Bank Zachodni WBK

Weekly economic update

17 – 23 December 2012

Rising EURUSD, zloty's appreciation versus main currencies and higher stock prices indicated from the very beginning of the week that investors were hoping the US central bank will sustain its easing bias in the monetary policy. Decision of Italian PM Monti to step down as soon as the national budget for 2013 is passed had only temporary negative impact on the global market sentiment. The Fed decided to replace the "Operation Twist" (ending this year) by additional monthly bond purchases of $45bn, which will extend the size of QE3 to $85bn bond purchases per month. Polish inflation declined in line with our expectations to 2.8%YoY (below 3% for the first time for 2 years). This publication did not have negative impact on the zloty (domestic currency gained due to optimism persisting on the market) and did not support bonds (slight correction occurred on Polish debt market).

Coming week will be full of data releases in Poland. As there was no strengthening of domestic bonds after CPI data, it seems that a stronger impulse is required to fuel expectations for rate cuts given the fact that investors are pretty aggressive in pricing-in monetary policy easing. Data on industrial output will show very slow growth but we do not expect the reading consistent with market consensus to have any visible impact on the market. Still, it is worth to remember that we are entering a period of very low liquidity in the debt market and so more visible fluctuations may occur even without any data releases. Given lack of reaction of the zloty to CPI data, publications from global economy (like US final 3Q GDP data, real estate market data) and reaction of the EURUSD to these releases may be crucial. Further euro's appreciation versus the dollar may cause the EURPLN to test the support at 4.08.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (17 December)					
11:00	**PL**	**Repurchase auction of EUR20130205 bond**					
		TUESDAY (18 December)					
14:00	**PL**	**Wages in corporate sector**	**Nov**	**%YoY**	**2.8**	**2.8**	**2.8**
14:00	**PL**	**Employment in corporate sector**	**Nov**	**%YoY**	**-0.2**	**-0.1**	**0.0**
		WEDNESDAY (19 December)					
11:00	DE	Ifo index	Dec	pts	102.0	-	101.4
14:00	**PL**	**Industrial output**	**Nov**	**%YoY**	**0.4**	**0.4**	**4.6**
14:00	**PL**	**Construction and assembly output**	**Nov**	**%YoY**	**-8.6**	**-11.3**	**-3.6**
14:00	**PL**	**PPI**	**Nov**	**%YoY**	**0.1**	**0.1**	**1.0**
14:30	US	House starts	Nov	k	875	-	894
14:30	US	Building permits	Nov	k	877	-	868
		THURSDAY (20 December)					
14:00	**PL**	**Core inflation**	**Nov**	**%YoY**	**1.7**	**1.7**	**1.9**
14:00	**PL**	**MPC minutes**					
14:30	US	GDP	Q3	%QoQ	2.7	-	1.3
14:30	US	Initial jobless claims	Week	k	358	-	343
16:00	US	Home sales	Nov	m	4.88	-	4.79
16:00	US	Philly Fed index	Dec	pts	-2.5	-	-10.7
		FRIDAY (21 December)					
10:00	**PL**	**Retail sales**	**Nov**	**%YoY**	**2.8**	**2.9**	**3.3**
10:00	**PL**	**Unemployment rate**	**Nov**	**%YoY**	**12.8**	**12.8**	**12.5**
10:30	GB	GDP	Q3	%QoQ	1.0	-	-0.5
14:30	US	Personal income	Nov	%MoM	0.3	-	0.0
14:30	US	Consumer spending	Nov	%MoM	0.4	-	-0.2
14:30	US	Core PCE	Nov	%MoM	0.1	-	0.1
15:55	US	Michigan index	Dec	pts	74.5	-	74.5

Source: BZ WBK, Reuters, Parkiet

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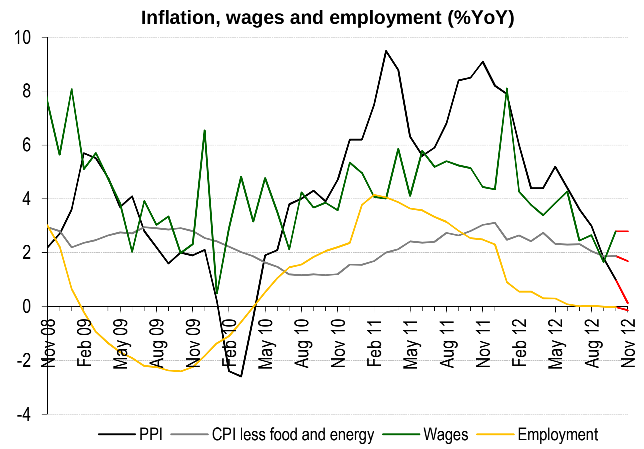
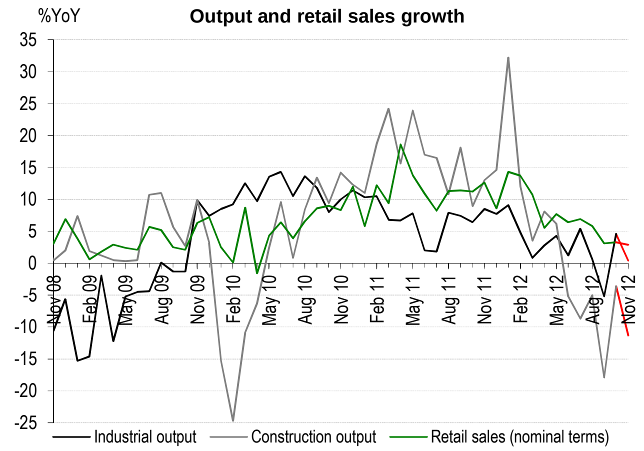
What's hot this week – Slowdown in output and sales growth



▪ We are expecting weak data from the domestic labour market for November. We estimated that growth rate of wages in corporate sector remained at October's 2.8%YoY, but uncertainty about timing of payments of mining sector bonuses is a risk factor for this forecast. Employment in corporate sector will show a negative annual growth rate (-0.1%YoY) for the first time in more than two years.

▪ Data on registered unemployment will in our view mirror the tendencies drawn by enterprise sector statistics – we are expecting an increase to 12.8%. Uncertainty of this forecast is generated, among others by scale of intervention of the Labour and Social Policy Ministry. We think that some upward potential of labour market recovery may appear at the end of 2013.

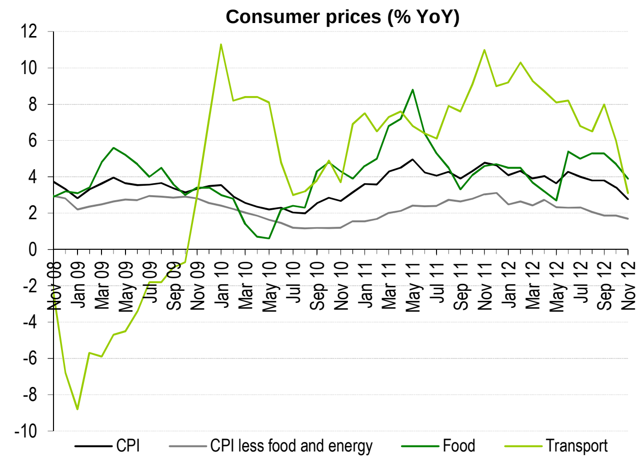


▪ We are anticipating a deceleration of growth in industrial and construction output in relation to October, as the effect of higher number of working days will be as strong as in the previous month. Industry and construction will be in doldrums for at least a couple of quarters and only economic recovery in the euro zone may provide some support, especially for industry.

▪ We are predicting that retail sales growth decelerated slightly in November, to 2.9%YoY. Still, growth in real terms maintained at October's level thanks to declining inflation. Falling inflation will also underpin real growth of consumption in the upcoming quarters.

▪ Based on the CPI data, we are estimating that core inflation excluding food and energy prices fell to 1.7%YoY from 1.9%. On the other hand, producer prices will be on the verge of deflation and will show 0.1%YoY.

Last week in the economy – Inflation below 3%, exports at all-time high



▪ In November the CPI inflation reached 2.8%YoY (down from 3.4% in October) and was the lowest for two years. Such a considerable decline of annual inflation was to a large extent due to high base effect, but a strong impact was provided also by lower fuel prices (-2.4%MoM). Food prices surprised most as they increased only by 0.5%MoM.

▪ Data on October's balance of payments surprised to the upside. The current account deficit improved to €650m, mainly due to surplus in trade balance (€225m). It is worth to notice, that in nominal terms, both exports (€14.2bn) and imports (€13.9m) reached highest levels since comparable data is available.

▪ Data on money supply showed a continuation of strong deceleration of growth in loans, including credit for households and companies.

Quote of the week – December's cut was not the last one

Adam Glapiński, MPC member, Reuters, 10.12
I would support three cuts in total, then adopting the "wait and see" mode.

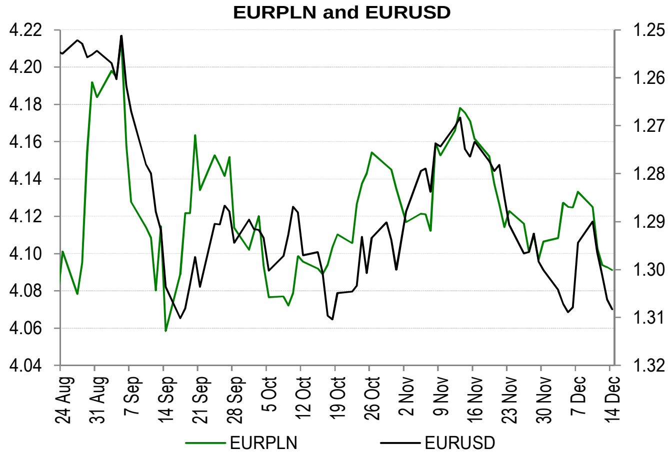
Anna Zielińska-Głębocka, MPC member, TVN CNBC, 10.12
We should cut rates by 100bps in the first cycle and then see if another cut or even cutting cycle is necessary. Cuts to 3.75% are a baseline scenario.

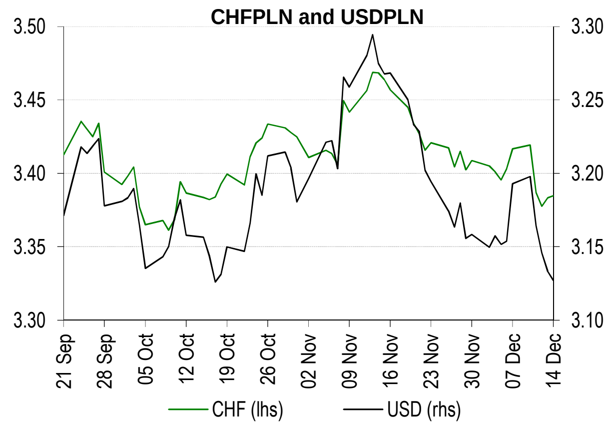
Jerzy Hausner, MPC member, Bloomberg, 13.12
We have sent a clear signal that the December's cut was not the last one and, based on discussion after the last meeting, I cannot rule out another cut in January. If we had wanted to make a pause in hiking cycle, then we would have signalled it.

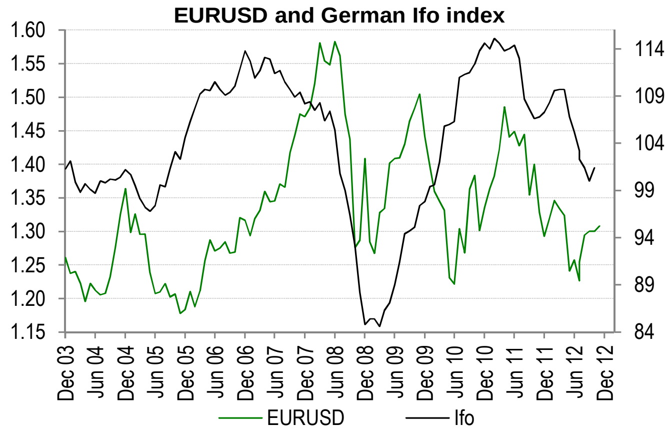
Andrzej Kaźmierczak, MPC member, PAP, 14.12
I cannot rule out my support for a cut in January, which does not mean that I will actually vote for such a decision.

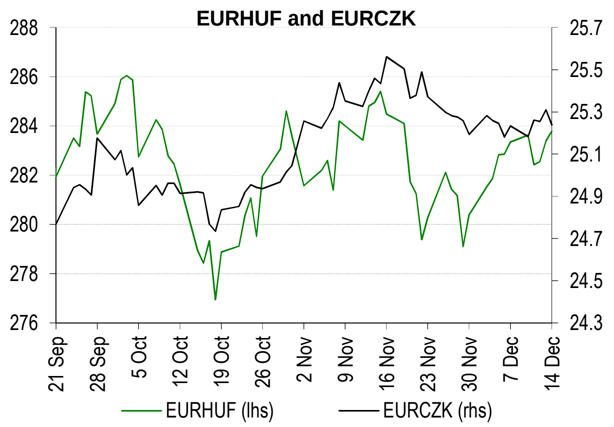
Last week was rich in MPC members' comments. These have confirmed that an interest rate cut in January is a done deal. However, views differ strongly as regards further steps. Like in the previous months, Bratkowski and Chojna-Duch are supporting strong cuts, while Winiecki sees little room for reductions. These members (along with Rzońca) are unlikely to change their minds abruptly, so it is more reasonable to scrutinize comments of other members. Zielińska-Głębocka is becoming more dovish and is suggesting a possibility of cuts deeper than 100bps. Some comments confirm our suggestions that the Council may make a pause in February in order to wait for results of inflation projection in March. Some hint on this matter is delivered by words of Hausner – a possible pause in cutting cycle would be suggested in the post-meeting statement.

Foreign exchange market – Global moods more important for zloty than domestic events









PLN does not react to CPI data and MPC's comments

▪ Hopes that the Fed will maintain its economic stimulus and a much better-than-expected reading of German ZEW index triggered zloty's appreciation, temporarily to 4.08 per euro. Due to the lack of more positive impulses that could push the exchange rate below this local minimum (the lowest level since the end of November) and as the data on preliminary manufacturing PMI for Germany disappointed, the EURPLN temporarily rebounded to 4.10. But at the end of the week it was close to 4.09.

▪ The euro's appreciation versus the dollar and the decline of the EURPLN pushed the USDPLN to 3.12 (the lowest level since mid-October).

▪ A significant decline in domestic inflation and dovish comments of the MPC members did not have a negative impact on the zloty in the past week. Also the correction on the debt market indicates that investors are currently pricing-in rate cuts in Poland too aggressively. Consequently, this factor may have smaller impact on the domestic currency in the coming days. The chart shows that in recent months, the zloty was following the EURUSD, so in the next few days the global mood can have a greater impact on EURPLN than national events. Significant levels for this week are 4.08 and 4.14 (exchange rate may test the support, 4.06 is its next level after the possible breaking of 4.08).

EURUSD close to local peak

▪ Investors' worries about destabilisation of political situation in Italy after Prime Minister Monti's decision to step down had temporarily undermined the sentiment at the beginning of the week. Still, in the following days the main role was played by expectations that the Fed will maintain its loose monetary policy. Decision of the US central bank lived up to these expectations, so correction triggered by profit-taking proved only short-lived. Due to a quick resume of increases, EURUSD rose almost to 1.312, the highest level in a week.

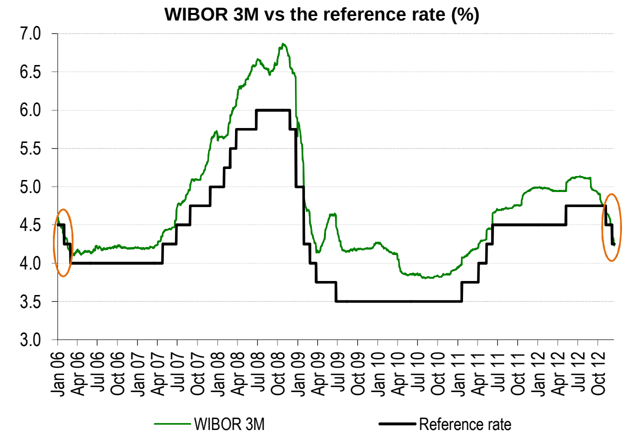
▪ Data from Germany were rather mixed (better-than-expected ZEW, weak PMI) so reading of Ifo may set the direction of assessment of Europe's economic prospects. Ifo climbed slightly in November and a continuation of this trend may push the EURUSD upwards. Signals from the USA will still be important (a row of macro data and further talks on fiscal cliff). At the end of the week EURUSD was slightly below resistance area at 1.312-1.314. If this resistance is broken, then the rate may head towards 1.317 (the highest level since early June, set in mid-September) in the upcoming days and weeks.

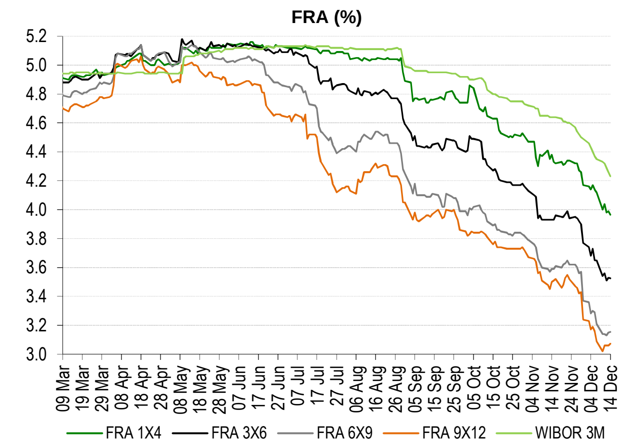
HUF under pressure of rate cuts

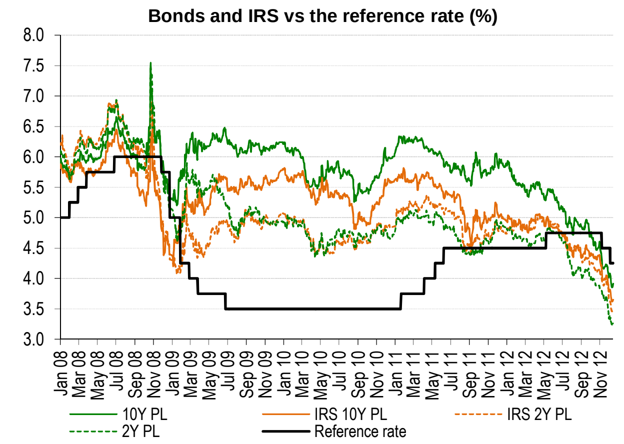
▪ The forint and the koruna did not benefit from the sanguine sentiment, which was prevailing on the market for the better prat of the week. The Hungarian currency was under pressure of expectations for further rate cuts and statement of the Moody's agency (reading that rating of 7 Hungarian banks may be cut). The koruna was in turn negatively affected by possible interventions of the Czech central bank. Over the week EURCZK did not change considerably (it is close to 25.22), while EURHUF climbed only temporarily (from 282.7 to 283.7).

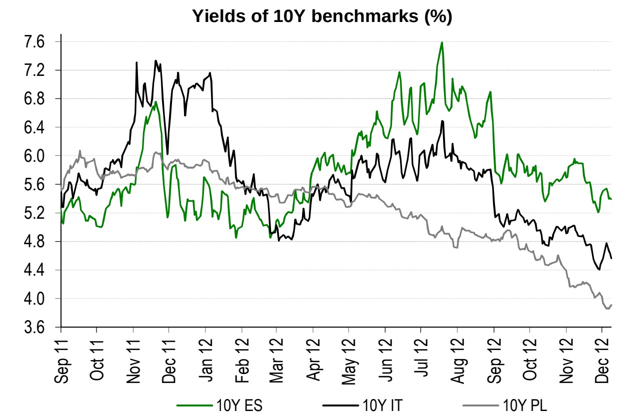
▪ The Hungarian central banks is making decision on interest rate cuts this week and this event may be the most important factor affecting the HUF. Similarly as in case of EURPLN, EURHUF has been moving in narrowing consolidation channel since July. Important levels for the upcoming days are 279 and 285.

Interest rate market – Stabilisation on debt market, investors' activity lower and lower









WIBOR 3M below the reference rate

- Last week downward trend of WIBOR rates has continued. In weekly terms rates declined by another 5-13bps, and the pace of change was the smallest in the case of 1M. One should notice that at the end of week WIBOR 3M was slightly below the current reference rate.
- The beginning of the week brought further decline in FRA rates, which during Wednesday's session reached all-time lows. November's CPI inflation reading did not influence the market, as we predicted. What is more we observed correction after significant fall in previous weeks. FRA contracts show that market players' view is now a bit more realistic, expecting that in one month time WIBOR 3M will decline by 25bps, while in 9 months horizon by ca 120bps.

Correction after significant rally

- Last week both yields of bonds and IRS rates achieved a new record lows. However, despite relatively positive investment mood, investors have decided to take some profit. Attempts to drag yields down after November's CPI release were unsuccessful and slightly negative sentiment has continued till week-end. One should notice that at the end of week bond yields and IRS rates stayed below levels observed at the end of previous one. In weekly terms yield curve moved down by 2-4bps, while IRS curve by 4-4bps.
- No visible reaction to inflation data (November CPI reading justifies further monetary easing) might suggest that currently market is pricing-in rates cut too aggressively and need some stronger impulse to push yields down.
- Poland's Ministry of Finance informed that it has pre-financed ca 23-24% of the 2013 gross requirements. The Ministry does not plan to change schedule of wholesales auction in 1Q 2013 – in January-March period the Ministry plans two auctions a month. Deputy minister of finance W. Kowaczyk repeated that "Poland will likely conduct issues on foreign markets in 2013, but feels no pressure, as it already financed almost full 2013 FX borrowing needs". It will be a supportive factor for debt market in medium terms.

Domestic macro data from real economy still ahead

- This week macroeconomic calendar is very heavy. CSO will release data from real economy, in which industrial output, retail sales and data from labour market. Market reaction to these data as in case of the headline CPI reading might be limited due to upcoming holiday period. Notwithstanding, data from real economy should confirm further deceleration in economic activity, supporting horizontal trend in yields.
- This week the Ministry of Finance will organise the first buy-back auction of euro-denominated bonds with maturity in February 2013. It wants to redeem bonds worth up to €200m. Commenting December's issuance plan the Ministry officials said that "we assume this will let us use the available foreign currencies more efficiently than by making deposits". We think that auction results will be rather neutral for the secondary bond market, but it should confirm the favourable liquidity situation.

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