Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

16 – 22 February 2015

Uncertainty and risk aversion weighed on the markets in anticipation of the talks on Greece and Ukraine. But the second half of last week brought positive market reaction to the cease-fire agreement in Minsk and news of a potential deal with Greece, easing investors' concerns over the crisis in Ukraine and the deadlock over Greece's future financing. S&P's decision to change Poland's rating outlook to positive has been, however, overshadowed by the news from abroad.

This week focus will shift back to Greece since the Eurogroup meets again on Monday and an agreement on the bailout terms still seems highly uncertain. The number of data releases abroad will be limited (with focus on the flash PMIs), but we will get to see many important indicators for Poland, showing what condition the economy is in at the start of the year. We expect to see relatively good news from the labour market, quite strong retail sales, but below-consensus industrial production (even though there is an upside risk to our pessimistic forecast). Last week's data from Poland were close to expectations, showing a slowdown of GDP growth to 3.0%YoY in 4Q14 (second-best result in the EU), deepening deflation in January (-1.3%YoY) and some rebound in export growth in December, with signs of a pickup in trade with the big euro zone countries (incl. Germany, France, US, Sweden, Netherlands). The Polish currency and bonds will probably remain more sensitive to changes in the global risk aversion in the near term (mainly due to Greece) than to domestic data releases.

Economic calendar

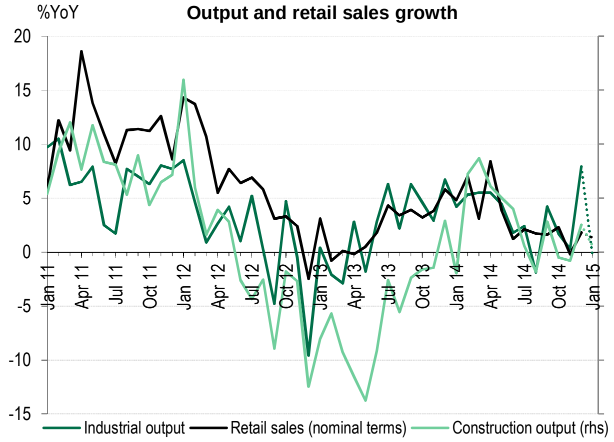
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (16 February)					
		No important data releases					
		TUESDAY (17 February)					
11:00	DE	ZEW index	Feb	pts	27.0	-	22.4
14:00	**PL**	**Wages in corporate sector**	**Jan**	**%YoY**	**3.3**	**3.3**	**3.7**
14:00	**PL**	**Employment in corporate sector**	**Jan**	**%YoY**	**1.5**	**1.4**	**1.1**
		WEDNESDAY (18 February)					
14:00	**PL**	**Industrial output**	**Jan**	**%YoY**	**2.3**	**-0.5**	**7.9**
14:00	**PL**	**Construction and assembly output**	**Jan**	**%YoY**	**2.1**	**1.1**	**5.0**
14:00	**PL**	**PPI**	**Jan**	**%YoY**	**-2.9**	**-3.4**	**-2.5**
14:00	**PL**	**Retail sales**	**Jan**	**%YoY**	**0.9**	**1.3**	**1.8**
14:30	US	House starts	Jan	k	1073	-	1089
14:30	US	Building permits	Jan	k	1070	-	1032
15:15	US	Industrial output	Jan	%MoM	0.4	-	-0.1
20:00	US	FOMC minutes					
		THURSDAY (19 February)					
	PL	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	-	-	304
16:00	US	Philly Fed index	Feb	pts	8.5	-	6.3
		FRIDAY (20 February)					
2:45	CN	Flash PMI – manufacturing	Feb	pts	49.5	-	49.7
9:30	DE	Flash PMI – manufacturing	Feb	pts	51.4	-	50.9
10:00	EZ	Flash PMI – manufacturing	Feb	pts	51.4	-	51.0

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

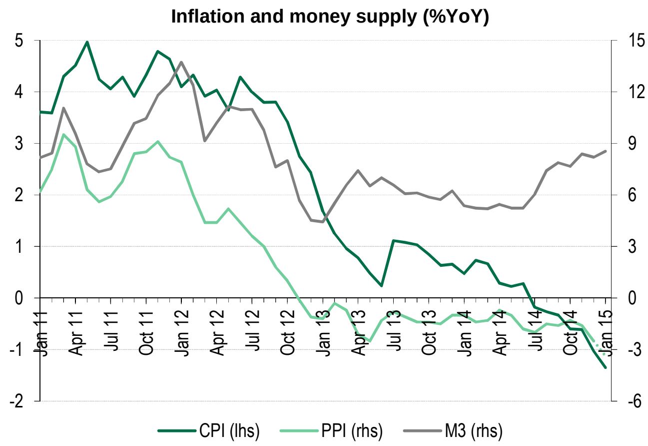
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

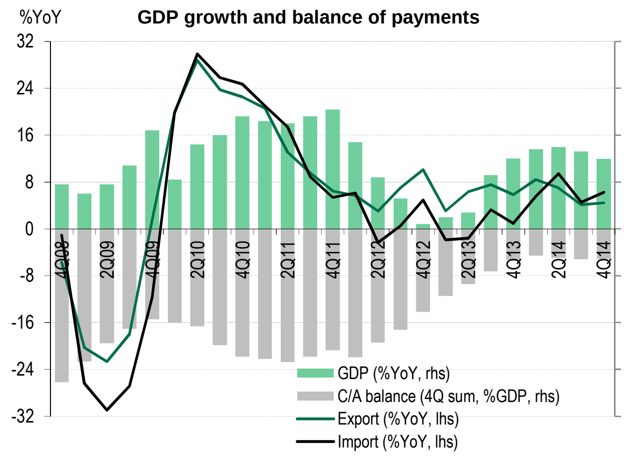
What's hot this week – Data may surprise



- This week's data releases may be potentially quite surprising. Employment growth for January is particularly hard to predict since it is subject to a sample change (as it is every year), which distorts the results. We expect decent growth in employment and wages, confirming that the labour market recovery is on track.
- Our forecast of industrial output is well below market consensus. On the one hand, news on high car production implies some upward risk to our forecast, but, on the other, the statistics office revised down the December output data. Even if the reading is above our prediction, we think it should be below the quite optimistic market consensus.
- In the case of retail sales, we see room for a positive surprise since data on new car registrations in January were very strong, pointing to robust consumer demand.

Last week in the economy – Deeper deflation, slower GDP growth





- CPI inflation fell to -1.3%YoY in January, mainly due to prices of food (-3.9%YoY) and fuels (-9.7%YoY), though the flash release could be revised next month when the statistics office recalculates weights of the CPI basket. However, we would not expect the correction to be significant. Based on our tentative estimate, core inflation excluding food and energy rose slightly to 0.6%YoY, while deflation may even deepen further in February. It now seems that CPI growth will not turn positive until the end of 3Q15.
- Loan growth accelerated in January, but it was mainly the effect of the significant zloty depreciation. We estimate that once the data is stripped off the FX effect, loan growth actually remained roughly stable.
- The current account deficit reached €633m in December and was bigger than expected, mainly due to weaker- than-expected exports. Despite the disappointment, exports still grew at a decent pace (6.6%YoY) and the NBP had even revised the November figure up. We still expect the euro zone's economic recovery to trigger a recovery of the Polish exports in the coming months. In fact, there have already been signs of export recovery to the euro zone's biggest countries since October of last year.
- GDP growth slowed to 3.0%YoY in 4Q14, according to a flash estimate, from 3.3%YoY in 3Q14. The result was marginally below our estimate (3.1%), but it does not change our general assessment of the situation. We think that 1Q15 may see slight but further slowdown in growth, but the upcoming quarters are likely to bring economic recovery, especially that we can already see signs of the euro zone's revival feeding into Polish export growth.

Quote of the week – Fiscal deficit in 2014 probably above 3.3% of GDP

Mateusz Szczurek, minister of finance, 11.02.2015, DGP

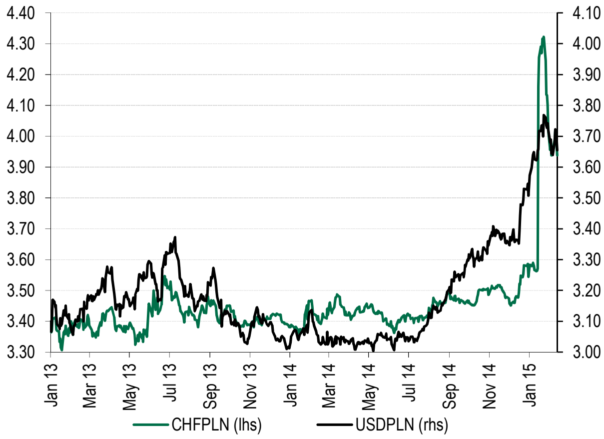
I see no such possibility [that the fiscal deficit was below 3% of GDP in 2014]. There is even a risk it will be above 3.3% of GDP. Preliminary data form the local governments indicate that despite a surplus until November 2014, the whole year closed with a deficit. Secondly, it looks like some railway projects (because of their parameters) will be included in the public sector. Additionally, last year's expenditures were raised by PLN3.2bn due to payments for clients of two bankrupt SKOKs (deposit-credit unions) by the Bank Guarantee Fund. Also, VAT revenues for January (accounted for last year's revenues in ESA) were quite weak amid shifts between January and February.

Even though the general government deficit was PLN30.9bn, or 2.5% of GDP, in the first nine months of 2014, in the final quarter it rose quite significantly, probably above 3.3% of GDP, boosted by some one-off elements. We think that this year's fiscal deficit will be cut below 3% of GDP, which will allow Poland to exit the Excessive Deficit Procedure in 2016. This is line with the Ministry of Finance's forecasts. As Szczurek pointed out, lifting of the EDP would allow the government to lower the VAT rate. Also, the minster reaffirmed his medium-term target for the general government deficit of 1% in 2018.

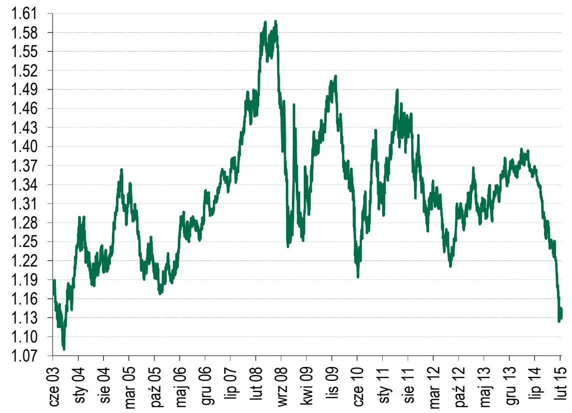
Foreign exchange market – Greece and data in the spotlight

EURPLN

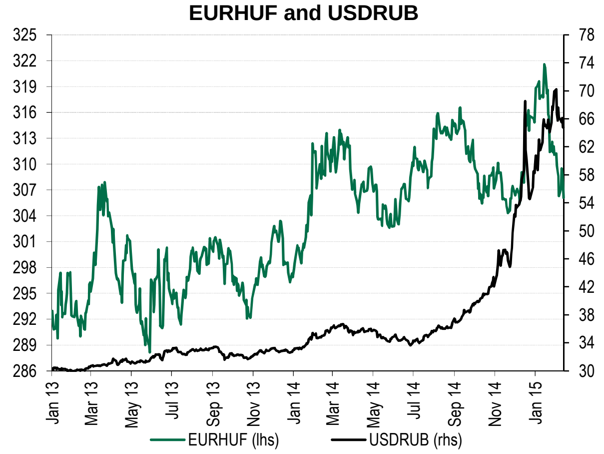
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



EURPLN fall comes to a stop

- Last week we pointed out that the weekly pace of EURPLN's fall is fading and that the exchange rate could now stabilise above its 4.146 low from late November. Indeed, uncertainty about negotiations between Greece and the euro zone stopped the zloty's appreciation vs. the euro and pushed EURPLN up temporarily above 4.22. Just like we had expected, the Polish CPI data for January surprised to the downside and this has also weighed on the currency towards the end of the week. Thus, the series of three consecutive weeks of EURPLN falls came to an end. At the same time, however, the zloty gained vs. the dollar for the third week in a row as EURUSD continued its rebound, which started in late January, soon after the ECB's decision to launch the QE program at full speed. USDPLN dropped last week to c.3.63 and it was as high at 3.80 mid-January.
- The Eurogroup holds a meeting on Monday and this is when it will resume negotiations with Greece about the terms of further financial support. The outcome of these talks may determine investor sentiment at least for the remaining days of the week.
- Alongside the global events and data, domestic factors may also have some impact on the zloty. After the below-consensus CPI release, we anticipate that industrial output data may also disappoint, hitting the domestic currency. Our forecast is well below market expectations, and, even though we see an upside risk to the data, it should come in below the relatively optimistic consensus.
- EURPLN returned to its c.4.14-4.24 range, in which it already hovered between August and mid-December. It may now be awaiting an impulse that could trigger a more noticeable and long-lasting move.

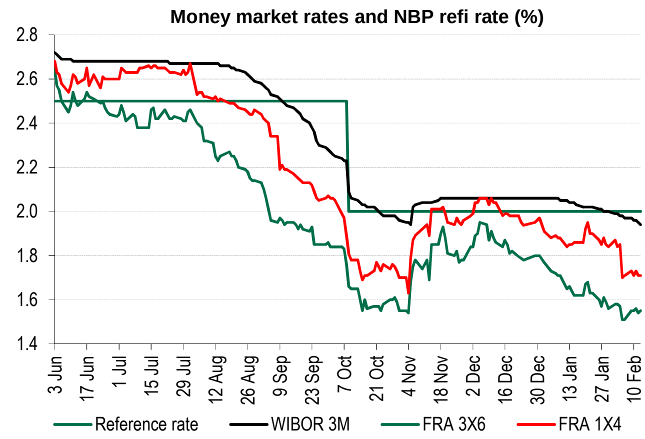
EURUSD higher despite Greek worries

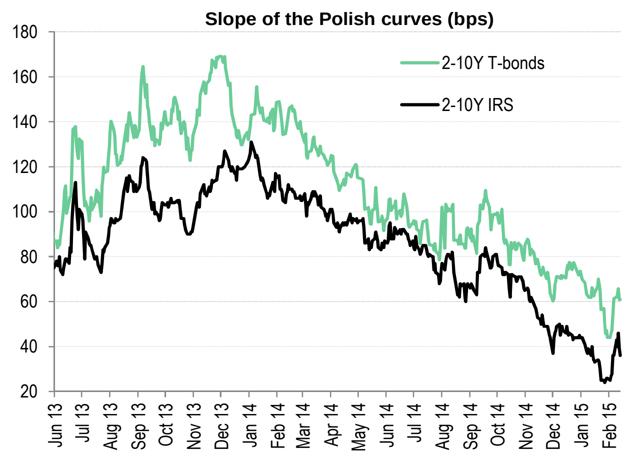
- Despite concerns over the situation in Greece that persisted for the better part of the week, EURUSD remained stable in the first few days before resuming its upward trend on hopes for a happy-end of the "Greek tragedy", which started to dominate in the market. On a weekly basis, EURUSD rose above 1.14 from 1.13.
- EURUSD has been rising steadily from the bottom at just below 1.11, reached after the ECB's decision to extend the asset purchase programme. The last time when the exchange rate rose for three consecutive weeks was in February. Ever since December 2012, it has never been so that after three weeks of increases, the upward move did not continue for at least one more week. Furthermore, the most recent rebound is the biggest since the downward trend in EURUSD started in May 2014. This suggests that the market has already priced-in the ECB's QE and that it would take a more euro-negative impulse to push the exchange rate lower.
- The still unresolved Greek crisis and important U.S. and euro zone data releases may fuel noticeable volatility this week in the EURUSD market.

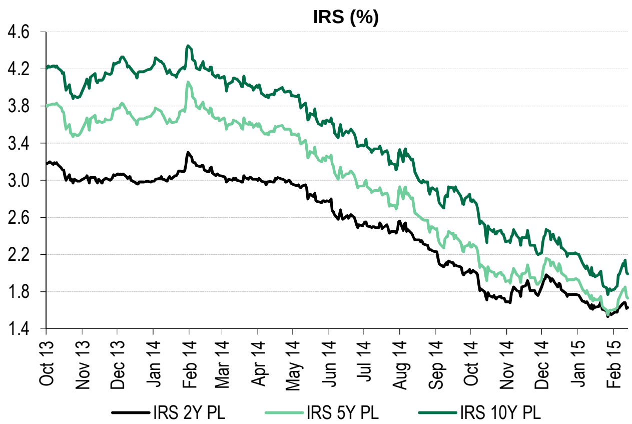
Ceasefire in Ukraine supports CEE currencies

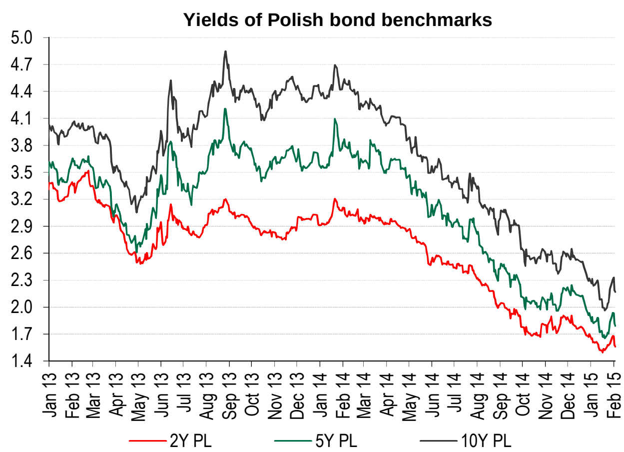
- The past week was very volatile for EURHUF. First, the exchange rate surged to 310 from 305 on the back of worries over Greece. Later, the forint recovered as the ceasefire in Ukraine was announced and investors started to price in that the Eurogroup's next meeting would bring closer a solution to the Greek issues.
- The ceasefire in Ukraine (plus a rebound in crude oil prices) also had a positive impact on the ruble – USDRUB declined for the second week in a row and reached nearly 64.3 vs. 67.5 on Monday.
- Market sentiment – and thus the CEE currencies – are likely to be driven by the situation in Greece and Ukraine this week, as well.

Interest rate market – Yields may fall again









High volatility in IRS and bond yields

- Expectations for more monetary easing in Poland kept pushing WIBOR lower, with the 3-12M rates falling further by 3bp and the 1M by 1bp. Now, all the 1M-12M WIBORs are below 2% as the shortest rate dropped to 1.99%.
- The past week was very volatile in the IRS and bond market. First, the IRS and bond yields rose sharply due to the hawkish U.S. nonfarm payrolls data released at the end of the previous week and, mainly, on the back of the high risk aversion fuelled by worries over Greece and the future of the euro zone. Consequently, the yield of the 10Y benchmark broke 2.30% and was nearly 40bps above the all-time low reached in late January. The 10Y IRS was temporarily more than 30bp above the record-low of 1.80% seen after the ECB's decision in January. However, global market sentiment improved later in the week, while a series of data releases in Poland came in dovish. This dragged the IRS and bond yields lower from the local peaks – both curves eased 10-15bp.
- We mentioned last week that the IRS and bond curves could start flattening after their sharp steepening seen in the last few sessions. Although the 2-10Y and 2-5Y spreads continued to widen in the first days of the past week, there was some correction in the shape of the curves at the end of the week.
- At Thursday's auction, the Polish Ministry of Finance sold bonds for PLN5bn, which was at the upper end of the planned supply range. The ministry raised over PLN1.3bn from the sale of its new 2Y bond, OK0717, and nearly PLN3.7bn from the new 5Y bond, PS0420. Demand reached c.PLN3bn and nearly PLN6.3bn, respectively, with yields at the auction at 1.667% and 1.987%, respectively. The auction's results were quite decent.

Downward trend remains intact

- For roughly thirteen months now (since end-January 2014), both yields and the IRS stayed in a downward trend that just had a few corrections. The recent rise in the bond yields was bigger than the previous increases only for the 10Y bond benchmark in the analysed time period (but only by 4bp vs. the correction from August 2014). This indicates that despite the latest weakening of the Polish debt market, the downward trend in the IRS and bond yields remains largely in place. Yields on the shorter-ends, in particular, would have to increase significantly to threaten the trend and cause its reversal.
- We think that domestic factors should continue to support the downward trend in yields and the IRS rates. Deflation is deepening and the MPC is likely to cut interest rates soon (we expect a 25bp rate cut in March and another one in April). Data on economic activity to be released in the nearest week may, however, paint a mixed picture – retail sales are set to be quite strong, the labour market should also be quite good, but, at the same time, industrial output may come in below consensus. On balance, this should not be negative for the Polish fixed-income market.
- The policy of monetary easing that is happening all over the world (already 18 central banks have eased policy so far in 2015) is also supportive of the Polish debt. However, global risk factors should not be ignored, including the situation in Greece and in Ukraine. The result of the Eurogroup's meeting at the start of the week may be key for market sentiment. Investors have recently become more optimistic on the outcome of these negotiations, which means that if the talks' outcome fails to bring good news, market sentiment may be hit by significant disappointment.

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.