Bank Zachodni WBK

Weekly economic update

14 – 20 January 2013

In line with market expectations, central banks' meetings were the most important events last week. Even though the decisions on official rates (Polish MPC cut rates by 25bps while the ECB kept rates unchanged), in both cases comments of governors during press conferences had a significant influence on investors' mood. Suggestion of the NBP's governor Marek Belka on a possible pause in the monetary easing cycle triggered a correction on the domestic bond market and strengthened the zloty. On the other hand Mario Draghi's acknowledgement of improvement of financial market situation and stabilization of economic growth supported appetite for risky assets on the global markets. At the end of the week investors focused their attention on financial results of the US companies.

This week almost a complete set of important domestic macroeconomic data will be published. We predict that data will have a definitely dovish tone, showing a significant decline in CPI inflation, a further worsening of the labour market situation and a slump in the economic activity in the last month of 2012. After this series of nasty macro figures we do not expect the MPC to take a break in easing cycle in February (as even Marek Belka suggested that it can rather occur in the upcoming months). Weak data should trigger another wave of Polish debt market strengthening, intensifying expectations on the scale of monetary policy easing. As regards foreign financial markets, the attention will concentrate on macroeconomic data from the USA and further financial results of the US enterprises.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 January)					
11:00	EZ	Industrial output	Nov	%MoM	0.1	-	-1.4
14:00	**PL**	**Money supply**	**Dec**	**%YoY**	**4.5**	**4.9**	**5.8**
		TUESDAY (15 January)					
9:00	DE	GDP	2012	%	0.8	-	3.0
14:00	**PL**	**CPI**	**Dec**	**%YoY**	**2.5**	**2.4**	**2.8**
14:30	US	Retail sales ex autos	Dec	%MoM	0.2	-	0.0
		WEDNESDAY (16 January)					
11:00	EZ	HICP	Dec	%YoY	2.2	-	2.2
14:00	**PL**	**Core inflation**	**Dec**	**%YoY**	**1.6**	**1.6**	**1.7**
14:30	US	Core CPI	Dec	%MoM	0.2	-	0.1
15:15	US	Industrial output	Dec	%MoM	0.2	-	1.1
20:00	US	Fed Beige Book					
		THURSDAY (17 January)					
14:30	US	Initial jobless claims	week	k	365	-	371
14:30	US	House starts	Dec	k	890	-	861
14:30	US	Building permits	Dec	k	904	-	900
16:00	US	Philly Fed index	Jan	pts	5.0	-	8.1
		FRIDAY (18 January)					
14:00	**PL**	**Industrial output**	**Dec**	**%YoY**	**-6.9**	**-10.3**	**-0.8**
14:00	**PL**	**Construction and assembly output**	**Dec**	**%YoY**	**-11.9**	**-12.4**	**-5.3**
14:00	**PL**	**PPI**	**Dec**	**%YoY**	**-0.6**	**-0.6**	**-0.1**
14:00	**PL**	**Wages in corporate sector**	**Dec**	**%YoY**	**2.0**	**1.9**	**2.7**
14:00	**PL**	**Employment in corporate sector**	**Dec**	**%YoY**	**-0.4**	**-0.4**	**-0.3**
14:00	**PL**	**Current account**	**Nov**	**€bn**	**-854**	**-816**	**-650**
14:00	**PL**	**Exports**	**Nov**	**€bn**	**13150**	**13250**	**14156**
14:00	**PL**	**Imports**	**Nov**	**€bn**	**13100**	**13100**	**13931**
15:55	US	Flash Michigan	Jan	pts	75.0	-	72.9

Source: BZ WBK, Reuters, Parkiet

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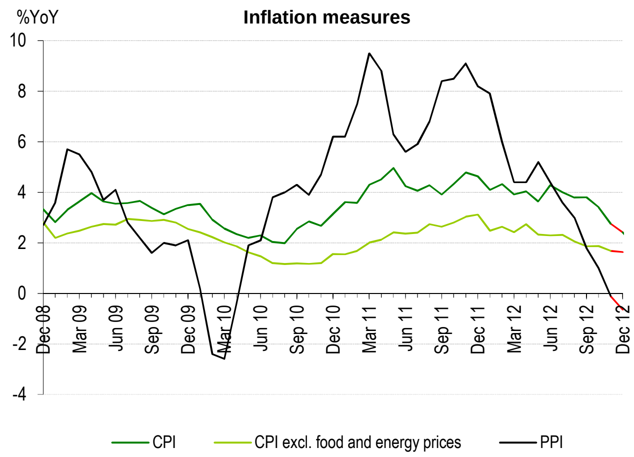
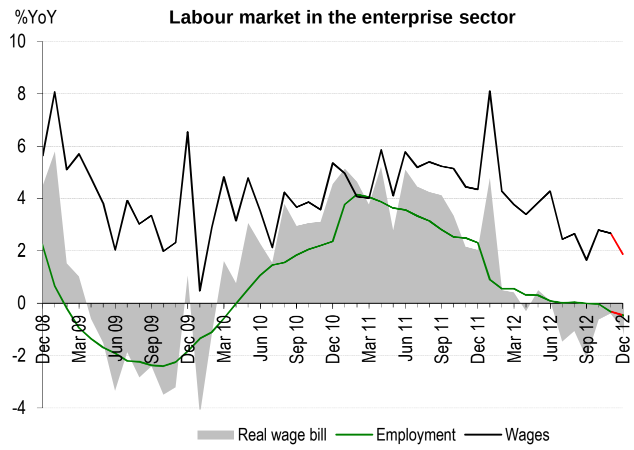
What's hot this week – Another set of dovish data from Polish economy



▪ This week will see the abundance of important data releases in Poland. The culmination will take place on Friday, when the data about production, labour market, and balance of payments will be released at the same time.

▪ According to our forecasts, all three main measures of inflation have decreased in December. CPI growth reached 2.4%YoY, falling below the official NBP target for the first time since August 2010. Core inflation excluding food and energy prices reached 1.6%YoY, while PPI growth dropped to -0.6%YoY. The data will confirm that there is no inflationary pressure in the Polish economy.

▪ We predict a slight widening of the current account deficit in November, caused by a bit smaller surplus in trade balance and even smaller than in previous months surplus in current transfers. We predict a slowdown in export and import growth, however they both should remain above zero.

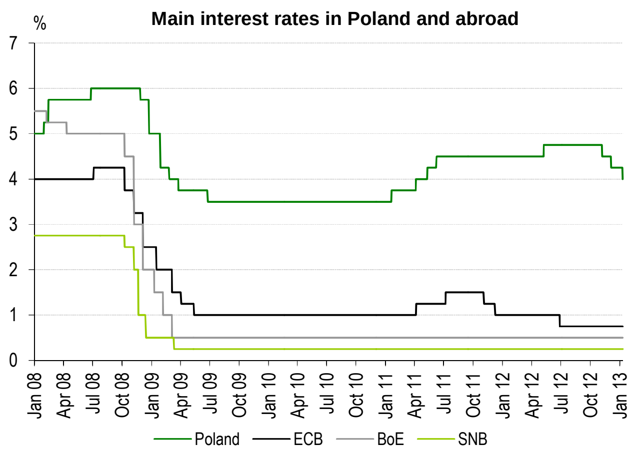


▪ Situation in the domestic labour market continued deteriorating in December. According to our estimates, average employment in corporate sector fell by 0.4%YoY and wage growth decelerated to 1.9%YoY. This would imply another drop of real wage bill in corporate sector, being a predictor of weak private consumption growth in Q4-2012.

▪ We expect to see particularly bad figures for industrial and construction production in December (our forecast for industrial output is the lowest in the market). This was caused by calendar effects (fewer working days) but also by the fact that underlying trend in those sectors is still pointing downwards.

▪ We think that the data to be released this week will boost market expectations for interest rate cuts at the nearest MPC meetings.

Last week in the economy – NBP rates trimmed third time in a row



▪ The MPC decided to cut interest rates third month in a row by 25bps. Now the main reference rate is at 4.0%.

▪ The official statement and comments during the press conference suggested that a pause in the easing cycle may be approaching, but on the other hand it remains clear that the Council is still under strong influence of current macro data. The drop of inflation in coming months and deceleration of economic growth will be so strong that contrary to suggestions on possible break, the MPC may decide again that – just like Marek Belka said in November – there is no time for a pause.

▪ The European Central Bank and the Bank of England both kept interest rates unchanged. The main interest rates are now respectively at 0.75% and 0.50%.

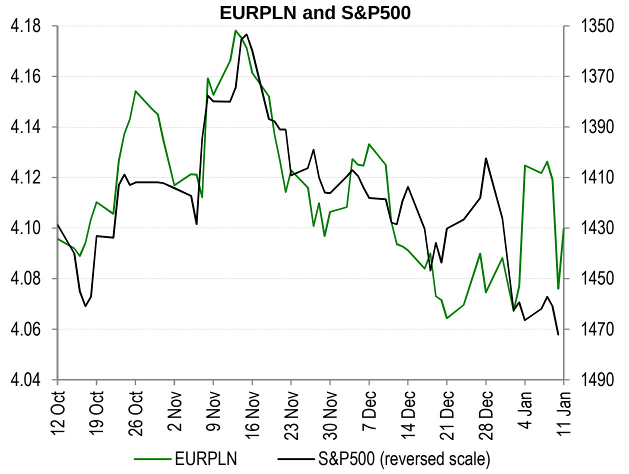
Quote of the week – Inflation fall will certainly allow bolder moves

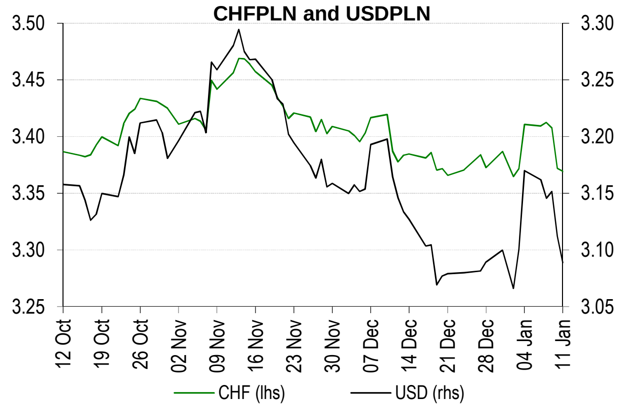
Marek Belka, NBP President, press conference, 9.01
Some round of interest rate cuts is coming to an end. (...) Interest rate cut (in February) is still possible, even likely, but not unconditional. (...) We do not exclude there may be another rate cut in February, but if this is the case, one should decisively count that in the next month or months there would be a break. (...) Inflation fall will certainly allow bolder moves of interest rates (but) I would like you to pay attention to core inflation. It will show whether the potential CPI drop – even below the target – will be temporary or not.

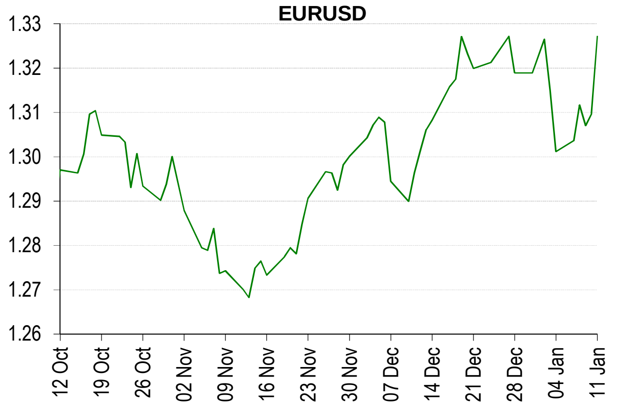
Anna Zielińska-Głębocka, MPC member, press conference, 9.01
It is a bit unfortunate wording that the cycle is coming to an end. We are rather talking about a pause.

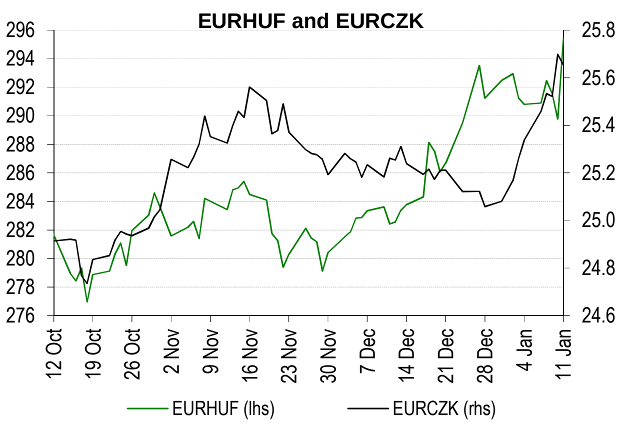
At the post-meeting MPC press conference the NBP President Marek Belka devoted much time to analyse the change in the last sentence of the MPC's communique. It was meant to signal that "some round of interest rate cuts is coming to an end". However, later on it turned out that it was not about an end of the cycle but rather about a pause in rate cuts. Moreover, the pause will take place rather not in February but later. What is even more, Belka said that fall in inflation will certainly allow for more decisive moves of interest rates. If this is the case, then a pause in monetary easing may not come anytime soon. According to our forecast CPI fell below 2.5% in December, below 2% in January, and will keep falling in next months. Core inflation is also likely to stay below 2%. Meanwhile, data from real economy will be still "nasty" (as described by Belka) in nearest months. Therefore, we expect the MPC to continue cutting interest rates in February and March.

Foreign exchange market – Zloty and euro under influence of central banks governors









Weak data may harm the zloty

- Last week the most significant impact on the zloty was exerted by the MPC decision, especially by the governor Belka's comments. NBP rates were cut – in line with expectations – only by 25bps, which initiated a slight positive reaction of the domestic currency. A most considerable downward move of EURPLN and USDPLN occurred after the suggestion that a pause in cutting cycle may be probable. As a result, EURPLN slid to 4.08 and USDPLN to 3.11. Strengthening of the single currency after the ECB meeting and successful auctions of Spanish and Italian debt stabilized the zloty. Still, on Friday the zloty weakened slightly in relation to the euro (EURPLN rose above 4.11).
- Zloty was relatively strong in relation to other main currencies. In weekly scale the domestic currency gained 2.6% versus USD, 2.1% versus GBP and 1.2% versus CHF. It is worth noting that GBPPLN declined below 5.0 again.
- This week PLN will stay under influence of domestic macro releases (mainly CPI inflation and industrial output). The data may again amplify expectations for further interest rate cuts, weakened by the MPC on Wednesday. This can generate an upward impulse for EURPLN towards 4.123. A strong support is at 4.06.

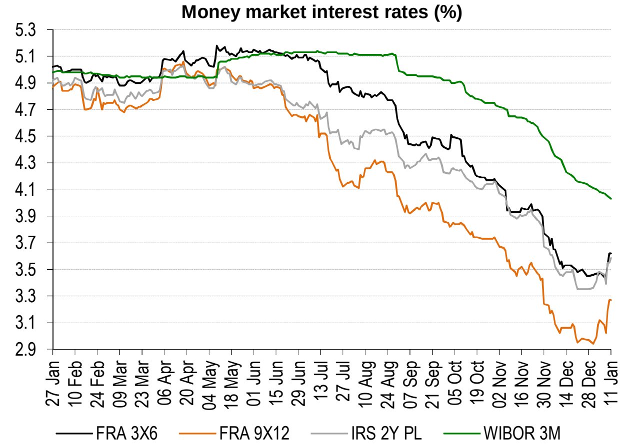
EUR strongest since April 2012

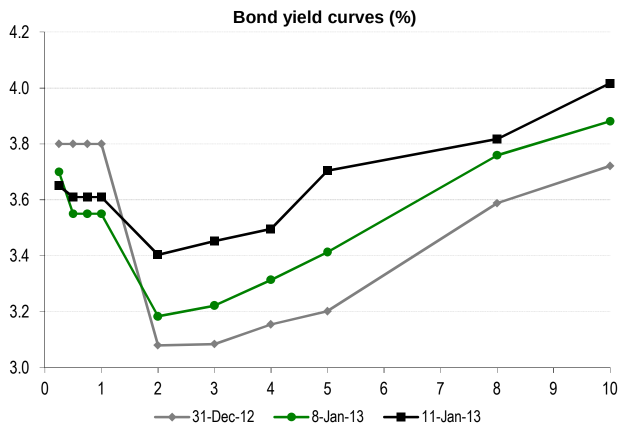
- Since beginning of the last week, the EURUSD exchange rate was moving in moderate upward trend. Worries about quarterly results of US companies and rumours about downgrade of French credit rating have only temporarily undermined the euro. The single currency was positively affected by results of Spanish bond auctions and the ECB decision to keep interest rates unchanged. During the press conference M. Draghi noted the positive developments in Europe and suggested that revival is possible later in the year, thus lowering chances for a rate cut in the upcoming time and underpinned the EURUSD's rise above 1.33, the highest level since April. A positive sentiment remained also during Friday's session, while EURUSD reached 1.335.
- This week investors will focus on US macroeconomic data (retail sales, output and CPI inflation) and on consecutive releases of companies' financial results. Crucial levels for EURUSD are 1.338 and 1.314.

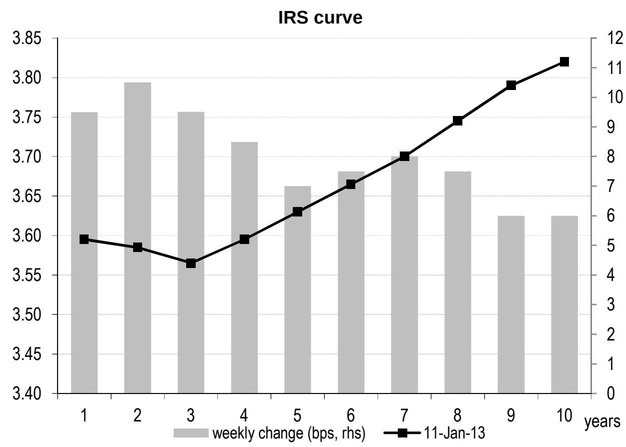
CEE currencies under pressure

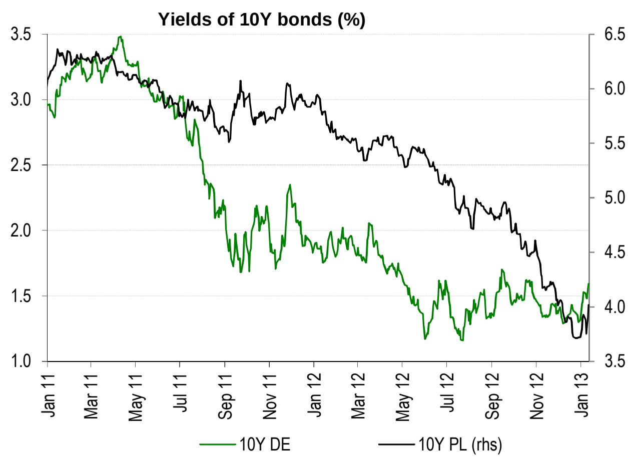
- CEE currencies were under pressure last week. The Czech koruna was losing in reaction to central bankers' comments, who confirmed their willingness to intervene if necessary. Still, the Hungarian currency was weakening due to concerns about independence of Hungarian central bank. The Prime Minister Orban said that the new central bank governor should closer cooperate with the government. EURHUF climbed to the highest level in 7 months.

Interest rate market – Will macro data intensify expectations for interest rate cuts?









Expectations about rate cuts corrected

- The MPC decision to cut interest rates by 25bps was line with analysts' expectations. Still, this decision came as a disappointment for some market players, who were expecting a deeper reduction. The statement and the clear-cut suggestion of a pause in cutting cycle caused a massive sell-off on the FRA market. Rates climbed by 11-24bps as compared to levels prior to the MPC decision, with the most considerable changes in case of 6x9 and 9x12 rates.
- Reaction of WIBOR rates to the MPC decision proved to be rather limited. WIBORs continued their gradual decline, which amounted to 5-6bps in weekly scale. It is worth noting that since the end of August 2012 (release of 2Q2012 GDP) the WIBOR3M has fallen by 108bps, substantially more than the reference rate.
- The suggestion of a pause in cutting cycle caused a change in expectations for future rate cuts. Currently, FRA contracts are pricing-in cuts by 75bps in 9 months' time as compared to more than 100bps at the beginning of 2013.

A considerable weakening of bonds after MPC

- Similarly as on the FX market, high volatility was also the case on the bond market. Expectations for interest rate cuts and strengthening of German debt caused that the upward correction of yields at the beginning of 2013 was almost erased. The situation changed significantly after the cautious MPC decision and suggestion about pause in cutting cycle. Bond yields rose across the curve, with most significant changes on the shorter end (27bps). Upward trend of yields persisted till the end of the week, but scale of changes was diminishing.
- Changes on the IRS after the MPC decision were less considerable than on the bond market. They amounted to 11-16bps with the most substantial increases in case of 2Y rate.
- The Finance Ministry was active on the primary market. The resort placed 6Y eurobonds worth €1bn (with demand at €1.9bn) with yields at 1.705% (65bps above average swap rate). According to the Ministry, ca. 26% of the issue was purchased by central banks and government agencies from Asia, Europe and Middle East, which is the strongest share ever.

Macro data will come to the fore

- This week investors will focus on macro data releases, mainly on CPI inflation and industrial output data. In our view inflation will run below the NBP target, while output will post a nasty decline, confirming the disinflationary trend and marked slowdown of economy. Should our scenario come true, can the market start to price-in interest rate cuts in the upcoming months aggressively again, at least no pause in cutting cycle in the upcoming months. As a result, the markets can trim losses (or at least most of them) after these releases.
- Longer end of the curve will still remain vulnerable to core markets situation. Further weakening of German debt can undermine domestic 10Y bonds, limiting their upward potential.

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