Bank Zachodni WBK

Weekly economic update

7 – 13 January 2013

Financial markets entered the New Year in quite sanguine moods, mainly due to information that the US House of Representative and Senate backed the agreement on tax changes that would decrease a risk of slippage of the US economy from the fiscal cliff. Nevertheless, investors' optimism started evaporating quickly, as they realised that US budget problems are still quite far from being resolved – the politicians still have to agree changes in spending and lift the debt limit, and it seems that deal on those issues may be harder to achieve than the last one. Weaker data on activity in euro zone's manufacturing also affected moods negatively, while at the end of the week markets were additionally depressed by hawkish tone of the Fed minutes, which suggested that some FOMC members were mulling a halt of quantitative easing already in 2013. Slightly better than expected data on US non-farm payrolls did not spur optimism, as they decreased even more chances for more monetary stimulus from the US central bank. Changes in global moods resulted in weakening of the zloty and Polish bonds at the start of the year. Domestic currency was also negatively affected by the data showing a significant rise Poland's in current account deficit and gross external debt, and deterioration of international investment position in Q3-2012.

This week market attention will be focused on central banks in Europe. Third rate cut in a row from the Polish Monetary Policy Council seems to be a deal done. We assume it will be again a (too) cautious move by 25bps, although chance for a bolder move have increased due to more disappointing data and growing likelihood of fast inflation drop in nearest months. As shown by the NBP, already in November there was only one vote missing to pass the motion to cut rates by 50bps. On the other hand, the MPC was unable to pass rate cut deeper than 25bps also in December, even though a motion to cut by as more as 150bps was submitted. We expect that in the MPC's statement a door to more monetary easing will be left open, although a pause in rate cuts in February is still possible, as the Council could wait for the results of new inflation and GDP projections prepared by the NBP. The ECB and the Bank of England are expected to keep their policies on hold.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (7 January)					
10:30	EZ	Sentix index	Jan	pts	-15.0	-	-16.8
11:00	**PL**	**Tender of 20-week T-bills**					
		TUESDAY (8 January)					
8:00	DE	Exports	Nov	%MoM	-0.5	-	0.3
11:00	EZ	Retail sales	Nov	%MoM	0.3	-	-1.2
12:00	DE	Industrial orders	Nov	%MoM	-1.4	-	3.9
		WEDNESDAY (9 January)					
	PL	**MPC decision**		**%**	**4.0**	**4.0**	**4.25**
12:00	DE	Industrial output	Nov	%MoM	1.0	-	-2.6
		THURSDAY (10 January)					
13:00	GB	BoE decision		%	-	-	0.50
13:45	EZ	ECB decision		%	-	-	0.75
14:30	US	Initial jobless claims	week	k	365	-	372
		FRIDAY (11 January)					
4:00	CN	CPI	Dec	%YoY	-	-	2.0
14:30	US	Trade balance	Nov	$bn	-41.5	-	-42.2

Source: BZ WBK, Reuters, Parkiet

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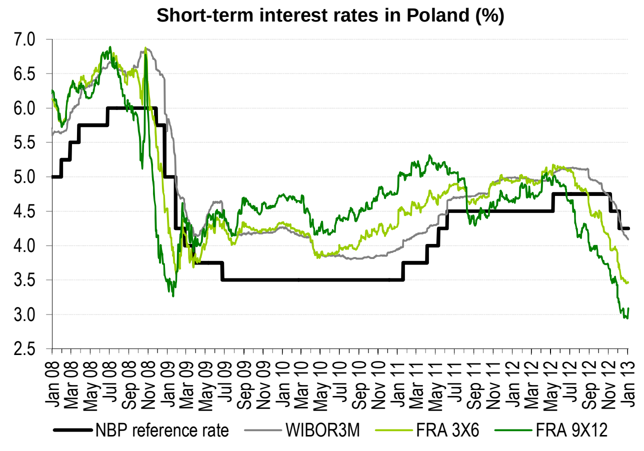
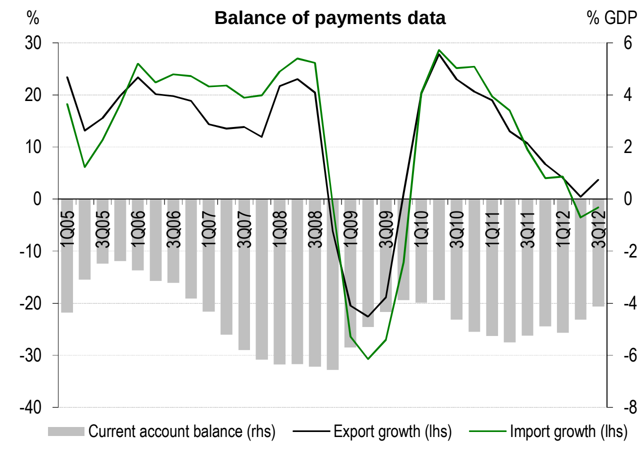
What's hot this week – Cut by 25bps is certain

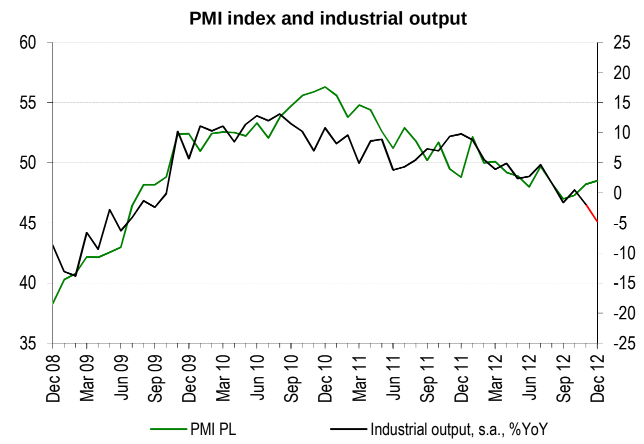


- The Monetary Policy Council is making decision on interest rates this week.
- We are expecting a reduction of reference rate by 25bps (to 4.00%) and all market analysts (according to Parkiet and Reuters surveys) support such a view. We think that the cut in January is a done deal, even A. Glapiński was certain about that, even though he has voted again cuts so far (at least until November).
- Results of November's vote (see details below) show that the group of MPC members supporting cuts more considerable than 25bps has grown considerably. However, this group failed to implement such stronger moves in November and December, so probably the same will happen in January. Still, we think that there is a risk the Council may decide for a more considerable rate reduction in January.

Last week in the economy – PMI rebounds slightly, C/A deficit revised upwards



- Current account deficit in Q3-2012 amounted to €3.7bn and was by almost €1bn higher than estimates based on monthly data. The revision decreased all balances of the current account components: trade balance fell by €200m, mainly due to downward revision of exports, services and income balances fell by more than €300m each, while current transfers balance declined by ca. €60m.
- It is worth noting that Q3-2012 was the first quarter since comparable statistical data are available (i.e. start of 2000) when total balance of trade and services turned positive (+€722m as compared to -€102m in Q2 and -€1000m in Q1). Cumulative 12M current account deficit climbed to 4.1% of GDP after the revision (vs. 3.9% before).



- Polish PMI index in manufacturing rose to 48.5pts in December from 48.2 in the previous month. The index was above expectations, however still remains well above the neutral threshold of 50 (for the ninth month in a row), suggesting that the Polish industry is still in contraction. On the other hand, the index climbed to the highest level since July 2013, which was mainly due to a less considerable weakening of output and the smallest decline of new orders since July. Deterioration of labour market conditions was confirmed by a fourth in a row decline of employment subindex (the longest such a period in more than 2.5 years).
- A rebound was posted also by the new export orders component, but this subindex is also languishing below 50pts and it was above this mark only once in last 19 months. Polish exports are undermined not only by slowdown abroad, but also by stronger competition from China and neighbouring European countries.

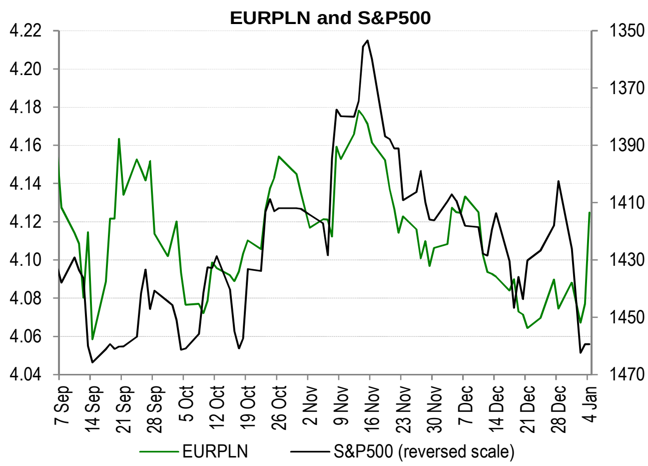
Quote of the week – Belka in minority supporting a cut by 50bps

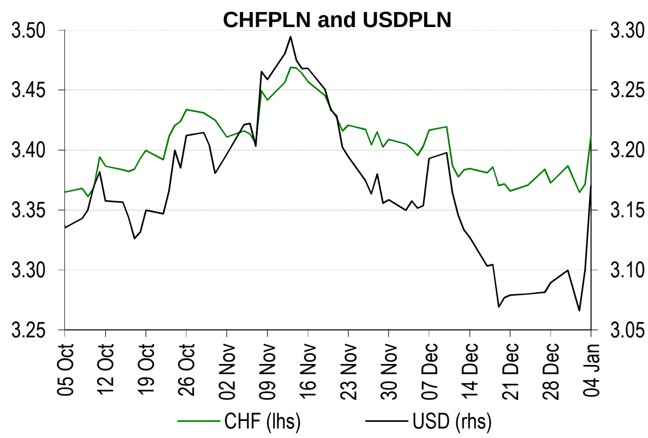
Elżbieta Chojna-Duch, MPC member, PAP, 31.12
Decision to cut rates more considerably would be justified (…) but it would be a distortion of the cycle. Cycle is more moderate, with decision at 25bps. I may support motion for cut [in January], but this is not a declaration.

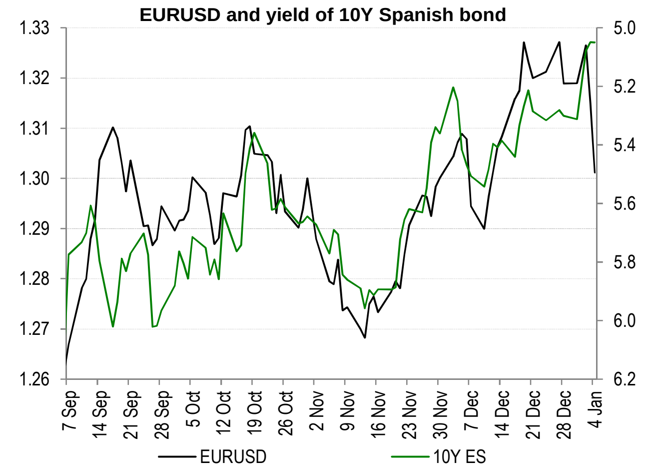
Jan Winiecki, MPC member, PAP, 31.12
I do not see much room in this matter [rate cuts]. (…) I can see some room next year (…) I said that [the downward inflation trend] is not persistent and I still stick to this opinion.

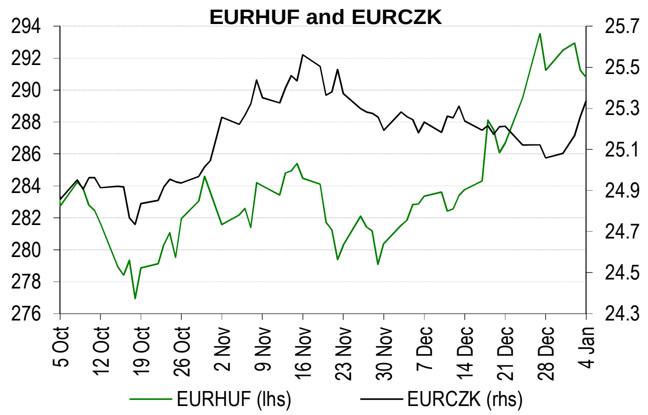
The NBP released detailed results of MPC votes in November. Three members voted against interest rate cut by 25bps: Gilowska, Glapiński and Kaźmierczak. On the other hand, cut by 50bps was supported by four members: Belka, Bratkowski, Chojna-Duch and Zielińska-Głębocka, so there was only one vote missing to implement this decision. The NBP President was in minority for the second time in a row, which shows that he does not have a strong influence on majority of MPC members. Even though the comment of Chojna-Duch seems to be sceptical about more considerable cuts or even cuts in general, but most probably she will still support more substantial reductions. On the other hand, Winiecki sees not much room for cuts, as he does not believe than disinflationary trend will be persistent. In our view Winiecki and Rzońca may soon recall their support for monetary policy easing, but, when inflation and economy will both slow even more markedly, they may be replaced in the cutting camp by someone else (e.g. Kaźmierczak).

Foreign exchange market – Zloty dependent on global moods









Zloty weaker at the beginning of the year

▪ The EURPLN stayed in the range of 4.06-4.12 in the last week of the past year. Swings of market expectations regarding the chances of avoiding the fiscal cliff in the US had biggest impact on the zloty. At the beginning of 2013 the zloty depreciated to 4.12 per euro as optimism after the agreement on US budget faded very fast.

▪ It is worth to remind that during first days of 2012 the zloty was underperforming only slightly more visibly – it lost 1.4% vs. the euro and 3.1% vs. the dollar. The increase of the EURPLN to ca. 4.13 and the USDPLN to 3.17 at the beginning of 2013 mean the zloty has so far lost 1.3% vs. single currency and 2.9% vs. the greenback. At the beginning of the past year the global market sentiment was very poor but due to few positive surprises from macro data releases and successful auctions on the peripheries of the euro zone improved investors' moods very fast. Currently the uncertainty (related to depth of economic slowdown of global and Polish economy and US budget) is also present on the market, though it is clearly smaller than at the beginning of 2012. Latest US data proved better than expected and yields on the euro zone's peripheral debt market are in the downward trend and this supports hopes that this time global sentiment will also improve or at least stabilize. If this actually happens, then the potential for zloty's depreciation due to expectations for more rate cuts by the MPC (suggestion of more easing to come is likely to be included this week in the statement from the MPC meeting) may be limited. 4-month correlation with the S&P500 is at -50% and with the EURUSD at -70% (particularly important due to auctions of Italian and Spanish bonds planned for this week) clearly shows the zloty is under visible impact from global sentiment. Important levels for the EURPLN are 4.05 and 4.14.

Only temporary appreciation of the euro vs. the dollar

▪ The EURUSD was relatively stable in the last days of 2012. Uncertainty about negotiations on fiscal cliff kept the exchange rate only slightly below the highest level since June 2012 (ca. 1.33). Still, the beginning of 2013 brought very sudden depreciation of the single currency as optimism related from the US budget deal faded and some members of the Fed considered termination of the QE3 in 2013.

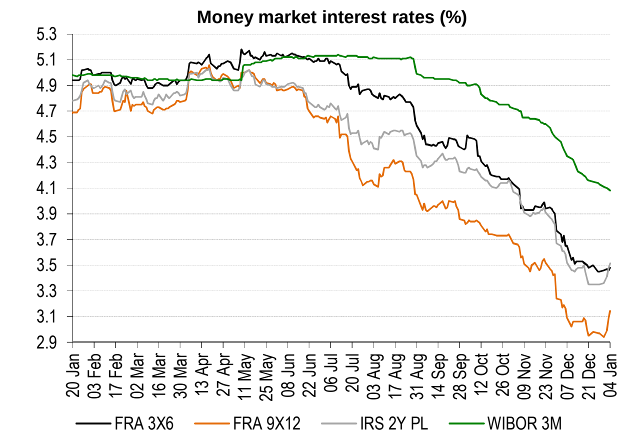
▪ Beginning of the year was very successful for long-term bonds from the euro zone's peripheries. Yields of 10Y Spanish and Italian debt plunged by ca. 20bps to 5.05 and 4.30, respectively, thus the results of auction of this bonds may have visible impact on the EURUSD in the nearest future. Correlation of the EURUSD with 10Y Spanish bond is close to -80% and the size of demand claimed after decline of yields at the beginning of the year may initiate the direction for the EURUSD for the next few days.

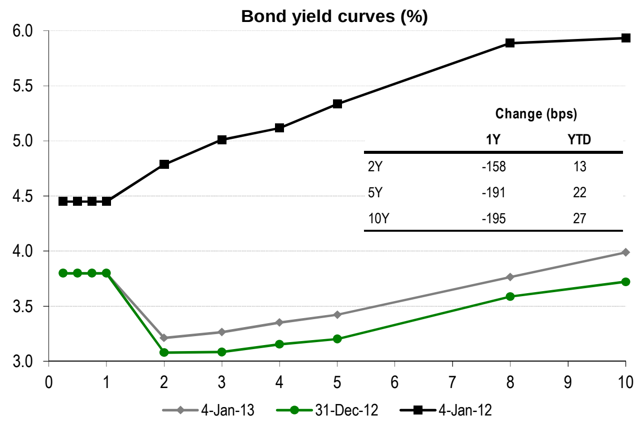
Koruna under pressure from possible c. bank intervention

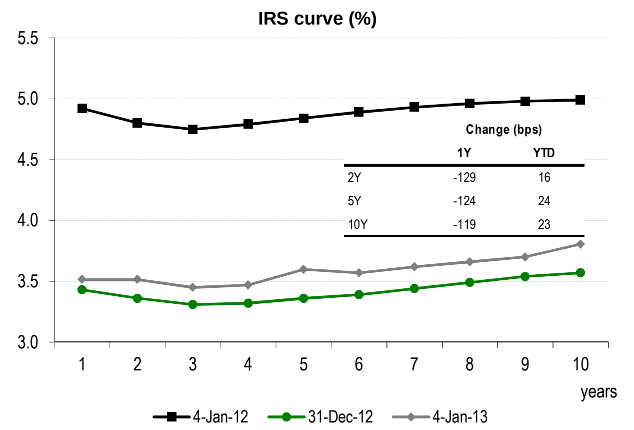
▪ Czech koruna plunged versus the euro at the beginning of the year. The EURCZK surged from 25.02 to 25.3 during the first three sessions of 2013. The koruna was under pressure of PMI data for Czech manufacturing (that dropped to the lowest level for 3.5 years) that fuelled expectations the Czech Central Bank may act to weaken the domestic currency.

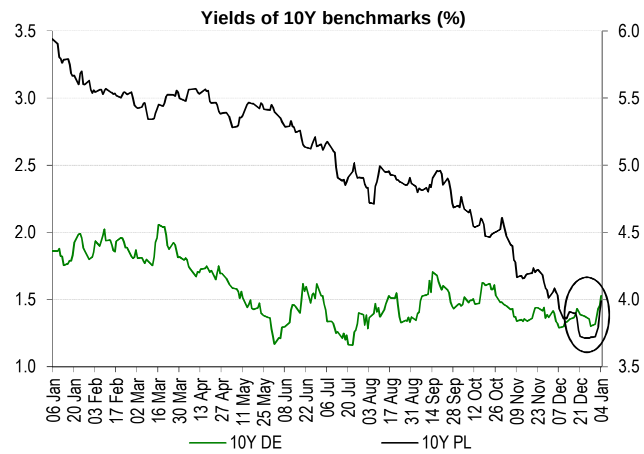
▪ In case of the EURHUF there were no major changes. The forint recovered slightly versus the euro after over a month of depreciation.

Interest rate market – Correction on the market, the MPC's meeting remains centre stage









WIBOR rates lower and lower

▪ End of 2012, but also the first week of new year brought further gradual decline in WIBOR rates. One should notice that 1Y WIBOR fell below 4.00%. What is more, WIBOR decline since the end of August (Q2 GDP data release) till 2012-end amounted to between 69bps for 1M and 114bps for 1Y, in which WIBOR 3M fell by 100bps vs a 50bps cut of official NBP's rates.

▪ Last days of 2012 on FRA market were quiet – rates stabilised at low turnovers. Correction on the bond market caused some sell-off on the FRA market in the first days of 2013. FRA 9x12 increased above 3%, first time since the mid of December. Consequently, market expectations on scale of WIBOR rate decline have changed – for the first time since late November the market expects 3M WIBOR to be lower by less than 100bps in next 6 months.

Correction after significant rally …

▪ As we expected the beginning of new year brought correction on the fixed income market. As regards bond market, the mid and long-end of the curve weakened significantly, with yield increase by 22bps for 5Y and by 27bps for 10Y. It came from weakening of safe haven assets (in which yield of 10Y Bund increased to 1.46%, up from 1.32% at the end of 2012) after reaching (partial) fiscal cliff agreement in the US. Results of domestic auction of DS1023 and WS0429 also put some negative pressure on investors' mood. The Ministry tapped bonds with higher yields compared with the levels on the secondary market (at 3.847% and 3.896%, respectively), with demand lower than the top of issuance limit (i.e. PLN5bn). Yield of 2Y benchmark increased by 13bps; the front end of the curve is still under expectations on further monetary easing.

▪ Poland's Ministry of Finance announced its issuance plan for Q1-2013. The Ministry wants to tap bonds worth PLN25-35bn at 5-6 auctions. The amount of January's offer (after Thursday's results 35-39% of planned target for Q1) is not a surprise taking into account liquidity situation. In January flows on the market will amount to PLN10bn from OK0113 redemptions and PLN2.5bn from interest payments from floating rate WZ series (25 Jan).

… but whether the MPC's statement will change it?

▪ This week the key event will be the MPC meeting. Rate cut is a done deal, so the attention will be focused on the official statement and Council's press conference. Crucial issue for the market will be whether the MPC will decide to suggest a pause in easing cycle in anticipation of March edition of inflation and GDP projections. If this is the case, one cannot exclude further upward pressure on yields along the curve. In our view, the scale of yields' decrease will be determined later on by the releases of new economic data (inflation, production). In case of money market, we expect a continuation of fall in WIBOR rates.

▪ As we wrote before, there is a strong correlation between Polish 10Y bond and corresponding German Bund. Further sale-off of safe assets may generate additional upward pressure on yields at the long end of the curve. This will result in further steepening of the curve – the trend which is observed also in global markets.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl