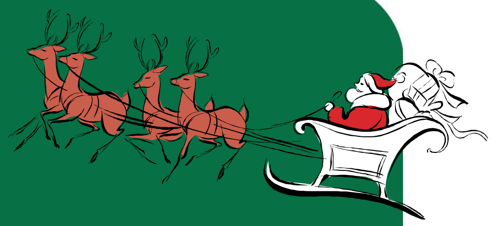
Bank Zachodni WBK

Bi-Weekly Economic Update



24 December 2012 – 6 January 2013

Last week before Christmas passed in rather positive moods, being supported by data from Europe (mainly Germany) and the USA, as well as temporarily rising hopes for striking a deal in the US Congress on avoiding fiscal cliff. The S&P's decision to upgrade Greece's sovereign rating was also positive for global risk appetite. In effect, stock market indices, German yields, and EURUSD rate, were all in upward trend, and the latter reached the highest level since April. Nevertheless, information about breakdown in talks in US House of Representatives boosted demand for safe assets again, which triggered a correction in equity markets. Data from domestic economy confirmed that economic activity is waning, which shows that more interest rate cuts are needed. Nevertheless, their impact on the financial market was limited. One should notice that the zloty remained quite immune to higher risk aversion and at the end of the week the EURPLN reached a local minimum at 4.055. Domestic bonds were also gaining strength with yields at new record lows.

In the nearest days investors' activity will be low due to Holiday period, which may result in greater volatility in financial markets. Investors will be still waiting for news from the US concerning talks on avoiding "fiscal cliff", however chances for reaching agreement before 31 December seem to have diminished. Just after the New Year a number of activity indicators will be released, which may affect market expectations concerning pace of global economic recovery. In the domestic debt market attention will be focused on supply plans for Q1-2013. Situation in core markets may affect the long end of the yield curve.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (26 December)					
15:00	US	S&P/Case-Shiller home price index	Oct	%MoM	0.4	-	0.4
		THURSDAY (27 December)					
14:30	US	Initial jobless claims	week	k	361	-	361
16:00	US	Consumer confidence index	Dec	pts	70.9	-	73.7
16:00	US	New home sales	Nov	m	380	-	368
		FRIDAY (28 December)					
16:00	US	Pending home sales	Nov	%MoM	1.1	-	5.2
		MONDAY (31 December)					
3:45	CN	PMI – manufacturing	Dec	pts	-	-	50.5
14:00	**PL**	**Inflation expectations**	**Dec**	**%YoY**			**3.8**
		WEDNESDAY (2 January)					
9:00	**PL**	**PMI – manufacturing**	**Dec**	**pts**	**48.1**	**48.0**	**48.2**
9:53	DE	PMI – manufacturing	Dec	pts	46.3	-	46.8
9:58	EZ	PMI – manufacturing	Dec	pts	46.3	-	46.2
14:00	**PL**	**Current account**	**Q3**	**€m**	**-**	**-2 457**	**-1 641**
14:00	**PL**	**Exports**	**Q3**	**€m**	**-**	**36 781**	**35 731**
14:00	**PL**	**Imports**	**Q3**	**€m**	**-**	**36 991**	**37 372**
16:00	US	ISM – manufacturing	Dec	pts	50.2		49.5
		THURSDAY (3 January)					
14:15	US	ADP report	Dec	k	130	-	118
20:00	US	Minutes Fed					
		FRIDAY (4 January)					
9:53	DE	PMI – services	Dec	pts	52.1	-	49.7
9:58	EZ	PMI – services	Dec	pts	47.8	-	46.7
11:00	EZ	Flash HICP	Dec	%YoY	2.2	-	2.2
14:30	US	Non-farm payrolls	Dec	k	140	-	146
14:30	US	Unemployment rate	Dec	%	7.8	-	7.7
16:00	US	ISM – services	Dec	pts	54.5	-	54.7

Source: BZ WBK, Reuters, Bloomberg

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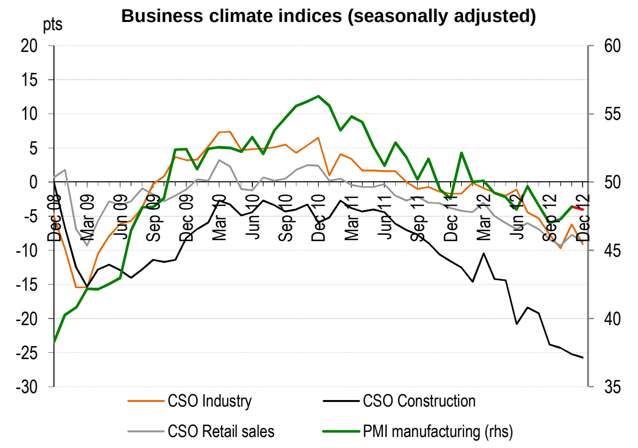
What's hot this week – What is the PMI index going to show?

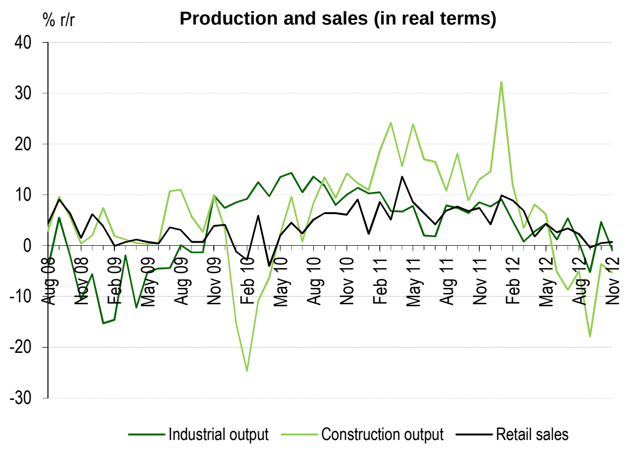


▪ We are expecting that the PMI manufacturing activity index for December will not change considerably as compared to November's reading and will stay below neutral level of 50pts for the ninth month in a row. Situation of domestic economy is still deteriorating and we currently see no potential for a long-lasting rebound in PMI. Our forecast is supported by results of CSO's business climate survey, which showed a deterioration of economic prospects assessment in all sectors.

▪ NBP will release data on current account in 3Q2012. Monthly data implied a marked decline of current account deficit to 3.9% of GDP from 4.6% of GDP in 2Q. However, some revisions are possible as usually.

▪ In our view the households' inflation expectations measure will post a considerable drop due to decline of inflation to 3.4% in October from 3.8% in September.

Last week in the economy – Weak data, but it's not the end of the world

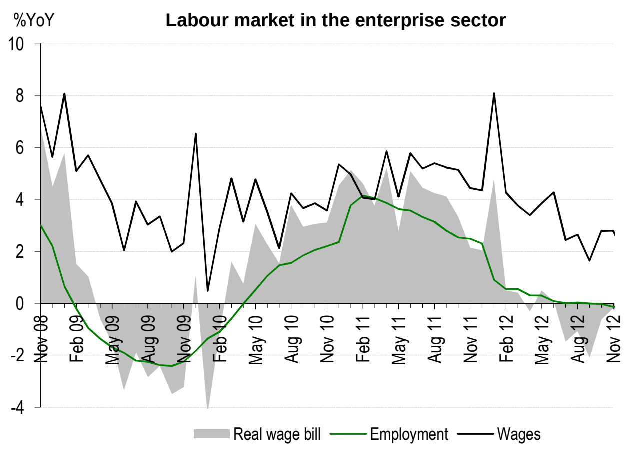


▪ Most of the data on economic activity released last week proved worse than expected. Construction output was the only exception (sic!), as if fell "only" by 5.3%YoY (versus forecasts at -8.6%YoY).

▪ Industrial output fell by 0.8%YoY. It is worth noting that number of working days in November was by one higher than one year before, thus negative pace of growth is a very disappointing result.

▪ Retail sales growth decelerated to 2.4%YoY in November. In real terms a slight acceleration as compared with previous month was recorded, but the growth rate (0.7%YoY) still remained close to zero, indicating that consumer demand is stagnating.

▪ PPI inflation, core inflation and retail sales deflator all posted significant declines. This is confirming a rapid mitigation of inflationary pressure.



▪ Wage growth in corporate sector decelerated in November to 2.7%YoY, while average employment fell by 0.3%YoY. As compared with October, the number of workplaces fell by 13k, which is the highest monthly decline since May 2009. This resulted mainly from a strong decrease of employment in retail trade, which so far was quite immune to slowing growth.

▪ Registered unemployment rate climbed in November to 12.9%. Number of the unemployed reached level of 2,058k and was by 7.5% higher than in the same period of 2011, while unemployment rate climbed by 0.8pp in comparison with November 2011. Unemployment is on the rise in spite of enhanced Labour Ministry intervention.

▪ Last week's data is another signal confirming that GDP growth in the final quarter of the year will be considerably weaker than in earlier quarters.

Quote of the week – Only a recession would change the MPC's view?

Minutes for MPC decision-making meeting, 5 December

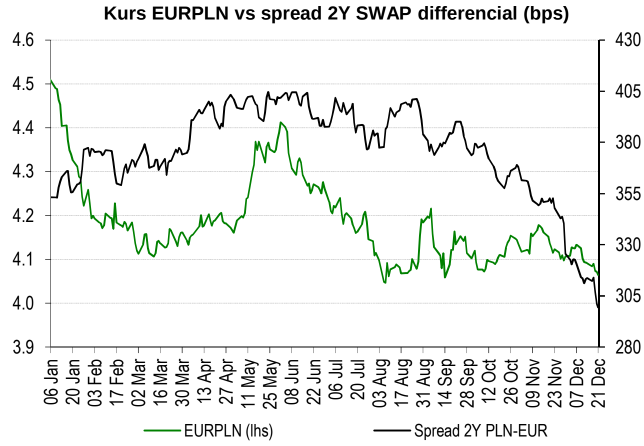
At the meeting, a motion was submitted to lower the basic NBP interest rates by 1.50 percentage point. The motion did not pass. A motion was also submitted to lower the basic NBP interest rates by 0.50 percentage point. The motion did not pass. At the meeting, a motion was also submitted to lower the basic NBP interest rates by 0.25 percentage point. The motion was passed.

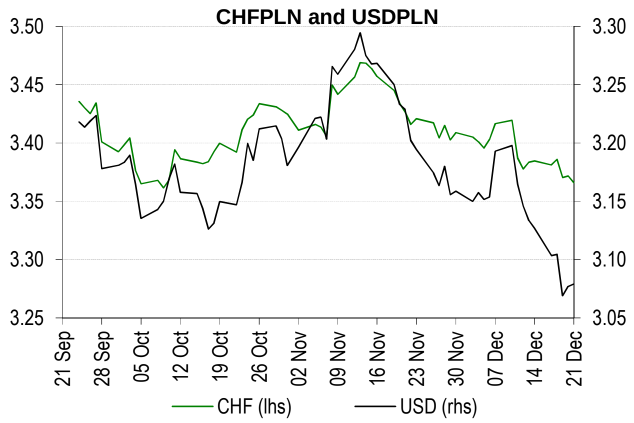
Adam Glapiński, MPC member, PAP/Reuters, 19.12

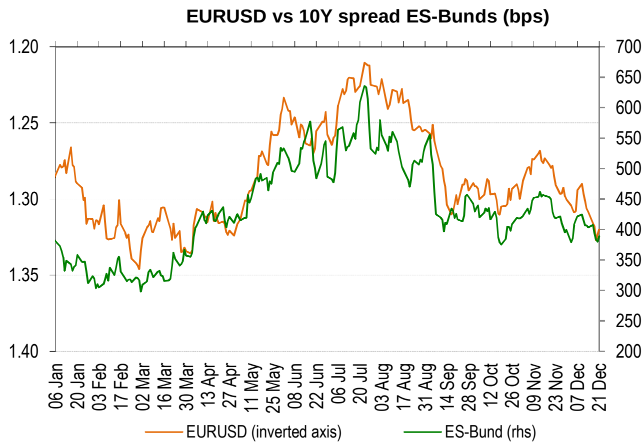
I maintain my view, I will support interest rate cuts by 25bps and I'd like to end the cycle with this move, at least until March projection. Recent macro data came as no surprise, only economic slowdown arrived a bit earlier. Only [a recession] would change the situation.

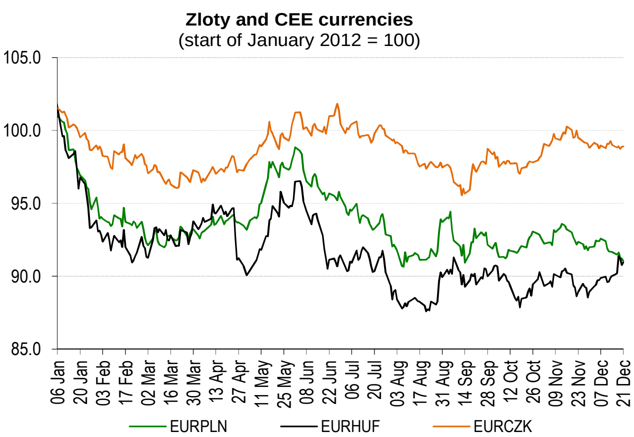
Information that in December the MPC voted on interest rate cut by 150bps was quite surprising. It is true that A. Bratkowski announced that he will submit a motion for a cut deeper than 50bps, but he also admitted that a cut by 75bps would be "extravagant", as it could not find support of majority of MPC members. According to the minutes, most MPC members were against deeper cuts due to "inflation persistence". We wonder whether a decline of CPI to ca. 2% in January and even below in following months will change their opinion in this matter. We hope that, contrary to suggestions of A. Glapiński, the Council will change its view before its policy actually pushes the economy into recession. A cut in January seems certain, probably by a mere 25bps again.

Foreign exchange market – Budget talks in the US still remain crucial for market mood









Zloty stronger and stronger at the end of year

▪ Last week the zloty continued appreciation trend against the main currencies. It was supported by PM Donald Tusk's announcement about adopting the euro. What is more, the positive mood also came from higher risk appetite (effect of increasing the EURUSD). During Friday's session the EURUSD after declining to 4.0515 (for a while), had stayed slightly above 4.06.

▪ Zloty has remained strong also against other currencies. During the week the USDPLN reached minimum at 3.0555 (the lowest level since October 2011), ended the week around 3.08. In the same time the CHFPLN declined below 3.37, while the GBPPLN fell below 5.0.

▪ Last days the zloty has performed strongly in comparison with other CEE currencies. In coming days we foresee investors' activity to remain relatively low due to holiday period, which might translate into higher volatility on the market. Factors that have been affecting the situation in the financial markets recently are still valid – the most crucial are news flow from the US about the fiscal cliff. We do not rule out the EURPLN to test 4.05 in coming days (important support level). The first resistance is at 4.085. As regards the USDPLN, we foresee the rate to stay between 3.055 and 3.10.

The EURUSD at the highest level since April 2012

▪ Signals from the US indicating that budget agreement between Republicans and Democrats is getting closer together with positive news flow from the euro zone (better than expected reading of Ifo for Germany, credit rating upgrade for Greece by S&P) supported risk-on mood. Consequently, the EURUSD increased above 1.33, i.e. the highest level since April 2012. However, unfavourable information about US budgetary talks caused some correction, shifting the capital towards safe haven assets (Bunds and the UST, decline in equity indices) and anchoring the EURUSD around 1.32.

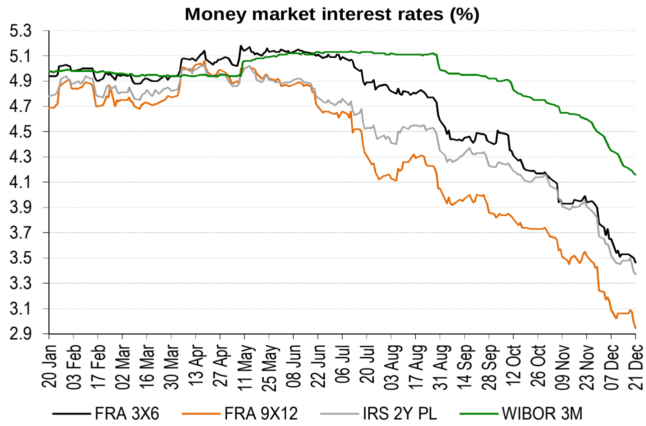
▪ The US budget talks will remain the crucial factor for financial markets in coming days/weeks. Dilly-dalling in agreement between Republicans and Democrats will support high volatility on the market. The important levels for the EURUSD are 1.319 and 1.33.

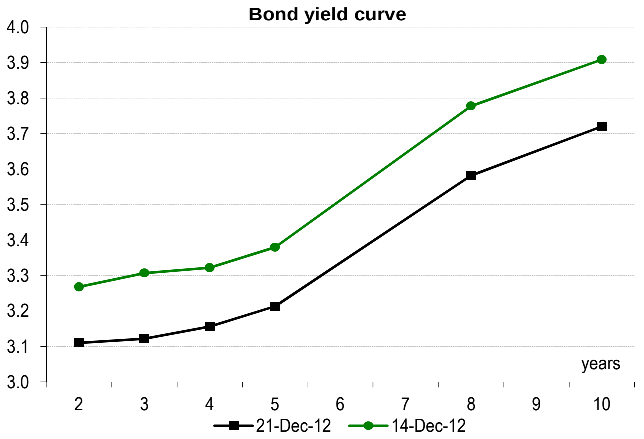
Hungarian currency supporting by outlook upgrade

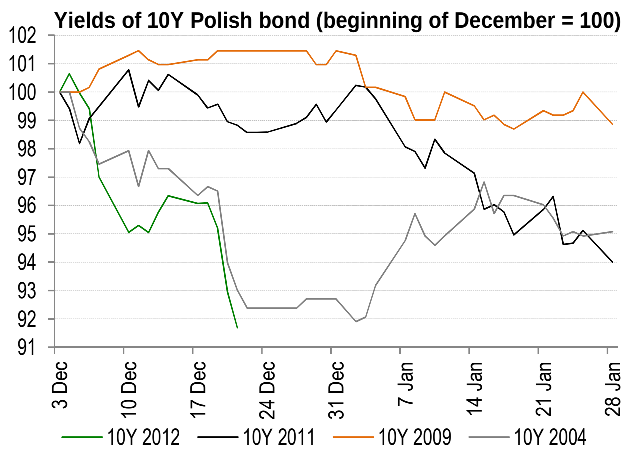
▪ The beginning of the week was unfavourable for Hungarian currency. The forint weakening came from many reasons, in which the most important were expectations on further rate cuts (as predicted NBH cut rates by 25bps at its December's meeting) and some profit taking as HUF has performed strongly during 2012. Fitch's decision to upgrade Hungary's rating outlook to stable from negative supported the HUF in short term. The EURHUF fell sharply from 290 to 284.4 (for a while). However, at the end of the week the rate was traded slightly above 287.

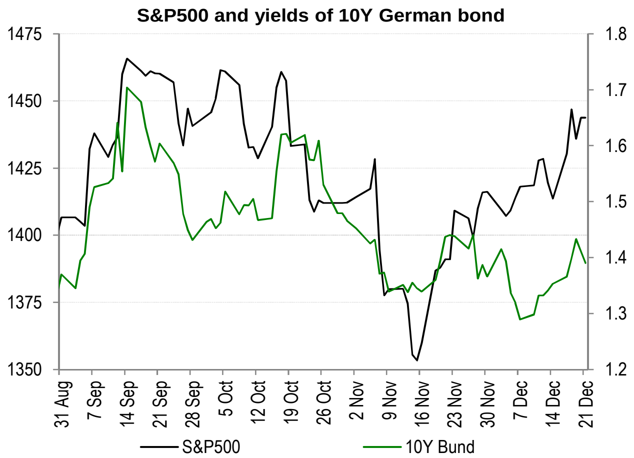
▪ As regards the EUCZK, rate has stayed below 25.2 during the week. The Czech crown did not react to a new fracture in the government. In coming days/weeks we foresee the range trading of the EURCZK.

Interest rate market – Slight potential for weakening in the debt market









WIBOR lower and lower

▪ During the past week WIBOR declined by 8-14bps. Rates for 6-12 months are already more than 100bps lower versus levels seen in late August, just before 2Q GDP data release, while NBP rates were cut by only 50bps in this period.

▪ During the upcoming days we do not expect a significant change of situation on the money market. FRA rates may be under some bigger impact of situation on the bond market than under expectations for more rate cuts (particularly if Polish bonds weaken slightly after Republicans and Democrats reach an agreement on fiscal cliff – find more details below). Currently FRA market expects the 3M WIBOR to decline by 100bps in coming 6 months.

Yields of Polish bonds at record lows, again

▪ Disappointing data on Polish industrial output triggered a continuation of the downward trend of yields of domestic bonds. Consequently, in case of 2Y, 5Y and 10Y benchmarks fresh record lows were recorded (3.11%, 3.21%, 3.72%, respectively). Still, the trade volume was very thin. IRS rates also plunged to record low levels.

▪ The Finance Ministry published auction calendar for 2013. Two auctions are planned for each month (with an exemption of August and December with only one auction scheduled). Head of FinMin Debt Department, Piotr Marczak, said that if favourable market conditions maintain, then the Ministry will use them to cover 50% of next year's borrowing needs until end of Q1-2013.

Situation in the US in the spotlight

▪ The chart shows how 10Y Polish bond performed in the December-January period for years, when in the coming year the inflation was falling (we expect 2013 will bring very fast and very considerable plunge of the CPI growth rate). It seems that there is rather limited room for weakening of bonds (also 2Y and 5Y ones). We assume that during next weeks the situation on the debt market may be similar to 2004, when after visible appreciation at the year-end a slight correction occurred at the very beginning of 2005. The factor that may initiate upward move of yields in 2013 may be possible positive end of talks between Republicans and Democrats. The German bonds follow situation on the US stock exchange and thus the outcome of talks in the US may influence the price of Bunds. Moving forward, the 4-month correlation of 10Y Polish debt with 10Y German debt is currently at ca. 60% and if yields of the long end of the German bond curve increase, this may also initiate some slight weakening of 5Y and 10Y domestic bonds.

▪ Data from the domestic economy will be clearly below market expectations and in our opinion this is not entirely priced in. These releases shall continue to support forecasts of more rate cuts to come. The fact that foreign investors are biggest holder of Polish bonds is in our view the factor that at least stabilizes the market (domestic bonds are perceived as decent alternative for debt issued by Western Europe Countries amid ultra-low interest rates). Thus the scale of possible weakening of Polish debt will be limited.

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