WEEKLY ECONOMIC UPDATE

25 – 31 January 2016

The first days after the S&P's rating downgrade brought some relief for the Polish assets. The zloty gained on dovish ECB signals and some supportive comments from Poland. Bond yields also retreated noticeably from the post-downgrade peaks, partly due to demand from investors lured by more attractive pricing, and partly due to global debt strengthening after ECB meeting. The dovish ECB rhetoric appeared more important than the hawkish message sent by the monthly data on industrial output, retail sales, employment and by MPC members' comments suggesting no need to cut interest rates in Poland. Spread to German Bunds remained elevated, near 270bp in case of 10Y bonds.

Important events and macro data releases are on the agenda this week. There appears to be a wide consensus that Fed rates will stay unchanged in January and the market will rather eye hints on the FOMC's future decisions. The recent comments of the Committee's members suggest there is no agreement on whether the next hike could take place in March and how many in total there might be in 2016. We think that if this week's statement is not overly hawkish, which could actually be the case due to the recent slump in oil prices and resurfacing concerns about China, it could work in favour of the risky assets.

In Poland, the flash GDP data for 2015 will be in focus. We expect to see 3.6% growth, implying that economic growth accelerated in the last quarter to 3.7-3.8% YoY. The Sejm will vote on Friday on new MPC members but we expect no surprise on this front – only PiS candidates are likely to be approved.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (25 January)					
10:00	DE	Ifo index	Jan	pts	108.4	-	108.7
		TUESDAY (26 January)					
10:00	**PL**	**GDP**	**2015**	**%YoY**	**3.5**	**3.6**	**3.4**
10:00	**PL**	**Unemployment rate**	**Dec**	**%**	**9.7**	**9.8**	**9.6**
14:00	HU	Central bank decision		%	1.35	-	1.35
16:00	US	Consumer confidence	Jan	pts	96.5	-	96.5
		WEDNESDAY (27 January)					
16:00	US	New home sales	Dec	k	500	-	490
20:00	US	FOMC decision		%	0.25-0.50		0.25-0.50
		THURSDAY (28 January)					
11:00	**PL**	**Bond auction**					
14:00	**PL**	**MPC minutes**					
14:30	US	Durable goods orders	Dec	%MoM	-0.5	-	0.0
14:30	US	Initial jobless claims	week	k	-	-	293
16:00	US	Pending home sales	Dec	%MoM	1.0	-	-0.9
		FRIDAY (29 January)					
11:00	EZ	Flash HICP	Jan	%YoY	0.4	-	0.2
14:00	**PL**	**Inflation expectations**	**Jan**	**%YoY**	**0.2**	**-**	**0.2**
14:30	US	Advance GDP	Q4	%YoY	0.7	-	2.0
16:00	US	Michigan index	Jan	pts	92.5	-	92.6

Source: BZ WBK, Reuters, Bloomberg

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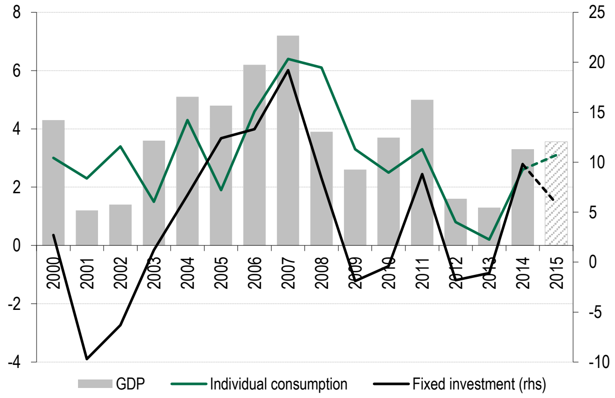
What's hot this week – Will 2015 GDP growth surprise to the upside?

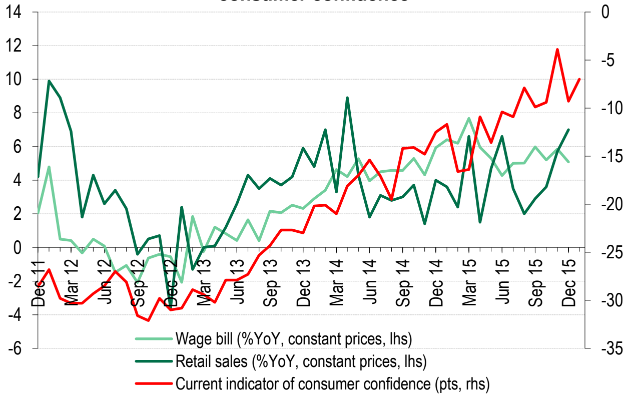
GDP, consumption and investment (%YoY)



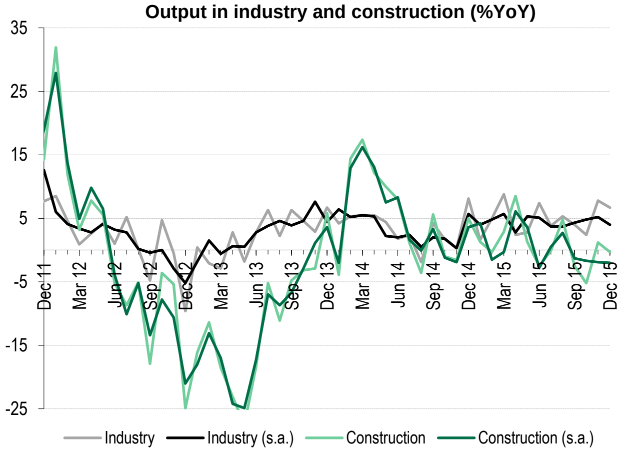
- Flash GDP data for 2015 will be the key domestic publication this week. The most recent monthly data releases (balance of payments, employment, production, sales) increased our optimism about economic growth in 4Q15, so currently we estimate that GDP growth in 2015 reached 3.6%, which implies 3.7-3.8%YoY growth in the fourth quarter. The growth should be supported by healthy consumption, investments and exports.
- According to the labour ministry's estimate the registered unemployment rate in December rose to 9.8%, which is in line with our forecast.
- On Friday the Sejm is supposed to vote on the new MPC members. In this case we expect no surprises – only candidates proposed by the PiS will be approved.

Last week in the economy – Solid economic activity in December

Retail sales, wage bill in corporate sector and consumer confidence



Output in industry and construction (%YoY)



- Employment growth in corporate sector accelerated in December to 1.4%YoY, its highest since December 2011. It was the first time since 2007 when the average number of jobs in December was higher than in November. In our view it reflects the strength of the underlying trend of investment growth. Average wage growth disappointed slightly, decelerating to 3.1%YoY in December, which shows that high labour demand has not been triggering a strengthening of wage pressure yet. However this is going to change in our view, as the unemployment rate is falling towards its record low and companies are facing growing problems with finding skilled workers. Accelerating growth of households' income should support private consumption growth in the coming months and quarters.
- Industrial production rose 6.7%YoY in December, while retail sales in constant prices soared 7.0%YoY. Total production growth would have been even higher if it had not been for a good weather (lowering energy output), and ailing mining sector – in manufacturing alone the production growth rose 9%YoY. Construction output disappointed, having fallen -0.3%YoY (vs. expected rise by 2-3%). The data confirm that in general economic activity in Poland was growing quickly at the end of 2015, being supported by both solid external demand (fuelling industrial production and exports) and accelerating households' spending (thanks to solid growth in labour income).
- Stats offices' business climate indicators for January showed a continuation of positive trends in major sectors, suggesting that economic situation keeps improving at the start of 2016. Consumer sentiment indicators also increased in January.

Quote of the week – Rates should remain stable

Marek Belka, NBP governor, TVN24 BiŚ; 19.01
I would not even mention a rate cut in a situation like we have today. I guess we do not want the zloty to lose the ground.

Eugeniusz Gatnar, MPC member, PAP, 20.01
Interest rate level is adequate from the point of view of current, stable economic situation. I see no reason to change it. We must wait until the new NBP inflation projection, which will be in March. We must also wait for the effects of the fiscal stimulation that the government had announced.

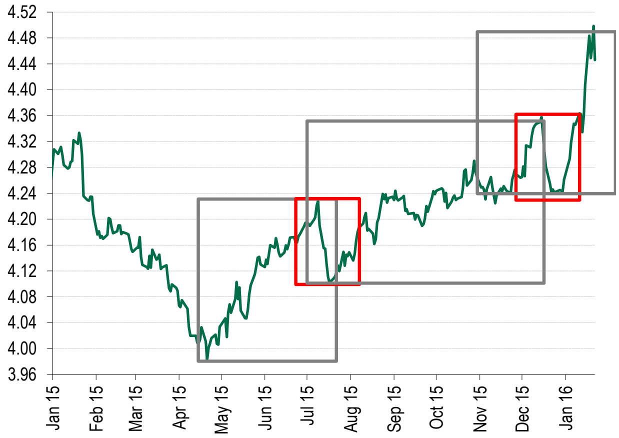
Jerzy Kropiwnicki, MPC member, PAP, 19.01
I see no need to change inflation target or interest rates in the near future.

Jerzy Osiatyński, MPC member, Bloomberg, 22.01
We're in a wait-and-see mode, with the prospect for monetary-policy tightening rather than loosening. Public finances as of 2017 seem difficult to hold on a leash. (I'm not) sure if new members will be convinced enough to use such a tool in reaction to possibly over-expansive fiscal policy.

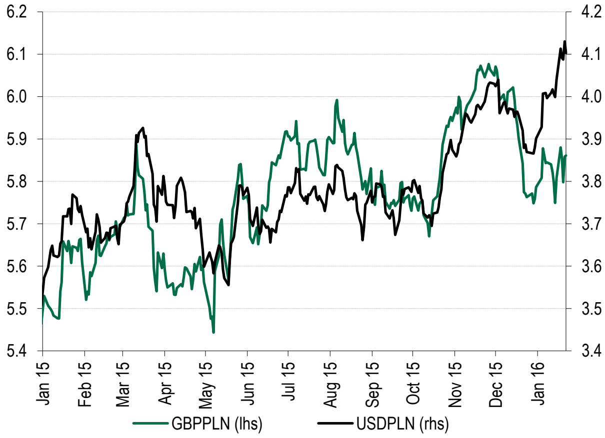
Surprisingly hawkish comments of the Polish central bank representatives and a significant weakening of the zloty suggest a lower probability of interest rate reductions in Poland in the nearest months. If next domestic data releases keep surprising on the upside, market expectations for a rate cut may decrease even further. However, please note that the new NBP inflation projection remains an important factor for the new MPC members. If it shows considerably lower CPI path, with deflation persisting even until 3Q16, and the zloty trims large part of its recent losses until March, a rate cut cannot be ruled out, especially if the ECB policy easing is on the horizon, and global growth outlook deteriorates further. It also remains to be seen what will be the opinions of the remaining policymakers to be appointed by the Sejm and the President.

Foreign exchange market – Internal factors could support the zloty

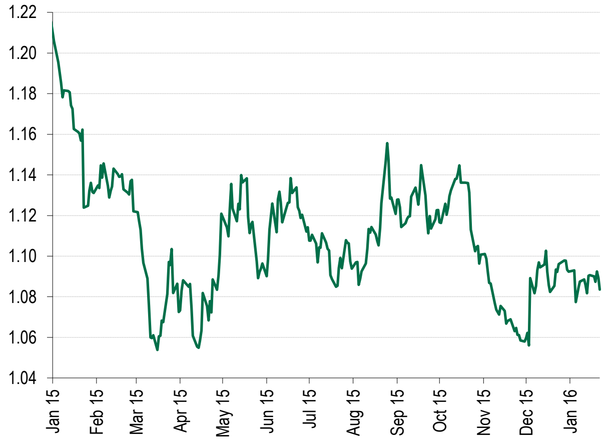
EUR/PLN



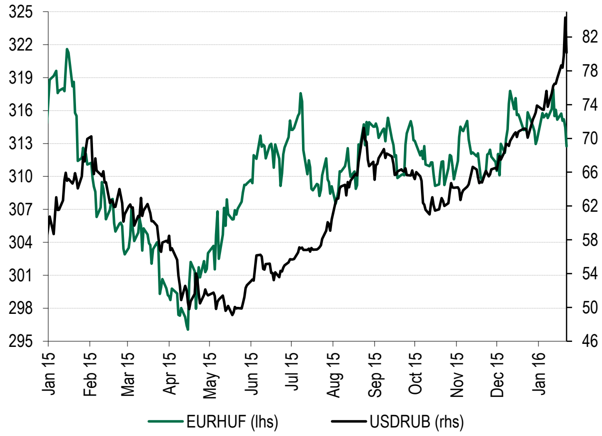
GBP/PLN and USD/PLN



EUR/USD



USD/RUB and EUR/HUF



EURPLN lower on external and internal factors

▪ The zloty's volatility in the last few days was clearly lower than in the previous week. Still, EUR/PLN rose temporarily above 4.51 on the significant deterioration of the global market sentiment, but later eased to 4.45 on dovish ECB signals, a hawkish comment of MPC's Osiatyński, Deputy PM Morawiecki's declaration that the government could sell euros from the EU on the market and better global investor sentiment. At the same time, the zloty got hit vs. the U.S. dollar, which gained sharply after the ECB meeting. As a result, USD/PLN jumped temporarily above 4.15, its highest since October 2002.

▪ We think domestic events could be quite positive for the zloty this week. 2015 GDP data should look good and, in our view, the annual figure could suggest that economic growth has accelerated in 4Q to 3.8% YoY. This figure, together with the recently rather cautious comments of MPC members (also the new members) on how much room there could be to cut rates, might help the zloty recover even more in the coming days.

▪ Globally, the FOMC's decision will be key, in our view. There appears to be a wide consensus that rates will stay unchanged in January and the market will rather eye hints on the Committee's future decisions. The recent comments of the Committee's members suggest there is no agreement on whether the next hike could take place in March and how many in total there might be in 2016. We think that if this week's statement is not overly hawkish, it could work in favour of the zloty.

Dollar gains on ECB

▪ The outcome of the ECB meeting was the biggest event for the EUR/USD market. ECB's statement was much more dovish than had been expected because it said that its monetary policy approach may change in March, when new GDP and inflation forecasts become available. At the press conference, Mario Draghi maintained the bank's dovish rhetoric, saying that "there are no limits to how far we are willing to deploy our instruments within our mandate to achieve our objective". The meeting strengthened market expectations for more easing in the euro zone, pushing EUR/USD sharply down to 1.08.

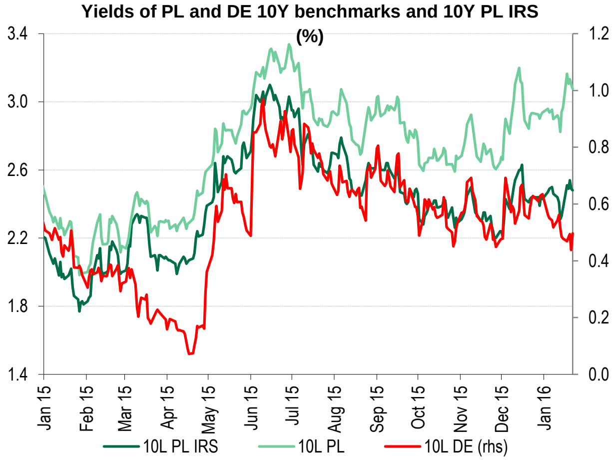
▪ ECB's dovish rhetoric may pressure the euro, but this week the FOMC will have a chance to respond and could use this opportunity to limit the scope of possible falls in EUR/USD. We think this may happen if the statement does not sound overly hawkish, which could actually be the case due to the recent slump in oil prices and resurfacing concerns about China. The December's low at 1.07 is the next support below 1.08.

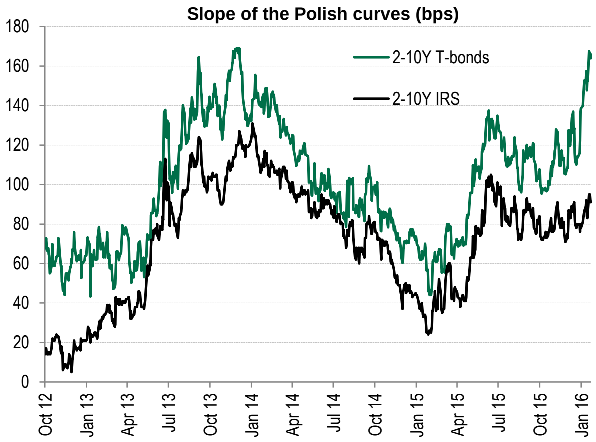
No more pain for the ruble?

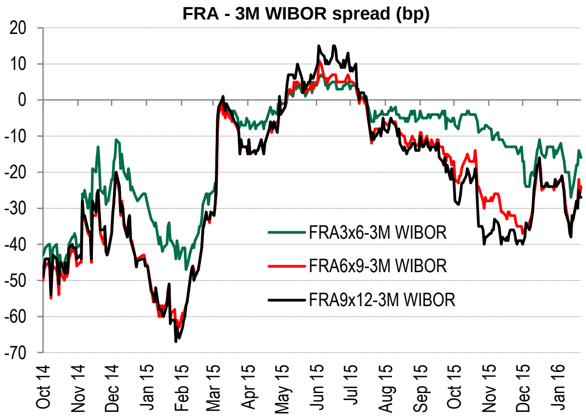
▪ The ruble was very volatile this past week, just like the price of Brent. USD/RUB rose first to c86 (well above its all-time intraday peak at c80) on the significant fall in the oil price. However, the ruble quickly recovered to below 80 per dollar on rebounding commodities.

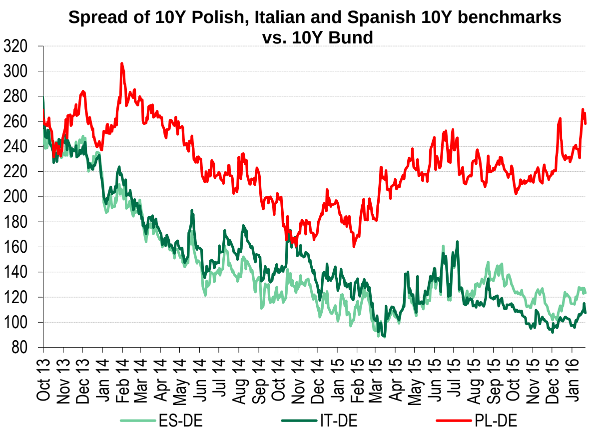
▪ We think, that the bottom for the oil price could be near and so there may be limited room for the ruble to depreciate further. The fall in oil prices is being supported by rising supply from Middle Eastern countries and by the US lifting its oil export ban. Note, however that Saudi Arabia has already announced spending cuts in its 2016 budget and strained finances could convince OPEC to agree to curb output . We do not expect a hard landing in China and market hopes that the government and central bank could take more action to stimulate economic growth could also support the oil price.

Interest rate market – Market rebounds thanks to ECB. Will the Fed do the same?









Dovish ECB turns storm into recovery

▪ Poland's assets weakened markedly at the start of the week in response to Friday's rating downgrade by S&P. Both yields and IRS rates jumped noticeably (4-21 bp across the board), with the largest move seen on the long end of the curves. However, the sell-off was only short-lived and the bonds and IRS were firming from one session to the next. The rise in yields was so attractive that it encouraged, among others, foreign investors searching for yields to buy in. What is more, the dovish rhetoric of the ECB (Draghi left the window wide open for further easing measures in March) also supported the domestic curves. As a result, Poland's bonds and IRS trimmed some of their earlier losses.

▪ On a weekly basis, the long end of the curves underperformed the front end and, as a consequence, the 2-10Y spread widened to 166 bp for the T-bonds (up from 152 bp the week before) and to 92 bp for the IRS (up from 86 bp). Despite the sentiment improvement, the spread over Bunds remained at an elevated level, i.e. close to 270 bp, the highest since March 2014. This means that the risk premium for Poland is still high and could remain high due to political risk.

▪ On the money market, WIBORs remained stable, with the FRA rates highly volatile though. FRAs fell in the second half of the week after having risen significantly at its start. This was caused by the improving sentiment on the IRS market. Investors now see 60% odds of a 25bp interest rate reduction on a three-month horizon, according to FRA market pricing.

Focus on FOMC and domestic bond auction

▪ This week is heavy with important domestic and external events, as well as macro data releases. On the domestic side, investors will focus on GDP data for 2015, the T-bond auction and the appointment of new MPC members by the Sejm. The latter is unlikely to surprise as the ruling party PiS's candidates (Ancyparowicz, Łon) will get the nominations. Ancyparowicz presented a rather cautious stance on further monetary policy easing, which is consistent with the current rhetoric of the other MPC members (Kropiwnicki, Gatnar, Osiatyński), while Łon was more dovish. Notwithstanding, this could result in gradual curve flattening.

▪ On Monday, Poland's Ministry of Finance will present details about Thursday's T-bond auction. We expect the Ministry to present a flexible approach and to offer different types of instruments, both fixed-rate (2Y and 10Y benchmarks, excluding 5Y PS0421, offered at the first regular auction this year) and floaters (WZ-series). In our view, liquidity should support the auction of bonds worth of PLN4.0-8.0bn as inflows from the OK0116 redemptions and interest rate payments will amount to cPLN15bn on January 25. We believe that the auction's results will be another test for foreign investors' appetite after the S&P decision.

▪ On the external side, the FOMC meeting (January27-28) will be the key event. We expect the FOMC to keep its monetary conditions unchanged. However, taking into account the turbulent start to 2016 (due to the situation in China), we think that the Fed should be careful in announcing quick rate hikes in the upcoming months. This means that a less hawkish Fed rhetoric could support debt markets globally, including Poland's.

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