Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

2 – 8 March 2015

The Eurogroup approved the Greek bailout extension last week, so the risk of a Grexit has fallen. Please note, however, that it was just one step forward for Greece and that there are more hurdles to deal within the coming weeks and months. But in the meantime, markets can focus on other issues, like the pace of the economic recovery or timing of the Fed's rate hike. The Fed chairman's speech last week seemed to lay the ground for a change in the policy stance, but we think that the first interest rate hike in the U.S. could be delayed until September. Data from Poland are still showing relatively a high resilience of the economy. GDP growth in 4Q14 slowed less than expected, to 3.1%YoY, amid a robust domestic demand (consumption growing 3.1%, investments 9%YoY). Meanwhile, seasonally adjusted unemployment kept falling, confirming that the situation on the labour market remains very good.

Central bank meetings will be in focus this week. We expect the Polish Monetary Policy Council to cut interest rates by 25bp and to leave the door open for further easing in the coming months. The ECB meeting will also be important since the bank will show its new economic forecasts and may reveal more technical information about its QE programme starting in March. The U.S. labour market data on Friday may be key when it comes to expectations about the Fed's monetary policy outlook. The PMI manufacturing index for Poland is likely, in our view, to show a slight correction, but it should remain in expansionary.

Economic calendar

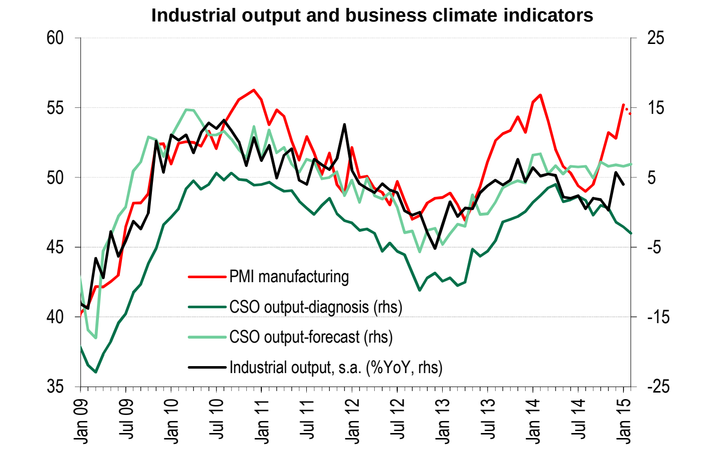
CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (2 March)					
9:00	**PL**	**PMI - manufacturing**	**Feb**	**pts**	**54.7**	**54.8**	**55.2**
9:55	DE	PMI - manufacturing	Feb	pts	50.9	-	50.9
10:00	EZ	PMI - manufacturing	Feb	pts	51.1	-	51.0
11:00	EZ	CPI	Feb	%YoY	-0.5	-	-0.6
14:30	US	Personal income	Jan	%MoM	0.4	-	0.3
14:30	US	Personal spending	Jan	%MoM	-0.1	-	-0.3
16:00	US	ISM - manufacturing	Feb	pts	53.2	-	53.5
		TUESDAY (3 March)					
		No important data releases					
		WEDNESDAY (4 March)					
9:55	DE	PMI - services	Feb	pts	55.5	-	54.0
10:00	EZ	PMI - services	Feb	pts	53.9	-	52.7
14:15	US	ADP employment	Feb	k	218	-	213
16:00	US	ISM - services	Feb	pts	54.5	-	57.0
	PL	**MPC decision**		**%**	**1.75**	**1.75**	**2.00**
		THURSDAY (5 March)					
8:00	DE	Industrial orders	Jan	%MoM	-0.1	-	4.2
13:45	EZ	ECB decision		%	0.05	-	0.05
14:30	US	Initial jobless claims		k		-	313
16:00	US	Industrial orders	Jan	%MoM	0.0	-	-3.4
		FRIDAY (6 March)					
8:00	DE	Industrial output	Jan	%MoM	0.5	-	0.1
9:00	EZ	GDP	Q4	%YoY	0.9	-	0.9
14:30	US	Non-farm payrolls	Feb	k	240	-	257
14:30	US	Unemployment rate	Feb	%	5.6	-	5.7

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

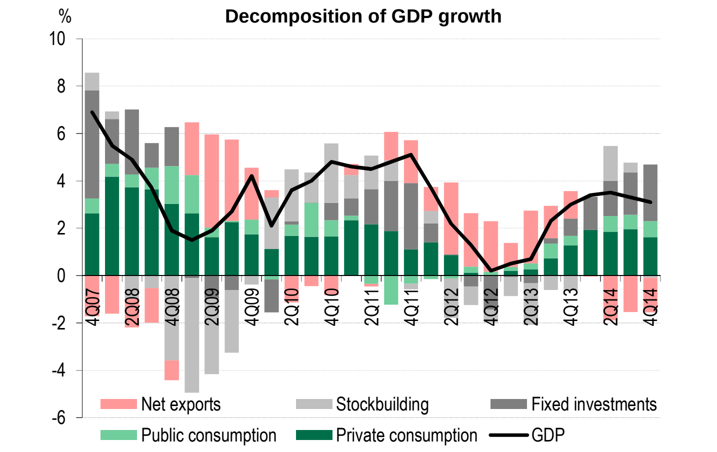
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

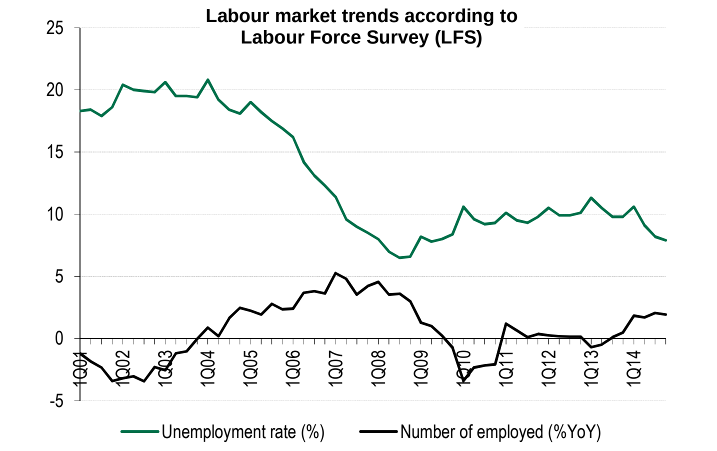
What's hot this week – An interest rate cut is likely, but rather cautious



- We expect that the manufacturing PMI index for Poland will show a slight correction in February after posting impressive growth to 55.2 in the previous month. Flash indices for Germany and the euro zone picked up slightly and alternative business climate indicators in the Polish manufacturing sector suggest that activity remains at a decent level. We do think, however, that the surge in January's PMI was over the top.
- Since the MPC had already clearly signalled that the odds of easing were high since the Council's last meeting, it would be a big surprise if there was no rate cut this week. Even though we see room for a 50bp rate cut, we think it is more likely that the Council will ease policy in two steps, by 25bp in March and again in April. Thus, the MPC's statement is likely to keep the door to further easing open, in our view. The NBP's new projections are likely to show a much lower CPI path than back in November, but the outlook for GDP will likely remain quite similar as before.

Last week in the economy – Domestic demand still strong, labour market booming





- GDP data for 4Q14 surprised positively again, showing a slight upward revision to 3.1%YoY from the 3.0%YoY flash estimate. Seasonally adjusted growth reached 0.7%QoQ (vs. flash 0.6%). Admittedly, the Polish economy slowed down a bit at the end of last year, but, in general, it seems that economic fundamentals remain healthy. Domestic demand rose 4.6%YoY amid private consumption growth of 3.1%YoY and fixed investment growth 9.0%YoY. Net exports had negatively affected GDP growth, taking away 1.5pp, but it should be noted that real export growth accelerated in 4Q to 6.9%YoY from 3.8% in 3Q. Import growth accelerated even faster, to 10.7%YoY. We think that GDP growth may slow down a bit more in 1Q15, slightly below 3%YoY, partly due to the high-base effect in fixed investments. However, the incoming quarters should see a re-acceleration of growth. Private consumption should remain strong amid the continuing improvement in the labour market (see below), and firms should benefit from the strengthening recovery in the euro zone.
- The registered unemployment rate rose in January 2015 to 12.0% from 11.5% in December but it was 1.9pp lower than in January 2014. According to our estimate, the seasonally adjusted unemployment fell by 0.1pp. A detailed analysis of labour market flows shows that the growth rate of the number of people removed from the unemployment rolls after taking up jobs have stalled, while the number of new registrations is still declining. At the same time, alternative measures of the Polish unemployment trends, based on the Labour Force Survey, showed a drop of the jobless rate to 8.1% in 4Q14 and a rise in the number of those employed by as much as 1.9%YoY. In general, these data confirmed that the labour market is in a good shape, offering strong support for the consumption outlook in the upcoming quarters.

Quote of the week – Last-minute decision

Andrzej Bratkowski, MPC member, 23.02.2015, Parkiet
I still believe there is room for rate cuts of 100bp in Poland. In the context of the FX fluctuations, we should deliver them slowly. But since we didn't change rates in February, it would be good to cut by 50bp in March. Still, I doubt such a motion would get majority support.

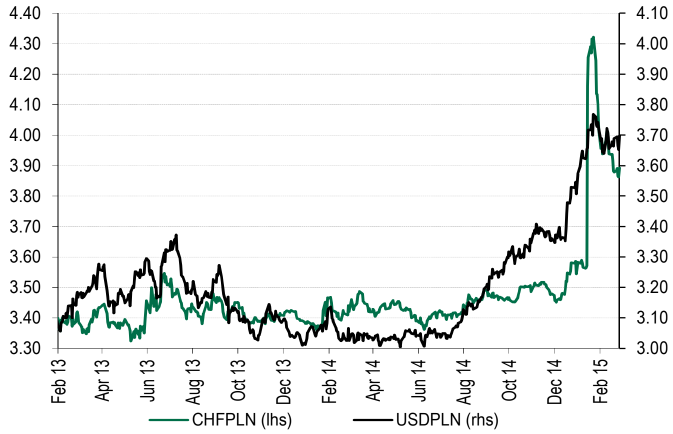
Elżbieta Chojna-Duch, MPC member
27.02.2015, Reuters: The (GDP) data present an optimistic outlook, they indicate stability of good economic growth.
25.02.2015, Bloomberg: I still have no idea what I'll do, it's going to be a tough, last-minute decision. The main consideration is persistent deflation, and the governor's view will be crucial. He's got the most data and the best feel for the markets.
23.02.2015, Bloomberg: We will have to consider the delayed effect of our decision on the economy as the Council is close to the end of its term and would like to leave the economy well-balanced. I don't like the hysteria around monetary policy easing globally.

Andrzej Bratkowski has recently been the biggest advocate of deep interest rate cuts (the only one who voted for a 100bp cut in December and January). But even his approach has become more cautious due to the recent FX volatility. It implies, in our view, that an interest rate cut bigger than by 25bp in one go is not very likely (even though the probability of such a scenario is rising slightly as the zloty appreciates).
In January, only Bratkowski and Osiatyński supported the motion to cut rates by 25bp. But after February's meeting, NBP President Marek Belka sounded quite confident that there would be majority for policy easing in March. While the recent comments of E.Chojna-Duch show she is still unconvinced, we think it could be Jerzy Hausner who could join the club, securing sufficient majority for a rate cut.

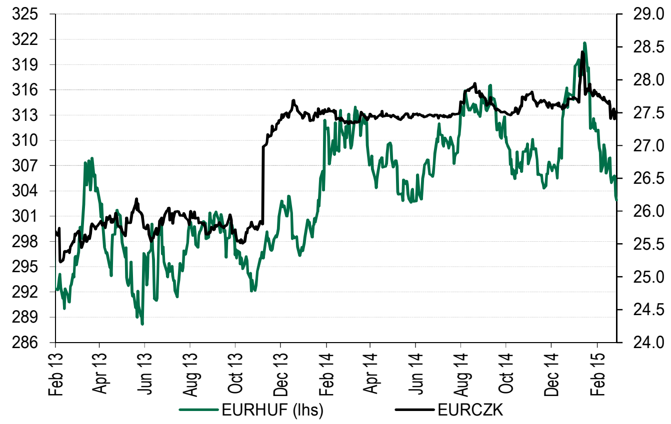
Foreign exchange market – EURPLN and EURUSD near key levels

EURPLN

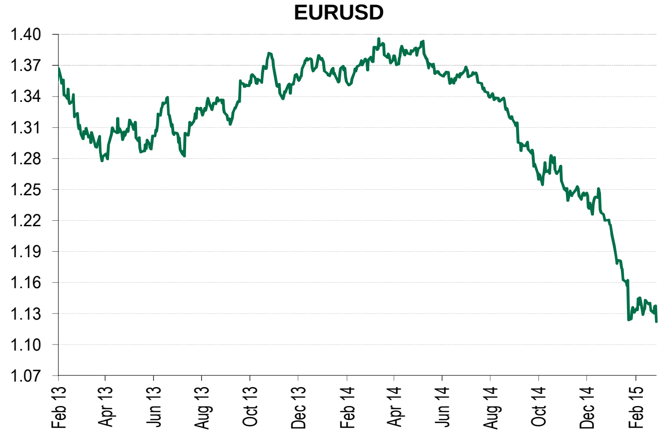
USDPLN and CHFPLN



EURHUF and EURCZK



EURUSD



Polish zloty stronger and stronger…

- Last week was favourable for the EM currencies, including the Polish zloty, as the risk of a Grexit diminished and the speech of the Fed governor was interpreted as quite dovish. EURPLN declined towards the bottom of its consolidation channel between 4.146 and 4.24, with the rate temporarily reaching 4.145, the lowest since July 2014.
- USDPLN was more volatile. In weekly terms, the zloty lost nearly 1% against the U.S. dollar due to the significant decrease of EURUSD. The rate climbed above 3.70, the highest since mid-February. As regards the other main currencies, the zloty was more or less stable against the CHF (in weekly terms), while it lost 1.1% against the British pound (due to the strengthening of GBP after solid data from the UK economy).
- This week will be very busy in terms of macroeconomic releases (including PMI indices, monthly data from the U.S. and central bank meetings). Please note that the recent attempts to break 4.15 had failed, which means that an additional impulse may be necessary to slide below this level. In our view, EURPLN will remain in a horizontal trend, very close to the lower boundary of the channel. On the one hand, the expected start of the ECB's QE programme could have a positive impact on the domestic currency as investors will be seeking higher-yielding assets, like the Polish bonds. Moreover, the PMI index for Poland's manufacturing sector should also be supportive. On the other hand, a 25bp rate but by the MPC and an announcement of another cut in the nearest future should act in the opposite direction. Support at 4.146 remains intact.

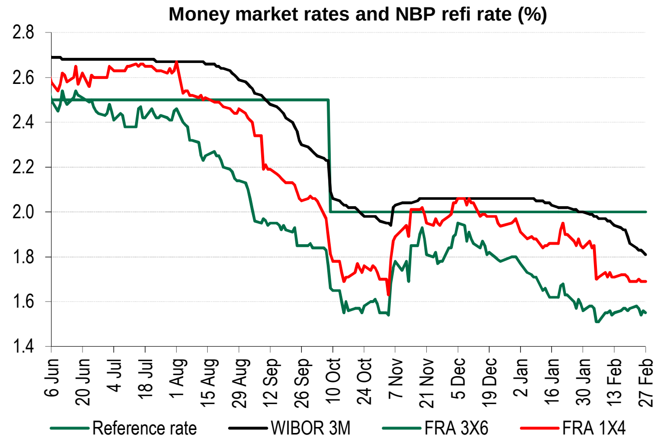
… just like the other CEE currencies

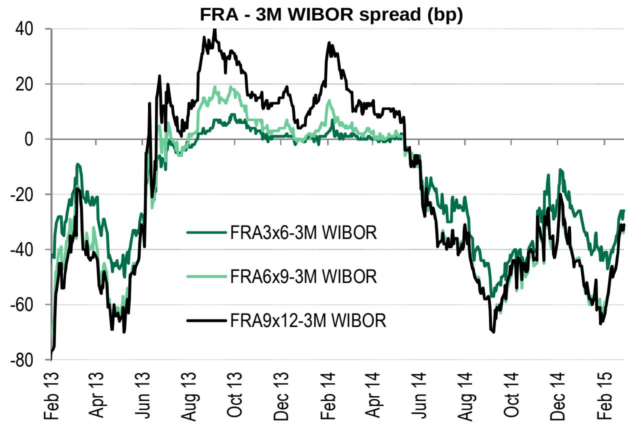
- Last week also brought a quite visible strengthening of the Hungarian forint. EURHUF reached 302.5 (9-month low) due to the lack of an interest rate cut at February's NBH meeting and strong demand for Hungarian bonds from foreign investors. At the same time, the Czech koruna also slightly appreciated to 27.3 against the euro, though EURCZK rose quickly a tad above 27.5 after some relatively weak macro data.
- The CEE currencies should stay under the influence of external factors. The continuously strong demand for higher-yielding assets, including the Hungarian bonds, should support EURHUF near its current level. We also expect range-trading on EURCZK.

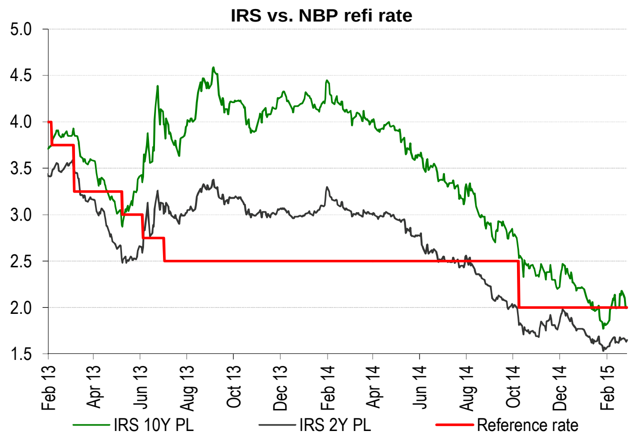
EURUSD falls sharply on U.S. data

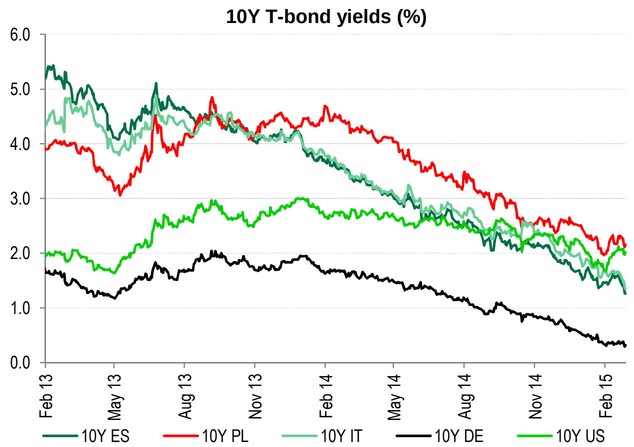
- EURUSD was relatively stable (around 1.13) for most of the week. However, U.S. inflation data brought the needed impulse and the rate fell sharply to 1.12, not far from the year-to-day lows at c1.11.
- EURUSD will be under the influence of macroeconomic data releases this week (including PMI indices for the European countries, monthly labour market data in the U.S.) and the ECB meeting. We think that this time the U.S. jobs' report will probably be more interesting than the ECB meeting as the latter should not bring any changes in the current monetary conditions. On the other hand, PMI data should confirm there is good momentum in the European economy, which should limit possible euro losses if the U.S. data should show further strong improvement. All in all, in our view, only a breakdown of this year's lows (c1.11) would mean the end of the ongoing consolidation channel that started in January and a return to the downtrend.

Interest rate market – Yields may drop again ahead of the ECB's QE programme









Polish rates drop ahead of the MPC meeting

- Money market rates continued their downward trend, with the WIBORs falling by 3-5bp and FRAs by 1-2bp in weekly terms. Consequently, spreads between the WIBORs and the reference rate widened quite visibly (for rates between 3M and 12M) to levels seen in September 2014, when investors were expecting significant monetary easing. Currently, the FRA3x6 is nearly c30bp below the current level of WIBOR3M and the latter is c19bp below the NBP reference rate.
- Domestic interest rates gained quite visibly in the last week of February as risk of a Grexit diminished and due to the relatively dovish testimony by the Fed governor's Janet Yellen. Strengthening on the core market also supported the domestic debt assets. As a result, both curves shifted down (by 2-18bp for IRS and by 8-18bp for T-bonds), with a stronger decline seen in the yields/IRS rates on the belly and long-end of the curves (with the 10Y IRS rate temporarily below 2%).
- Yields/rates were, on average, 15bp higher than at the end of January. Moreover, in spite of the recent changes on the interest rate market in the last week of February, a bear-steepening took place, with the 2-10Y spread for bonds widening to 57bp from 44bp at the end of January.
- In line with expectations, Poland's Ministry of Finance scheduled two auctions for March: one regular auction with an offer worth PLN3-6bn of long-term bonds (WZ0124, DS0725 and WS0428) and a switch tender, on which the Ministry will bid on bonds maturing in April, July and October 2015. Moreover, the Ministry plans a buy-back auction of the USD-denominated bonds up to $500m. Supply is quite limited and we do not exclude that after 1Q15, the Ministry will have covered even over 50% of the 2015 borrowing requirements.
- Last week was very interesting on Europe's other markets. Bond rates fell sharply, with the exception of the Greek rates, which rose. We saw solid demand on both the primary and secondary market. One should notice that the German 5Y benchmark bond was launched with a negative yield, for the first time in history.

Central banks meetings in the spotlight

- This week investors will focus on the central banks meetings: Poland's MPC and the ECB. We expect that the MPC will cut interest rates by 25bp and will keep the door open for further monetary adjustment in the nearest months. Money market rates are, therefore, likely to continue trending downwards, with the WIBOR 3M approaching 1.60% even before April. Otherwise, the downward trend in the WIBORs may slow a bit.
- In our view, both IRS and the T-bond markets have fully priced-in a rate reduction by 25bp, so investor focus will shift on the post-meeting statement. If the tone of the communique does not disappoint, there will only be minor changes in yields/rates. The domestic debt market could react more significantly to the ECB meeting as the start of the large-scale buying of sovereign debt, wiping out a large part of the new bond supply in the euro area, is very close. We believe that this factor should support Polish assets, pushing yields/rates down towards minimal levels.
- In our view, the belly and the long-end of the curves could benefit the most from the QE programme. We, therefore, predict that investors will quickly return to their curve flattening strategy, something that we have already seen in the last few 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.