Bank Zachodni WBK
Grupa Santander

BI-WEEKLY ECONOMIC UPDATE

30 March – 12 April 2015

Recent days showed that the zloty and bond markets are sensitive to expectations regarding the Fed's policy outlook. EURPLN fell to a two-year low on the back of the relatively dovish FOMC stance, only to rebound on stronger U.S. labour market data and some Fed members' comments. We may see increased currency volatility in the next two weeks as market liquidity is likely to dry out before the Easter holiday, while the next data releases in the U.S. (including ISM and non-farm payrolls) could affect investors' expectations of the Fed's possible rate hikes. It will also be an important moment for the euro zone as some key activity indicators are due to be released. What is more, Greece is scheduled to present its creditors with a specific list of reforms that it plans launch.

The only key data release in Poland in the next two weeks will be the manufacturing PMI for March. We expect the index to grow, especially since the corresponding flash indices for Germany and the euro zone had soared, while most of Poland's alternative economic activity indicators improved. LFS unemployment data is to be released by the Eurostat and it will probably show further decline in the jobless rate, which means that companies continue to hire people.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (30 March)					
14:30	US	Personal income/Consumer spending	Feb	%MoM	0.3/0.2	-	0.3/-0.2
16:00	US	Pending home sales	Feb	m	0.4	-	1.7
		TUESDAY (31 March)					
9:00	CZ	GDP	4Q	%YoY	1.5	-	2.2
11:00	EZ	Flash HICP	Mar	%YoY	-0.3	-	-0.3
14:00	**PL**	**Balance of payments**	**4Q**	**€ m**	**-1332**	**-1332**	**-1777**
14:00	**PL**	**Inflation expectations**	**Mar**	**%YoY**	**-**	**-**	**0.2**
16:00	US	Consumer confidence index	Mar	pts	96.6	-	96.4
		WEDNESDAY (1 April)					
9:00	**PL**	**PMI – manufacturing**	**Mar**	**pts**	**55.3**	**55.6**	**55.1**
9:55/10:00	DE/ EZ	PMI – manufacturing	Mar	pts	52.4/51.9	-	51.1/51.0
14:15	US	ADP report	Mar	k	225	-	212
16:00	US	ISM – manufacturing	Mar	pts	52.5	-	52.9
		FRIDAY (3 April)					
14:30	US	Non-farm payrolls	Mar	k	250	-	295
		MONDAY (6 April)					
16:00	US	ISM – services	Mar	pts	56.7	-	56.9
		TUESDAY (7 April)					
9:55/10:00	DE/EZ	PMI – services	Mar	pts	-	-	55.3/54.3
		WEDNESDAY (8 April)					
8:00	DE	Industrial orders	Feb	%MoM	-	-	-3.9
9:00	HU	CPI	Mar	%YoY	-	-	-1.0
	US	FOMC minutes					
		THURSDAY (9 April)					
8:00	DE	Industrial output/Exports	Feb	%MoM	-	-	0.6/-2.1
9:00	CZ	CPI	Mar	%YoY	0.3	-	0.1
11:00	**PL**	**Bond auction**					

Source: BZ WBK, Reuters, Bloomberg

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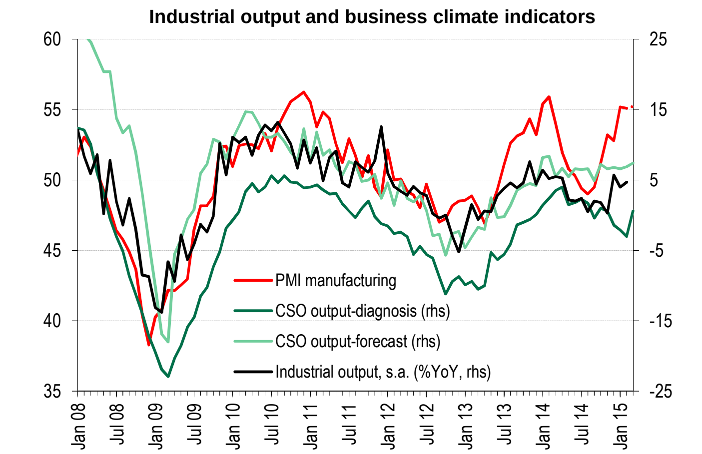
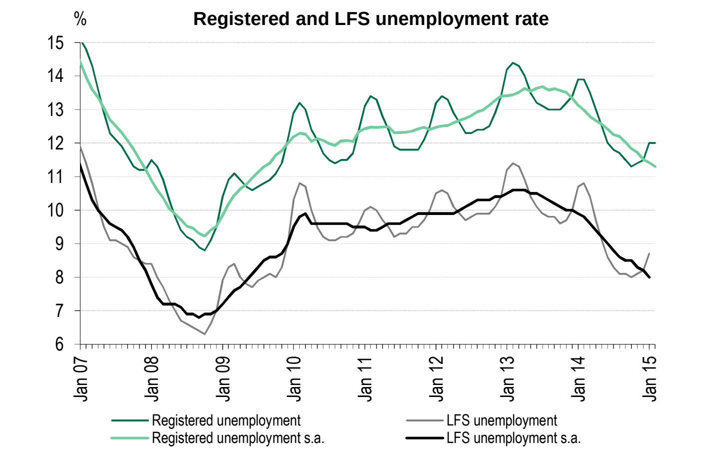
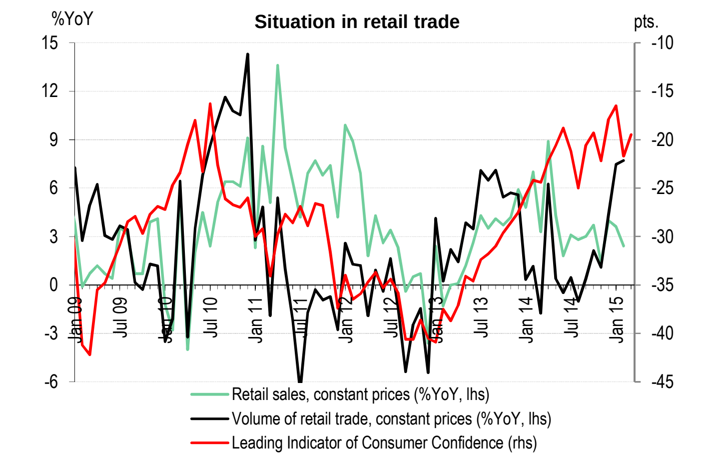
What's hot in the next two weeks – Will PMI surprise positively again?



- After a series of positive surprises from the Polish manufacturing PMI in the last few months, we now expect yet another slight improvement of the index in March. Virtually all the other measures of the business climate in Poland improved this month, showing that the industrial sector was expanding. There was also a clear pickup in the economic activity indicators in the euro zone and Germany, which should positively affect moods of the Polish entrepreneurs. Therefore, we think that further PMI increase in March is likely, even though the PMI is already near its last peak, and the index is probably overstating a bit the real situation in the manufacturing sector (please note the divergence between PMI and industrial output growth in recent months).
- The quarterly balance of payments data will probably show revisions of the earlier released figures. However, their impact on the market should be limited.

Last week in the economy – Labour market still showing signs of strength





- In line with expectations, the registered unemployment rate stayed flat at 12.0% in February, which points to further falls in seasonally-adjusted terms. On March 31, Eurostat will release unemployment data, based on the Labour Force Survey (LFS), which are more accurate, in our view, than the registered unemployment data (as the latter are biased due to the fact that some people working in the grey economy are registering in labour offices to get healthcare benefits).
- Detailed labour market data published in the statistics office's monthly bulletin confirmed our expectations that the deceleration of wage growth in February was due to lower payments in the mining sector as some mining companies decided to split the bonus payments into two instalments (the second one now due in September). Pay rises in other sectors remain decent. Trends in employment stayed roughly unchanged vs January, with industrial manufacturing remaining the main driver behind employment growth. The data confirmed that the labour market has been improving and we expect these positive trends to hold in the near future. This will have a positive effect on consumer demand and economic growth.
- The real volume of retail trade increased by 7.7%YoY in February after 7.5%YoY in January, clearly outpacing retail sales growth (which slowed to 2.4%YoY in February from 3.3%YoY in January, in real terms). This seems to confirm our hypothesis that the true trends in private consumption have been underrepresented in recent months. Please note that retail sales data comprise of only bigger shops, employing more than 9 people, which leaves the small companies out of the sample. It seems that food sales in small shops may explain large part the discrepancy between the data. Booming sales online (almost 50%YoY) could be another explanation, as many online shops are probably too small to be reflected in the retail sales.

Quote of the week – Stronger zloty still not a headache for the MPC

Marek Belka, NBP governor, 23 March, Bloomberg

The zloty has been surprisingly resistant to appreciation. While we can't be sure this will continue, we're not panicking. The central bank is very closely monitoring the currency market and portfolio capital flows. So far, we don't see anything that changes our baseline scenario. The zloty is holding up nicely and we don't see a reason to change our plans, intentions and thinking about monetary policy.

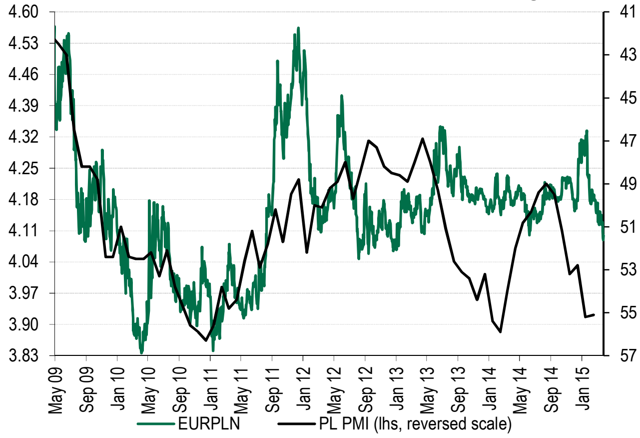
Andrzej Rzońca, MPC member, 27 March, PAP

The fact that the zloty is strengthening does not mean it will continue to appreciate. We have a floating exchange rate. (…) I do not see the issue of FX rate development as anything that would put the MPC in a tight spot.

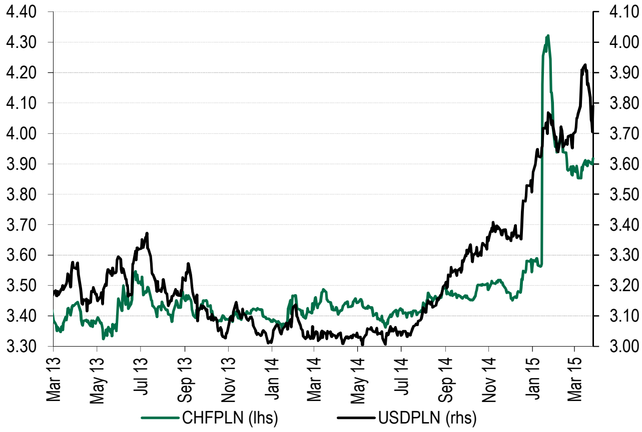
We still think that excessive zloty appreciation could be a potential trigger for the central bank to consider additional monetary easing. And indeed, after the zloty's recent appreciation (EURPLN hit a two-year low last week) and governor Marek Belka's recent comments, the market started pricing-in a growing possibility that interest rates in Poland may be reduced further. However, in our view, the currency's strengthening would have to go much further to trigger a central bank action. Meanwhile, uncertainty over the Fed's policy outlook and the persisting geopolitical risks (Ukraine, Greece) are limiting the pace of the move. Thus, our base-case scenario still assumes stable NBP interest rates until the end of this year.

Foreign exchange market – U.S. data to show the direction

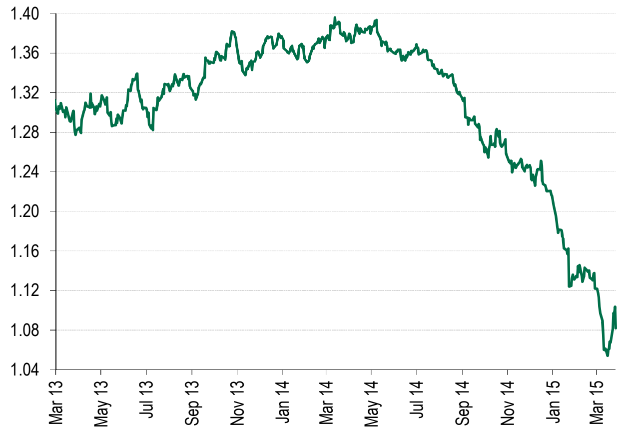
EURPLN and PMI for Polish manufacturing



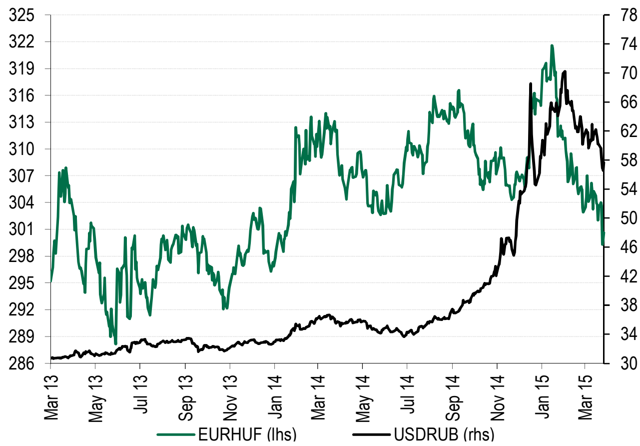
USDPLN and CHFPLN



EURUSD



EURHUF and USDRUB



EURPLN tests 4.08

- The emerging currencies were quite volatile in the past week and this was also the case of the Polish FX market. During the first few sessions, the zloty continued to gain vs. the euro and the dollar on the back of the FOMC's recent signals and sound Polish data. Consequently, EURPLN tested 4.08, while USDPLN fell temporarily below 3.70. However, global sentiment began to deteriorate later on, pushing both the exchange rates up. The zloty then lost some of its earlier gains.
- We think the zloty will remain strong. First, rate cut expectations will no longer weigh on the currency. Second, even after the recent rate cut, real interest rates in Poland are still among the highest in the emerging universe. This, combined with the euro zone's quantitative easing, could finally lead to bigger capital inflows to the Polish debt market, which may also support the zloty. Furthermore, the outlook for economic growth is improving, in our view, and upcoming data releases should confirm this optimistic picture. We expect the Polish manufacturing PMI index to have climbed further in March. The recent change in the FOMC's statement suggested that monetary policy tightening in the U.S. was less imminent, but last week showed that the market is very sensitive to the U.S. macro data releases. And the next two weeks will bring numerous important data, including the non-farm payrolls and manufacturing ISM. Both will be watched most closely. Should this data surprise to the upside, there could be more profit taking from the zloty's recent appreciation. Still, we expect any upward move in EURPLN to be only temporary. USDPLN should be more dependent on EURUSD.
- From the technical analysis point of view, even if EURPLN rose to 4.16, its down trend would still be valid. Meanwhile, if 4.08 was broken for good, then the next support would be at 4.05.

EURUSD still struggling with 1.10

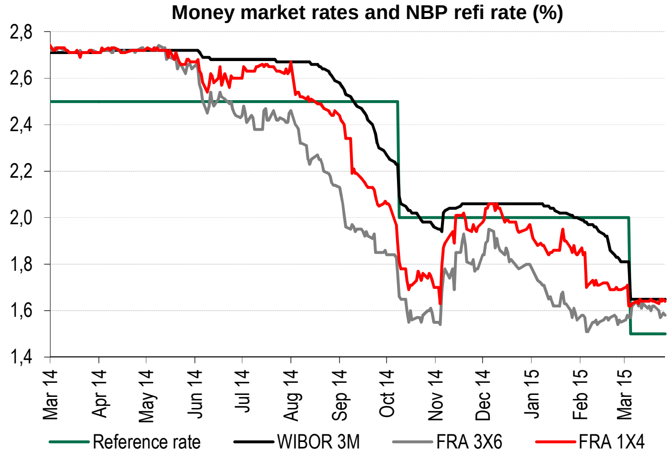
- Strong data from the euro zone and Germany led to three attempts to break the EURUSD's local peak at c1.103, but investors failed to keep the exchange rate above this level for longer.
- The recent correction in EURUSD's downward trend was triggered by a less hawkish-than-expected outcome of the last FOMC meeting. The pledge that the Committee would be "patient" in deciding on rate hikes was removed, making the potential changes in monetary policy more data dependent these days. There is plenty of U.S. releases on the agenda for the next two weeks, including the manufacturing ISM index and, in particular, the March non-farm payrolls. The latter figure kept surprising to the upside in the last four months and if this is the case also this time, the dollar could regain its appreciation momentum.

Central banks drive forint and koruna

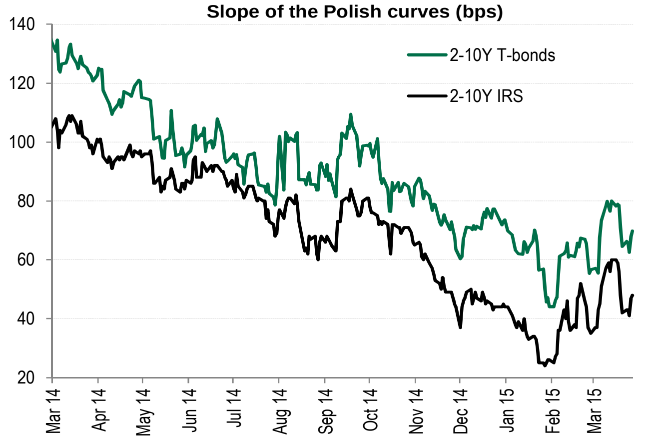
- The forint appreciated noticeably thanks to the lower-than-expected interest rate reduction by the Hungarian central bank, which made EURHUF drop to 300. The MNB cut rates only by 15bp (with 20bp expected) and said that more easing was likely. However, it seems that it was more important for the Hungarian currency that the rate cut was smaller in March than that more easing could be underway.
- As expected, the Czech central bank kept interest rates unchanged, but it pointed out that there are growing chances for shifting up of the EURCZK floor of 27 (which was introduced in November 2013). The bank's assessment of the deflationary pressures will be the key factor here. EURCZK rose to 27.57 from 27.35.
- The next two weeks will bring important Czech and Hungarian data that, next to the global market sentiment, may be important drivers for both the koruna and forint.

Interest rate market – External factors remain key for domestic assets

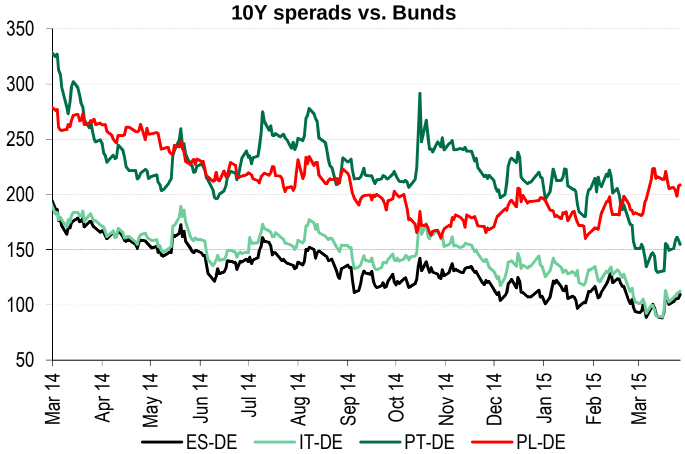
Money market rates and NBP refi rate (%)



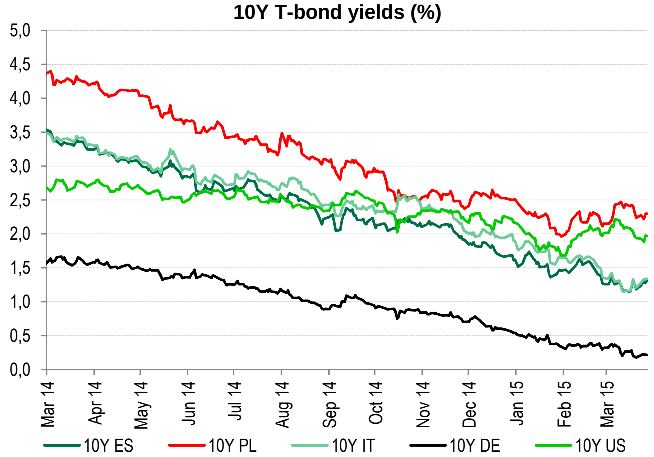
Slope of the Polish curves (bps)



10Y sperads vs. Bunds



10Y T-bond yields (%)



Market sees odds for more monetary easing

- This was yet another week of stable WIBORs, in contrast to the FRA rates, which fell significantly across the board. Since the MPC meeting in March, the longer FRAs (e.g. 15x18, 18x21, 21x24) dropped over 20bp. Consequently, while in mid-March the market had been pricing-in the first rate hike in roughly 18 months, it now sees rising odds of additional monetary easing as soon as this year. Falls in the FRAs were fuelled, in our view, by the recent strengthening of the Polish currency that, if continued, could make some MPC members consider further rate cuts. Despite some profit taking at the end of the week, FRAs were by 3-7bp lower than a week ago.
- In our opinion, the WIBOR rates should remain roughly stable in the upcoming two weeks due to an absence of important data releases or events. However, FRAs will be more vulnerable to the currency movements, especially since NBP governor Marek Belka had recently signaled that monetary policy adjustment could not be ruled out if the zloty firmed significantly. We believe that the scale of the zloty's appreciation would have to be much more noticeable than it had recently been to push the central bank into action. We, therefore, do not expect more rate cuts in our base case scenario and we think that a significant decline in the FRA rates is unjustified.

Mixed sentiment on bond and IRS markets

- For the better part of the week, the bond and IRS markets were strengthening due to the improved global sentiment. Despite the favorable auction results, domestic debt lost at the end of the week due to hawkish comments of some Fed members, strong data from the U.S. labour market and rising geopolitical risk. As a result, the 10Y benchmark yield temporarily rose to 2.35%.
- The belly and long-end of the curves lost the most and, consequently, the 2-10Y spread widened quite visibly towards levels that were seen at the end of the previous week. Moreover, risk premium rose, with the spread over the 10Y Bund growing to nearly 210 bp, the highest in a week.
- The switch auction was very successful. The Finance Ministry sold bonds for PLN6.5bn and nearly PLN4bn was raised from selling the 5Y benchmark PS0420. As we had expected, the new WZ0120 floater also attracted high interest. We estimate that at the end of March, the Ministry had covered nearly 55% of this year's gross borrowing needs.

External factors and issuance plan for 2Q are key

- The upcoming two weeks will be very interesting taking into account the important macro data releases abroad and the Easter holiday. We think that the beginning of the week could be very volatile due to the end of the month and the end of the first quarter. We do not exclude the possibility of some strengthening on the interest rate market due to the "window dressing" effect. Liquidity on the domestic FI market may be limited just before Easter, creating scope for elevated volatility of yields/IRS rates.
- Last week once again showed that domestic curves were significantly affected by the U.S. monetary policy outlook expectations. The monthly non-farm payrolls due on Good Friday might, therefore, prove to be key for the domestic assets. However, market reaction to these data will likely be muted due to the Easter holiday, possible showing more strongly on the market the following week.
- Investor sentiment could be affected by the 2Q 2015 issuance plan. We expect the offer of T-bonds to be moderate despite the quite significant inflows of cPLN19bn in total from the PS0415 redemption and interest rate payments in April.

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.