-5000	5694.2	22.05	IDS1024	1000-2000	1270.0			
June	5.06	DS/WS/WZ	3000-5000	4989.7					18.06	OK0714/WZ0115	WZ0119/PS0719
July	3.07	DS0725/WS0428	1000-3000	2419.0	23.07	WZ0119/PS0719	2000-6000	5999.0			
August	-	-	-	-	-	-	-	-	-	-	-
September	4.09	DS0725/WS0124	2000-3000	3595.0	25.09	USD20150716**	Up to $400m	$354.4m	18.09	WZ0115/PS0415	WZ0119/PS0719
October	23.10	OK0716/PS0719	2000-6000	6062.1					2.10	WZ0115/PS0415	WZ0124/DS0725/WS0428
November	6.11	WZ/DS/WS	2000-4000	4495.7					20.11	WZ0115/PS0415/OK0715	WZ0119/PS0719
December									18.12	WZ0115/PS0415/OK0715	PS0719/WZ0124/DS0725
January '15	15.01	WZ/DS/WS	3000-5000	4198.5	22.01	OK0717/PS0420	5000-7000	7005.2			
February	5.02	WZ/DS/WS	3000-5000	5980.0	12.02	OK0717/PS0420	3000-5000	5000.0			
March	5.03	USD20150716/ USD20151019**	up to $500m	$400.6m	12.03	OK0717/PS0420	3000-5000		26.03	PS0415/OK0715/DS1015	choice will depend on the market conditions

** with supplementary auction, ** buy-back auction, *** demand/sale.*

Source: MoF, Reuters, BZ WBK.

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
9 March DE: Exports (Jan) CZ: CPI (Feb)	**10** HU: CPI (Feb)	**11**	**12** EZ: Industrial output (Jan) US: Retail sales (Feb)	**13** ***PL: CPI (Feb)*** ***PL: Money supply (Feb)*** CZ: Industrial output (Jan) US: Flash Michigan (Mar)
16 ***PL: Balance of payments (Jan)*** ***PL: Core inflation (Jan)*** US: Industrial output (Feb)	**17** ***PL: Wages and employment (Feb)*** DE: ZEW index (Mar) EZ: HICP (Feb) US: House starts (Feb) US: Building permits (Feb)	**18** ***PL: Industrial output (Feb)*** ***PL: Retail sales (Feb)*** ***PL: PPI (Feb)*** US: FOMC decision	**19** ***PL: MPC minutes*** US: Philly Fed index (Mar)	**20**
23 US: Home sales (Feb)	**24** CN: Flash PMI – manufacturing (Mar) DE: Flash PMI – manufacturing (Mar) EZ: Flash PMI – manufacturing (Mar) US: CPI (Feb) US: New home sales (Feb) HU: Central bank decision	**25** DE: Ifo index (Mar) US: Durable goods orders (Feb)	**26** CZ: Central bank decision	**27** US: Final GDP (Q4) US: Michigan index (Mar)
30 US: Personal income (Feb) US: Consumer spending (Feb) US: Pending home sales (Feb)	**31** ***PL: Balance of payments (Q4)*** ***PL: Inflation expectations (Mar)*** EZ: Flash HICP (Mar) CZ: GDP (Q4) US: Consumer confidence index (Mar)	**1 April** ***PL: PMI – manufacturing (Mar)*** CN: PMI – manufacturing (Mar) DE: PMI – manufacturing (Mar) EZ: PMI – manufacturing (Mar) US: ISM – manufacturing (Mar) US: ADP report (Mar)	**2** US: Industrial orders (Feb)	**3** US: Non-farm payrolls (Mar) US: Unemployment rate (Mar)
6 US: ISM – services (Mar)	**7** DE: PMI – services (Mar) EZ: PMI – services (Mar)	**8** DE: Industrial orders (Feb) HU: CPI (Mar) US: FOMC minutes	**9** DE: Industrial output (Feb) DE: Exports (Feb) CZ: CPI (Mar)	**10** CZ: Industrial output (Mar)
13 ***PL: Balance of payments (Feb)***	**14** ***PL: Money supply (Mar)*** EZ: Industrial output (Feb) US: Retail sales (Mar)	**15** ***PL: MPC decision*** ***PL: CPI (Mar)*** EZ: ECB decision US: Industrial output (Mar) US: Fed Beige Book	**16** ***PL: Core inflation (Mar)*** US: House starts (Mar) US: Building permits (Mar) US: Philly Fed index (Apr)	**17** ***PL: Wages and employment (Mar)*** EZ: HICP (Mar) US: CPI (Mar) US: Flash Michigan (Apr)

Calendar of MPC meetings and data releases for 2015

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
ECB meeting	22	-	5	15	-	3	16	-	3	22	-	3
MPC meeting	13-14	3-4	3-4	14-15	5-6	2-3	7-8	-	1-2	5-6	3-4	1-2
MPC minutes	22	19	19	23	21	18	-	20	17	22	19	17
Flash GDP*		13			15			14			13	
GDP*	-	27	-	-	29	-	-	28	-	-	30	-
CPI	15	13[a]	13[b]	15	14	15	15	13	15	15	13	15
Core inflation	16	-	16	16	15	16	16	14	16	16	16	16
PPI	21	18	18	20	20	18	17	19	17	19	19	17
Industrial output	21	18	18	20	20	18	17	19	17	19	19	17
Retail sales	27	18	18	20	20	18	17	19	17	19	19	17
Gross wages,employment	20	17	17	17	19	17	16	18	16	16	19	16
Foreign trade					about 50 working days after reported period							
Balance of payments*			31									
Balance of payments	13	13	16	13	15							
Money supply	14	13	13	14	14							

* quarterly data. [a] preliminary data for January. [b] January and February.
Source: CSO, NBP, Ministry of Finance, Reuters, Bloomberg

Economic data and forecasts for Poland

Monthly economic indicators

		Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep14	Oct14	Nov 14	Dec 14	Jan 15	Feb 15E	Mar 15E
PMI	pts	55.9	54.0	52.0	50.8	50.3	49.4	49.0	49.5	51.2	53.2	52.8	55.2	55.1	55.2
Industrial production	% YoY	5.3	5.5	5.5	4.4	1.8	2.4	-1.9	4.2	1.7	0.3	8.1	1.7	5.6	10.0
Construction production	% YoY	14.4	17.4	12.2	10.0	8.0	1.1	-3.6	5.6	-1.0	-1.6	5.0	1.3	-0.1	4.6
Retail sales [a]	% YoY	7.0	3.1	8.4	3.8	1.2	2.1	1.7	1.6	2.3	-0.2	1.8	0.1	1.0	0.6
Unemployment rate	%	13.9	13.5	13.0	12.5	12.0	11.8	11.7	11.5	11.3	11.4	11.5	12.0	12.0	11.7
Gross wages in corporate sector	% YoY	4.0	4.8	3.8	4.8	3.5	3.5	3.5	3.4	3.8	2.7	3.7	3.6	3.1	3.4
Employment in corporate sector	% YoY	0.2	0.5	0.7	0.7	0.7	0.8	0.7	0.8	0.8	0.9	1.1	1.2	1.3	1.3
Exports (€)	% YoY	7.3	9.5	5.1	10.4	5.7	6.7	-0.9	6.1	4.1	3.1	6.6	-1.1	1.7	8.1
Imports (€)	% YoY	6.9	4.1	8.9	11.8	7.5	7.2	0.1	6.1	4.7	3.9	10.7	0.2	-0.5	13.5
Trade balance	EUR mn	-79	132	39	-160	86	-167	-102	648	-8	103	-633	-59	194	-587
Current account balance	EUR mn	-651	345	269	-161	-927	-811	-987	18	-470	143	-1,005	-1,194	-352	-409
Current account balance	% GDP	-1.2	-1.1	-1.1	-1.1	-1.2	-1.3	-1.4	-1.3	-1.4	-1.2	-1.3	-1.3	-1.2	-1.4
Budget deficit (cumulative)	PLN bn	-11.7	-17.5	-21.3	-22.5	-25.4	-26.4	-24.6	-22.4	-27.2	-24.8	-29.8	-0.6	-11.3	-18.7
Budget deficit (cumulative)	% of FY plan	24.7	36.8	44.8	47.3	53.4	55.5	51.9	47.1	57.4	52.1	62.7	1.3	24.5	40.6
CPI	% YoY	0.7	0.7	0.3	0.2	0.3	-0.2	-0.3	-0.3	-0.6	-0.6	-1.0	-1.3	-1.5	-1.3
CPI excluding food and energy	% YoY	0.9	1.1	0.8	0.8	1.0	0.4	0.5	0.7	0.2	0.4	0.5	0.7	0.5	0.4
PPI	% YoY	-1.4	-1.3	-0.7	-1.0	-1.8	-2.0	-1.5	-1.6	-1.3	-1.6	-2.7	-2.9	-2.7	-2.8
Broad money (M3)	% YoY	5.2	5.2	5.4	5.2	5.2	6.0	7.4	7.9	7.7	8.4	8.2	8.5	8.8	8.4
Deposits	%YoY	4.7	4.7	5.4	5.5	5.5	6.7	7.8	7.5	7.8	8.5	8.1	8.1	8.4	8.0
Loans	%YoY	4.7	5.3	6.1	5.4	4.9	5.4	6.3	6.2	7.2	7.4	7.3	7.9	7.9	7.7
EUR/PLN	PLN	4.18	4.20	4.18	4.18	4.14	4.14	4.19	4.19	4.21	4.21	4.21	4.28	4.18	4.13
USD/PLN	PLN	3.06	3.04	3.03	3.04	3.04	3.06	3.15	3.25	3.32	3.38	3.42	3.68	3.68	3.85
CHF/PLN	PLN	3.42	3.45	3.43	3.42	3.39	3.41	3.46	3.47	3.48	3.50	3.50	3.96	3.93	3.88
Reference rate [b]	%	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.00	2.00	2.00	2.00	2.00	1.50
3M WIBOR	%	2.71	2.71	2.72	2.72	2.69	2.68	2.65	2.45	2.07	2.03	2.06	2.03	1.92	1.67
Yield on 2-year T-bonds	%	3.06	2.99	2.94	2.79	2.54	2.45	2.30	2.02	1.77	1.78	1.84	1.60	1.60	1.65
Yield on 5-year T-bonds	%	3.79	3.68	3.60	3.36	3.10	2.89	2.73	2.40	2.12	2.04	2.16	1.82	1.88	1.96
Yield on 10-year T-bonds	%	4.47	4.26	4.10	3.80	3.54	3.34	3.23	2.98	2.63	2.54	2.55	2.21	2.20	2.30

Note: [a] in nominal terms, [b] at the end of the period.
Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

Quarterly and annual economic indicators

		2012	2013	2014	2015E	1Q14	2Q14	3Q14E	4Q14	1Q15E	2Q15E	3Q15E	4Q15E
GDP	PLN bn	1,615.9	1,662.1	1,724.7	1,781.7	403.1	418.4	426.8	476.4	412.1	431.6	440.3	497.8
GDP	% YoY	1.8	1.7	3.3	3.2	3.4	3.5	3.3	3.1	2.9	3.1	3.2	3.5
Domestic demand	% YoY	-0.4	0.2	4.7	4.6	3.4	5.6	4.9	4.6	4.4	4.7	4.4	4.8
Private consumption	% YoY	1.0	1.1	3.0	3.6	2.9	3.0	3.2	3.1	3.5	3.6	3.6	3.5
Fixed investments	% YoY	-1.5	0.9	9.5	8.4	11.2	8.7	9.9	9.0	9.0	9.0	8.0	8.0
Industrial production	% YoY	1.0	2.3	3.4	6.7	4.9	3.7	1.8	2.8	5.9	6.9	7.3	6.8
Construction production	% YoY	-1.0	-10.3	4.3	5.7	9.8	9.9	1.1	1.0	2.2	6.2	6.8	6.1
Retail sales [a]	% YoY	6.0	2.6	3.1	3.4	5.1	4.6	1.9	1.4	0.6	1.5	4.4	6.7
Unemployment rate [b]	%	13.4	13.4	11.5	10.9	13.5	12.0	11.5	11.5	11.7	10.4	10.3	10.9
Gross wages in the national economy [a]	% YoY	3.7	3.4	3.6	3.9	4.2	3.5	3.5	3.1	3.5	3.5	4.1	4.1
Employment in the national economy	% YoY	0.0	-1.1	0.1	0.8	-0.3	0.1	0.3	0.5	0.7	0.7	0.6	0.6
Exports (€)	% YoY	6.5	5.7	5.9	5.8	8.4	7.0	4.1	4.5	3.0	4.8	6.8	8.5
Imports (€)	% YoY	2.2	0.2	6.4	7.4	5.6	9.4	4.6	6.2	4.6	6.5	8.5	10.0
Trade balance	EUR mn	-7,146	635	-33	-2,611	159	-35	381	-538	-452	-703	-257	-1,199
Current account balance	EUR mn	-13,697	-5,245	-5,320	-7,784	-1,403	-808	-1,777	-1,332	-1,955	-1,285	-2,792	-1,751
Current account balance	% GDP	-3.5	-1.3	-1.3	-1.8	-1.1	-1.2	-1.3	-1.3	-1.4	-1.5	-1.7	-1.8
General government balance	% GDP	-3.9	-4.3	-3.4	-2.9	-	-	-	-	-	-	-	-
CPI	% YoY	3.7	0.9	0.0	-0.6	0.6	0.3	-0.3	-0.7	-1.4	-0.8	-0.6	0.3
CPI [b]	% YoY	2.4	0.7	-1.0	0.8	0.7	0.3	-0.3	-1.0	-1.3	-0.7	-0.4	0.8
CPI excluding food and energy	% YoY	2.2	1.2	0.6	0.8	0.8	0.8	0.5	0.4	0.5	0.6	0.8	1.2
PPI	% YoY	3.4	-1.3	-1.5	-2.1	-1.2	-1.2	-1.7	-1.9	-2.8	-2.4	-2.3	-1.0
Broad money (M3) [b]	% oY	4.5	6.2	8.2	6.0	5.2	5.2	7.9	8.2	7.6	7.1	6.5	6.0
Deposits [b]	%YoY	4.7	6.0	8.1	6.2	4.7	5.5	7.5	8.1	7.6	7.1	6.7	6.2
Loans [b]	%YoY	1.2	3.6	6.9	6.2	5.3	4.9	6.2	7.3	7.0	6.7	6.5	6.2
EUR/PLN	PLN	4.19	4.20	4.18	4.09	4.19	4.17	4.18	4.21	4.20	4.10	4.06	4.02
USD/PLN	PLN	3.26	3.16	3.15	3.61	3.06	3.04	3.15	3.37	3.74	3.74	3.55	3.43
CHF/PLN	PLN	3.47	3.41	3.45	3.81	3.42	3.42	3.45	3.50	3.92	3.84	3.79	3.70
Reference rate [b]	%	4.25	2.50	2.00	1.50	2.50	2.50	2.50	2.00	1.50	1.50	1.50	1.50
3M WIBOR	%	4.91	3.02	2.52	1.71	2.71	2.71	2.59	2.06	1.87	1.66	1.65	1.65
Yield on 2-year T-bonds	%	4.30	2.98	2.46	1.64	3.01	2.76	2.26	1.80	1.62	1.63	1.63	1.70
Yield on 5-year T-bonds	%	4.53	3.46	2.96	2.05	3.71	3.35	2.67	2.11	1.89	2.03	2.08	2.23
Yield on 10-year T-bonds	%	5.02	4.04	3.49	2.31	4.38	3.82	3.18	2.58	2.24	2.19	2.33	2.50

Note: [a] in nominal terms, [b] at the end of period. Source: CSO, NBP, Finance Ministry, BZ WBK estimates.

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