POST-MPC COMMENT

4 March 2015

Last action heroes

The Polish central bank's Monetary Policy Council cut interest rates by 50bp.in a surprise move on Wednesday. The market consensus pointed to a quarter point cut. We forecast the latter too, with a further 25bp reduction in April. It looks as if the MPC preferred to concentrate monetary easing and to adjust rates in a single move to the new environment (deeper deflation) and new forecasts (the bank's new inflation projection points to CPI at c1% in 2016-17). Before today's decision, the FRA market was pricing in more than 50bp within six months, but we think that more easing is now unlikely. 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. As a reminder, eight out of nine MPC members will be replaced at the start of 2016 and it is not certain whether the NBP governor will stay for a second term. We also think the swap curve is too low, given the likely bottoming-out of inflation soon and continuation of strong growth driven by domestic demand.

The Monetary Policy Council (MPC) decided to cut the main Polish interest rates by 50bp, 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 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 be now at 10%.

After National Bank of Poland (NBP) Governor Marek Belka signalled in February that monetary easing at the next meeting is very likely, a rate cut in March was widely anticipated. We had expected total easing of 50bp, but we thought it would come in two steps of 25bp each in March and April. Our view stemmed from the fact that recent MPC members' comments were quite cautious and the same arguments members could have used against easing last month (according to the Council) could also have been valid today. Some economic data releases surprised to the upside (showing the labour market is booming and domestic demand remains quite strong). Apparently, the MPC members were influenced by deepening deflation and the new medium-term projections prepared by the NBP staff (see table below). The inflation projection shows very low CPI with the mid-point at slightly below 1% in 2016 and slightly above 1% in 2017, with inflation not reaching the target in the medium-term. Such a level of course does not take into account today's 50bp cut, but Belka said that even if today's decision is taken into account, the inflation projection would not change substantially. He also said that monetary easing is now sufficient and the statement from the communique is very strong. The MPC said that ***decision to lower interest rates at the current meeting concludes the cycle of monetary easing.***

During the press conference, Belka said that possible consequences of the ECB's quantitative easing (and other central banks' activity) were significant reasons behind the cut. He said the decision was a difficult one and a debate was intense, although a 'solid majority' was formed. Governor Belka reiterated several times today that he (and the MPC) saw no room for additional easing after this cut (not to mention MPC members who did not support today's cut).

In terms of GDP projections, the mid-point increased moderately, especially for 2015 (by c0.5pp), while the first projection for 2017 showed moderate GDP growth continuing.

Inflation and GDP projections

	GDP growth				CPI inflation			
	Mar 14	Jul 14	Nov 14	Mar 15	Mar 14	Jul 14	Nov 14	Mar 15
2014	2.9-4.2	3.2-4.1	2.9-3.5	-	0.8-1.4	-0.1-0.4	0.0-0.2	-
2015	2.7-4.8	2.6-4.5	2.0-3.7	2.7-4.2	1.0-2.6	0.5-2.1	0.4-1.7	-1.0-0.0
2016	2.3-4.8	2.3-4.5	1.9-4.2	2.2-4.4	1.6-3.3	1.3-3.1	0.6-2.3	-0.1-1.8
2017	-	-	-	2.4-4.6	-	-	-	0.1-2.2

According to the NBP projections, the GDP and CPI growth will fall to within the ranges given above with probability of 50%.

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

The conclusion after today's meeting is that the MPC wanted to adjust rates to the new economic situation and outlook (deeper deflation) and preferred to do that in one shot. Therefore, any additional changes in monetary policy parameters 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 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 one might ask whether today's move was pro-cyclical. We would argue that it was not. Simply, the very low starting point in terms of inflation (4 pp below the 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 (an uncertain effect of the monetary easing spree in Europe), even if the NBP governor rejected (rightly) any FX targeting today. We do not see further rate cuts in Poland as likely or justified unless there is a massive appreciation of the PLN. So far, this is not happening.

Fragments of the MPC statement (indication of changes as compared to February statement)

The rise in global economic activity growth remains moderate, although the situation varies across countries. ~~In the United States GDP growth in 2014 Q4 stayed relatively robust compared to most developed economies, and the economic outlook is still positive. In turn, in the euro area, which is Poland's main trading partner, activity growth has continued to be weak and the incoming information signal a merely slow recovery in the subsequent quarters.~~ **In the United States, economic growth is significantly higher than in the euro area, though it slowed down somewhat in 2014 Q4.** In the largest emerging economies, including China, ~~economic activity~~ **GDP growth** remains ~~weak~~ **low** as for these countries, and in Russia in has probably slid below zero. Since the previous Council meeting, oil prices have ~~fallen again~~ **have increased slightly, but remained fat lower than in previous years** ~~accompanied by a decline in the prices of some other commodities~~. **At the same time, the prices for other commodities, including agricultural products, continued to decrease.** ~~Along with moderate global economic growth, this has been pulling down inflation in many countries. In Poland's immediate environment including the euro area and most of the Central and Eastern European countries the annual price growth has declined below zero.~~ **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. ~~At the same time, the European Central Bank has expanded its asset purchase programme significantly, adding sovereign bonds to the range of instruments targeted. The Swiss National Bank, in turn, unexpectedly abolished the Swiss franc's asymmetric peg to the euro, which resulted in its sharp appreciation vis-a-vis other currencies, including the zloty. The SNB also decreased its policy interest rates.~~ **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, ~~preliminary national accounts data for 2014 indicate that GDP growth decreased slightly in 2014 Q4, remaining above 3%~~ ~~.~~ **the pace of economic growth in 2014 Q4 slowed down slightly, but stayed close to 3%.** ~~Stable growth in consumption was accompanied by some weakening in investment growth.~~ **GDP growth remained stable due to further rise in consumer demand and still high, despite some deceleration, investment growth**. ~~At the same time, imports growth slowed down more than that of exports, thus reducing the negative contribution of net exports to GDP growth. In December, growth in industrial output, construction and assembly output and retail sales picked up. Bank lending both to households and enterprises continues to rise at a steady rate. At the same time, the sharp appreciation of the Swiss franc has increased the indebtedness of households with liabilities in this currency, which may limit their consumption.~~ **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.**
~~Labour market data point to a further decline of unemployment (in seasonally adjusted terms) resulting to a large extent from rising corporate employment. Yet, wage pressure in the corporate sector remains limited, as indicated by continued moderate wage growth. In December, CPI inflation fell to -1.0% y/y, lower than expected. This was accompanied by a further decrease in most core inflation indices, which confirms the absence of demand pressure in the economy. At the same time, the decline in producer prices deepened, pointing in turn to the lack of cost pressure. Inflation expectations of enterprises and households remain very low~~. **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.**
The Council became acquainted with the projection of inflation and GDP prepared by the Economic Institute, which is one of the inputs to the Council's decisions on NBP interest rates. In line with the March projection based on the NECMOD model – prepared under the assumption of unchanged NBP interest rates and taking into account data available until 17 February 2015 (projection cut-off date) – there is a 50-percent probability that the annual price growth will be in the range of -1.0÷0.0% in 2015 (as compared to 0.4÷1.7% in the November 2014 projection), -0.1÷1.8% in 2016 (as compared with 0.6÷2.3%) and 0.1÷2.2% in 2017. At the same time, the annual GDP growth rate – in line with this projection – will be with a 50-percent probability in the range of 2.7÷4.2% in 2015 (as compared with 2.0÷3.7% in the November 2014 projection), 2.2÷4.4% in 2016 (as compared with 1.9÷4.2%) and 2.4÷4.6% in 2017.

Taking into account ~~the recently heightened volatility in the financial markets~~ **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 ~~leave~~ **decrease** NBP interest rates ~~unchanged~~. ~~However, the Council does not rule out a monetary policy adjustment in the nearest future, should the expected period of deflation be extended, which would increase the risk of inflation remaining below the target in the medium term. A more comprehensive assessment of the outlook for inflation returning to the target will be possible after the Council gets acquainted with the incoming information, including the March NBP projection~~. **Decision to lower the interest rates at the current meeting concludes the monetary easing cycle.**

This analysis is based on information available until 04.03.2015 has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT

al. Jana Pawła II 17, 00-854 Warszawa. fax +48 22 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): http://www.skarb.bzwbk.pl

Maciej Reluga* – Chief Economist

tel. +48 22 5341888. Email: maciej.reluga@bzwbk.pl

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

* Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2711 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań

tel. +48 61 856 58 14/30

fax +48 61 856 44 56

Warszawa

al. Jana Pawła II 17
00-854 Warszawa

tel. +48 22 586 83 20/38

fax +48 22 586 83 40

Wrocław

ul. Rynek 9/11
50-950 Wrocław

tel. +48 71 369 94 00

fax +48 71 370 26 22

IMPORTANT DISCLOSURES

ANALYST CERTIFICATION:

The views expressed in this report accurately reflect the personal views of the undersigned analyst(s). In addition, the undersigned analyst(s) have not and will not receive any compensation for providing a specific recommendation or view in this report: **Maciej Reluga*, Piotr Bielski*, Agnieszka Decewicz*, Marcin Luziński*, Marcin Sulewski*.**

* Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2711 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

IMPORTANT DISCLOSURES (CONT.)

This report has been prepared by Bank Zachodni WBK S.A. and is provided for information purposes only. Bank Zachodni WBK S.A. is registered in Poland and is authorised and regulated by The Polish Financial Supervision Authority.

This report is issued in the United States by Santander Investment Securities Inc. ("SIS"), in Poland by Bank Zachodni WBK S.A. ("BZ WBK"), in Spain by Banco Santander, S.A., under the supervision of the CNMV and in the United Kingdom by Banco Santander, S.A., London Branch ("Santander London"). SIS is registered in the United States and is a member of FINRA. Santander London is registered in the United Kingdom and subject to limited regulation by the Financial Services Authority, UK ("FSA"). SIS, BZ BWK, Banco Santander, S.A. and Santander London are members of Grupo Santander. A list of authorised legal entities within Grupo Santander is available upon request.

This material constitutes "investment research" for the purposes of the Markets in Financial Instruments Directive and as such contains an objective or independent explanation of the matters contained in the material. Any recommendations contained in this document must not be relied upon as investment advice based on the recipient's personal circumstances. The information and opinions contained in this report have been obtained from, or are based on, public sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate, complete or up to date and it should not be relied upon as such. Furthermore, this report does not constitute a prospectus or other offering document or an offer or solicitation to buy or sell any securities or other investment. Information and opinions contained in the report are published for the assistance of recipients, but are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, are subject to change without notice and not intended to provide the sole basis of any evaluation of the instruments discussed herein.

Any reference to past performance should not be taken as an indication of future performance. This report is for the use of intended recipients only and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without the prior written consent of BZ WBK.

Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realised. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

The material in this research report is general information intended for recipients who understand the risks associated with investment. It does not take into account whether an investment, course of action, or associated risks are suitable for the recipient. Furthermore, this document is intended to be used by market professionals (eligible counterparties and professional clients but not retail clients). Retail clients must not rely on this document.

To the fullest extent permitted by law, no Santander Group company accepts any liability whatsoever (including in negligence) for any direct or consequential loss arising from any use of or reliance on material contained in this report. All estimates and opinions included in this report are made as of the date of this report. Unless otherwise indicated in this report there is no intention to update this report.

BZ WBK and its legal affiliates may make a market in, or may, as principal or agent, buy or sell securities of the issuers mentioned in this report or derivatives thereon. BZ WBK and its legal affiliates may have a financial interest in the issuers mentioned in this report, including a long or short position in their securities and/or options, futures or other derivative instruments based thereon, or vice versa.

BZ WBK and its legal affiliates may receive or intend to seek compensation for investment banking services in the next three months from or in relation to an issuer mentioned in this report. Any issuer mentioned in this report may have been provided with sections of this report prior to its publication in order to verify its factual accuracy.

Bank Zachodni WBK S.A. (BZ WBK) and/or a company in the Santander Group is a market maker or a liquidity provider for EUR/PLN.

Bank Zachodni WBK S.A. (BZ WBK) and/or a company of the Santander Group has been lead or co-lead manager over the previous 12 months in a publicly disclosed offer of or on financial instruments issued by the Polish Ministry of Finance or Ministry of Treasury.

Bank Zachodni WBK S.A. (BZ WBK) and/or a company in the Santander Group expects to receive or intends to seek compensation for investment banking services from the Polish Ministry of Finance or Ministry of Treasury in the next three months.

ADDITIONAL INFORMATION

BZ WBK or any of its affiliates, salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BZ WBK or any of its affiliates' trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

Investment research issued by BZ WBK is prepared in accordance with the Santander Group policies for managing conflicts of interest. In relation to the production of investment research, BZ WBK and its affiliates have internal rules of conduct that contain, among other things, procedures to prevent conflicts of interest including Chinese Walls and, where appropriate, establishing specific restrictions on research activity. Information concerning the management of conflicts of interest and the internal rules of conduct are available on request from BZ WBK.

COUNTRY & REGION SPECIFIC DISCLOSURES

U.K. and European Economic Area (EEA): Unless specified to the contrary, issued and approved for distribution in the U.K. and the EEA by Banco Santander, S.A. Investment research issued by Banco Santander, S.A. has been prepared in accordance with Grupo Santander's policies for managing conflicts of interest arising as a result of publication and distribution of investment research. Many European regulators require that a firm establish, implement and maintain such a policy. This report has been issued in the U.K. only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). This document must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is only regarded as being provided to professional investors (or equivalent) in their home jurisdiction. **United States of America (US):** This report is being distributed to US persons by Santander Investment Securities Inc ("SIS") or by a subsidiary or affiliate of SIS that is not registered as a US broker dealer, to US major institutional investors only. Any US recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security or issuer discussed herein should contact and place orders in the United States with the company distributing the research, SIS at (212) 692-2550, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the US Securities Exchange Act of 1934) under this report and its dissemination in the United States. US recipients of this report should be advised that this research has been produced by a non-member affiliate of SIS and, therefore, by rule, not all disclosures required under NASD Rule 2711 apply. **Hong Kong (HK):** This report is being distributed in Hong Kong by a subsidiary or affiliate of Banco Santander, S.A. Hong Kong Branch, a branch of Banco Santander, S.A. whose head office is in Spain. The 1% ownership disclosure satisfies the requirements under Paragraph 16.5(a) of the Hong Kong Code of Conduct for persons licensed by or registered with the Securities and Futures Commission, HK. Banco Santander, S.A. Hong Kong Branch is regulated as a Registered Institution by the Hong Kong Monetary Authority for the conduct of Advising and Dealing in Securities (Regulated Activity Type 4 and 1 respectively) under the Securities and Futures Ordinance. The recipient of this material must not distribute it to any third party without the prior written consent of Banco Santander, S.A. **Japan (JP):** This report has been considered and distributed in Japan to Japanese-based investors by a subsidiary or affiliate of Banco Santander, S.A. - Tokyo Representative Office, not registered as a financial instruments firm in Japan, and to certain financial institutions defined by article 17-3, item 1 of the Financial Instruments and Exchange Law Enforcement Order. Some of the foreign securities stated in this report are not disclosed according to the Financial Instruments and Exchange Law of Japan. There is a risk that a loss may occur due to a change in the price of the shares in the case of share trading and that a loss may occur due to the exchange rate in the case of foreign share trading. **China (CH):** This report is being distributed in China by a subsidiary or affiliate of Banco Santander, S.A. Shanghai Branch ("Santander Shanghai"). Santander Shanghai or its affiliates may have a holding in any of the securities discussed in this report; for securities where the holding is greater than 1%, the specific holding is disclosed in the Important Disclosures section above. **Poland (PL)**: This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only and it is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Information presented in the publication is not an investment advice. Resulting from the purchase or sale of financial instrument, additional costs, including taxes, that are not payable to or through Bank Zachodni WBK S.A., can arise to the purchasing or selling party. Rates used for calculation can differ from market levels or can be inconsistent with financial calculation of any market participant. Conditions presented in the publication are subject to change. Examples presented in the publication is for information purposes only and shall be treated only as a base for further discussion.