Bank Zachodni WBK

Weekly economic update

21 – 27 January 2013

It is hard to point which event of the last week had the key impact on the global financial market. Successful debt auctions in Spain and Italy were coupled with a reduction of economic growth forecasts by the World Bank and the release of data showing that German GDP declined in the final quarter of 2012. Amid varying moods abroad, domestic foreign exchange market was moving in a horizontal trend. EURPLN was hovering near 4.13, and yields of bonds were fluctuating close to levels reached after the correction seen at the start of the year. Only the release of weak domestic data on Friday triggered a clear correction in the FX market (EURPLN weakened by ca. PLN0.05). Bond market has discounted weak readings even before the release.

Last week saw a number of comments of MPC members, suggesting that there will be no break in monetary easing cycle in February. This is consistent with our baseline scenario, assuming a rate cut by 25bps. It is worth noting that before the February's meeting the MPC will already know the flash GDP data for 2012.

Publications of economic activity indicators for the euro zone and Germany will draw most of investors' attention this week. In recent months PMI and Ifo have stabilised, showing that pace of business climate deterioration has weakened, which was pointed out in the last ECB's statement. If those indicators improve again (which is expected by the market), it will fuel investors' hopes that next months will also see improvement of situation. This should support risky assets. Meetings of the Eurogroup and Ecofin will create opportunities for European policymakers to express opinions about the outlook for euro zone's economy and about chances for ending the debt crisis. After numerous data releases last week, the nearest days will see very little domestic publications. Nevertheless, the recent data releases should continue influencing domestic financial markets. The market attention will focus on auction of new two-year benchmark OK0715 and 5Y PS0418. Liquidity situation (redemption of OK0113 and coupon payment on WZ series) together with expectations for interest rate cut in February should be positive for auction results, at which we expect to see a solid demand. Potential for EURPLN drop below 4.13 seems to be limited in nearest days.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (21 January)					
		Eurogroup meeting					
	US	Market holiday					
		TUESDAY (22 January)					
12:00	DE	ZEW index	Jan	pts	12.0	-	6.9
16:00	US	Home sales	Dec	m	5.08	-	5.04
		WEDNESDAY (23 January)					
		ECOFIN meeting					
11:00	**PL**	**Bond auction OK0715/PS0418**					
16:00	EZ	Consumer confidence index	Jan	pts	-26.0	-	-26.6
		THURSDAY (24 January)					
2:45	CN	Flash PMI – manufacturing	Jan	pts	-	-	51.5
9:28	DE	Flash PMI – manufacturing	Jan	pts	46.8	-	46.0
9:58	EZ	Flash PMI – manufacturing	Jan	pts	46.5	-	46.1
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	350	-	335
16:00	US	Leading indicators	Dec	%MoM	0.3	-	-0.2
		FRIDAY (25 January)					
11:00	DE	Ifo index	Jan	pts	103.0	-	102.4
10:30	GB	Flash GDP	Q4	%YoY	0.2	-	0.0
16:00	US	New home sales	Dec	k	385	-	377

Source: BZ WBK, Reuters, Parkiet

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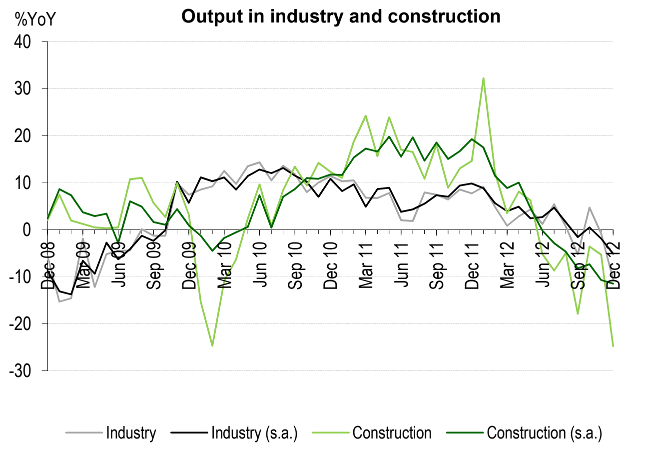
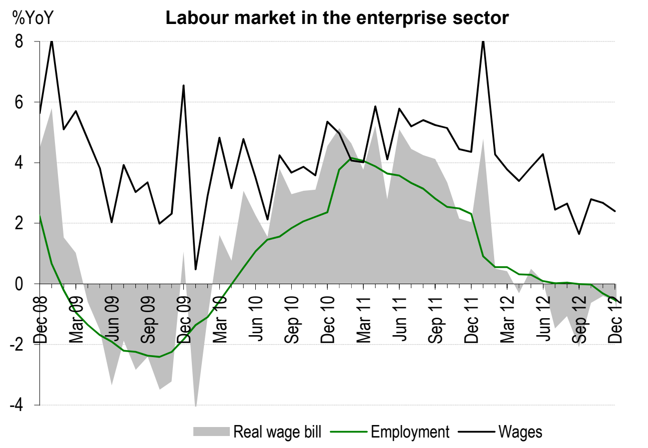
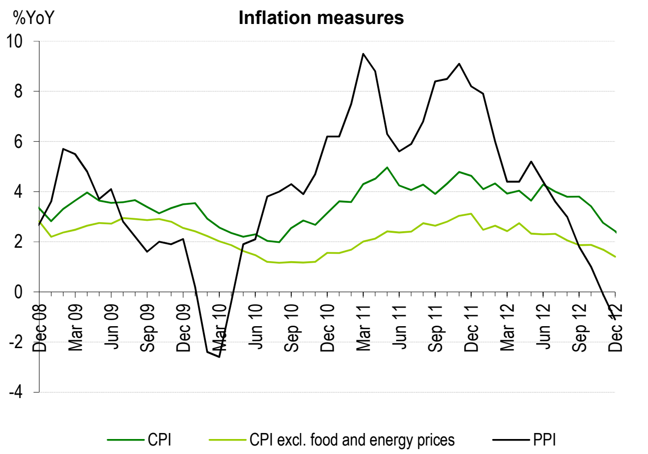
What's hot this week – Downward tendencies prevail







Sharp production drop

▪ line with our forecast industrial production recorded a double-digit drop in December by more than 10%YoY. Moreover, construction and assembly sector recorded a sharp slump by ca. 25%YoY, which was much below expectations. Although these results were under impact of smaller number of working days (two days less than in 2011), the seasonally adjusted growth rates also showed considerable drops. Overall, in Q4 output in both sectors posted weaker increases than in Q3, thus supporting our forecast of further deceleration of economic growth.

Further deterioration of labour market

▪ In December the employment in corporate sector declined by 0.5%YoY, slightly more than predicted. In monthly terms the number of employed plunged by 23k, which was the biggest decline since March 2009. Since January the employment in corporate sector declined by 77k and past year was one of weakest for a few last years. In our opinion demand for labour will continue to fade.

▪ Wages advanced in December by 2.4%YoY, slightly more than forecast. Still real growth of wage bill was negative, thus supporting our forecast of weak growth of private consumption in the final quarter of 2012.

… and quick decline of inflation

▪ CPI Inflation decelerated in December to 2.4%YoY, i.e. dropped below the official NBP target for the first time since August 2010. In spite of a marked rise in food prices, no inflationary pressure is visible in other categories, which was reflected in another considerable decline of core inflation excluding food and energy prices to 1.4%YoY. All three other measure of net inflation also fell (currently all inflation gauges are below NBP target).

▪ PPI inflation slowed to -1.1%YoY, i.e. much more than expected. The data show weakness of cost inflationary pressure on entrepreneurs.

Trade balance in negative territory again

▪ Current account deficit increased markedly in November (to €1.49bn nearly two times higher than in October). This was mainly an effect of deterioration in trade balance

▪ This quite considerable deficit in trade after two months of trade surplus resulted from deeper-than-forecast weakening of exports and higher-than-predicted growth of imports. It is likely that in December, when the number of working days was 2 days lower than year ago and industrial production fell sharply, trade data might deteriorate significantly.

Quote of the week – There will be no pause in February

Adam Glapiński, MPC member, PAP, 14.01
Cutting cycle has come to end in January or will come in February. Cuts can be cut to 4.00%, maybe 3.75% at most. (December data) will be crucial as regards a possible cut (in February).

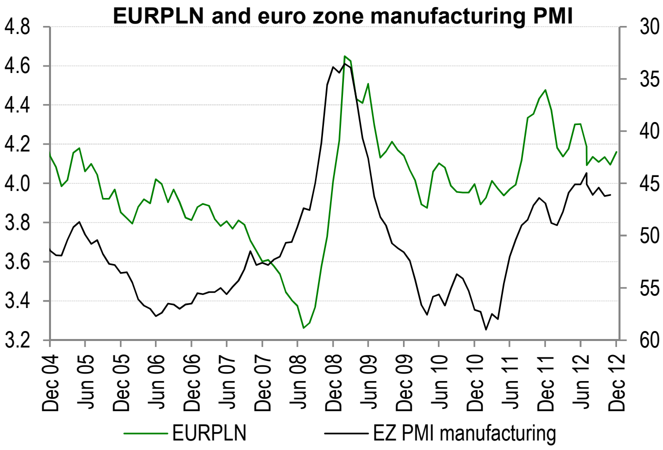
Elżbieta Chojna-Duch, MPC member, Reuters, 14.01, 15.01
Suitable level for rates is between 3.0% and 3.5%. (…) Cut deeper than 25bps would be a distortion of current cycle and an unintelligible signal.

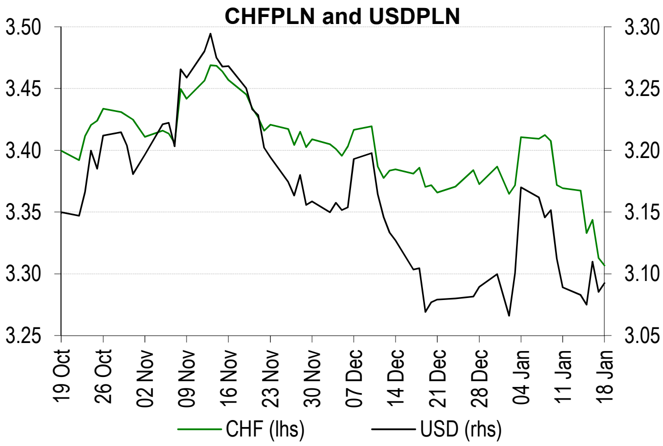
Anna Zielińska-Głębocka, MPC member, Reuters, 15.01, 18.01
Further moves should not be higher than 25bps. Some pause will probably take place, but I do not think it will be in February.

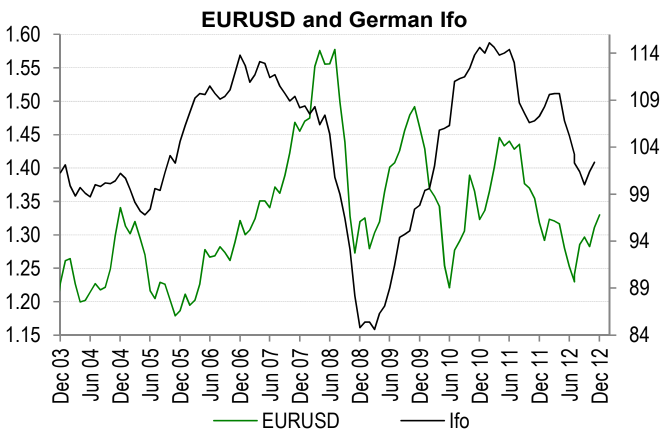
Jerzy Hausner, MPC member, Reuters, 18.01
The Council did not rule out a cut in February and I support such a declaration.

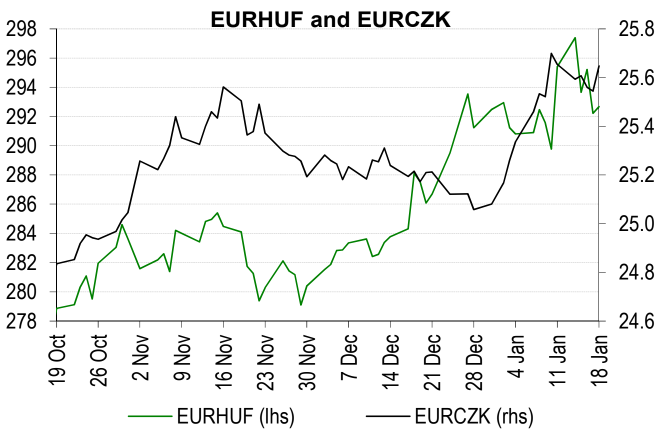
January's post-meeting MPC communiqué included a less dovish sentence referring to further cuts, which was intended at suggesting a possibility of pause or of an imminent end of cutting cycle. At the same time, the MPC made their decision in February conditional on December's data. As we know, these were clearly dovish and they will probably encourage the MPC to cut rates in February. Support for such a move was even suggested by A. Glapiński and J. Hausner, who earlier were rather less eager to cut. It is hard to expect moves deeper than 25bps, as even according to the most dovish members this would be an unintelligible distortion of the cycle. We think that the Council will cut rates in March again, after seeing the NBP projection. Yet, a probability of this step is lower than in February – some members, like Glapiński, can recall their support, as he sees an imminent end of cutting cycle. On the other hand, decline of inflation (below 2% in Q1) can invigorate other members to support the easing cycle (e.g. Kaźmierczak).

Foreign exchange market – Zloty weaker under influence of domestic data









EURPLN highest since November after weak Polish data

- EURPLN stayed in the range of 4.10-4.13 since the beginning of the week. It is worth to notice that during periods of improved market sentiment the zloty did not gain versus the euro. This suggests that latest comments from the government and the NBP on harming effect of further appreciation of the zloty on Polish economy and possible more rate cuts by the MPC limit the potential for lower EURPLN rate.
- After the ECB president said the situation on the market normalized, the euro started to appreciate not only versus the dollar, but also to Swiss franc (perceived as safe haven). Due to this positive comment of Mario Draghi, the EURCHF surged to over 1.255, highest level since May 2011. Consequently, the CHFPLN plunged temporary even to ca. 3.26, lowest since July 2011.
- At the end of the week the EURPLN broke the resistance area at 4.13-4.14 after below consensus data on industrial output and higher-than-expected current account deficit. The exchange rate surged above 4.16 and reached highest level since second half of November.
- However, breaking the resistance area at 4.13-4.14 does not yet mean the horizontal trend of the EURPLN is over. After the industrial output data the exchange rate got close to next resistance at 4.16-4.18 and is still below the local peak from early August / late September at nearly 4.22. As the EURUSD did not break 1.34 and in the coming days may get closer to 1.326 and expectations for rate cuts strengthened, there is limited potential for a decline of the EURPLN below 4.13 in the coming days.

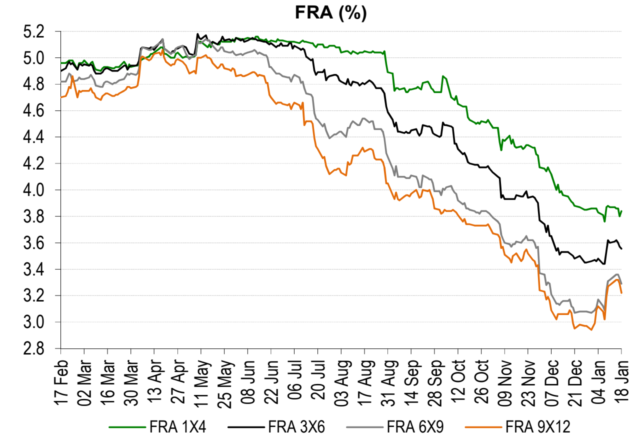
EURUSD stable at high level

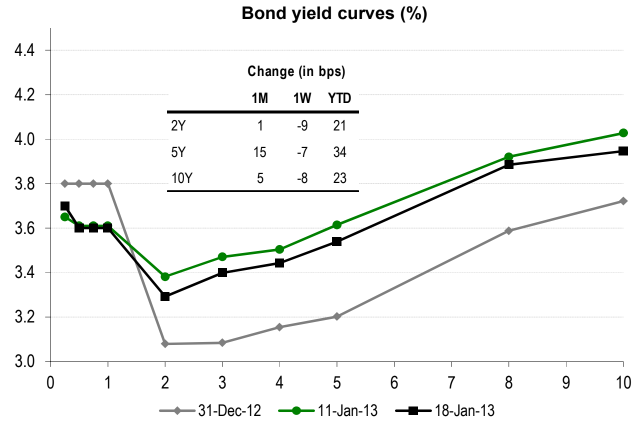
- At the very beginning of the week the EURUSD continued the upward momentum initiated during the ECB press conference. Consequently, the exchange rate broke 1.34 for a while and reached highest level since March 2012. In the following days the EURUSD stayed in the range of 1.326-1.34.
- This week the assessment of future performance of the European economy will probably have the most significant impact on the foreign exchange market. So far quarterly financial results of US companies were better than expected and if indexes of activity also surprise to the upside, then optimism may stay on the market for some longer period of time.
- We expect the range trading for the EURUSD for the coming days of 1.326-1.34. Data from Europe may decide whether the exchange rate will again try to break 1.34 (and open the way towards 1.35) or will prevent from falling to 1.30.

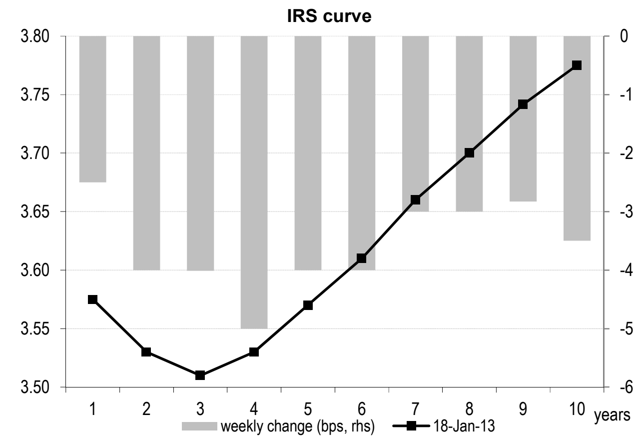
Stabilisation of forint and koruna

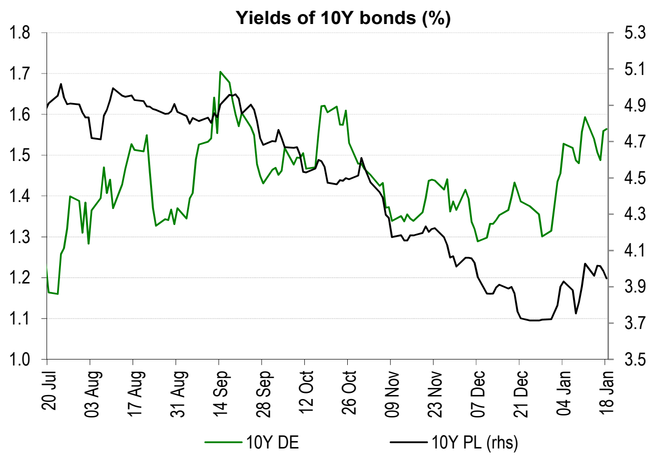
- Forint and koruna recovered slightly after quite visible weakening seen since the beginning of the year. Hungarian currency was supported slightly by comments from the national government suggesting that EURHUF should decline to ca. 275-285 from current 292.

Interest rate market – Bond auction takes centre stage









Data from real economy support money market…

- Waiting for macroeconomic data figures (CPI inflation, industrial output, data from labour market) WIBOR rates 3M and 6M have remained stable. WIBOR 1M, 9M and 1Y decreased by 1bp in weekly terms.
- The beginning of the week brought some increase in FRA rates. CPI inflation decline to 2.4%YoY was priced-in a bit earlier, therefore market reaction was neutral. But market reaction to core inflation figures (which are more important for the MPC's members) was more visible – contracts' quotations declined by 3-6bps. Contracts also shift down after weak industrial output data (fall by 10.6%YoY).
- Recent statements of the MPC members clearly suggest that there will be a majority within the Council to support reduction in interest rates (by 25 pb) in February this would be in line with our forecast. This is partly priced-in by the market, therefore we are expecting the continuation of the gradual decrease in rates WIBOR in next weeks.

… and debt market. Auction takes centre stage

- Inflation data, similarly to money market, did not influence bonds and IRS. Release of core inflation measures slightly supported the front end of curves. Downward trend in yields continued before Friday's publications of real economy data (industrial production, wages and employment), bond yields decreased by 3-6bps, while IRS rates by 3-4bps. Market continued to strengthen in the day of data releases (yields declined by another 3-8bps), pricing-in weak figures. However, the end of the week brought some profit taking. Undoubtedly, statements of the MPC members (A. Zielińska-Głębocka, J. Hausner) also bring support for market, suggesting that the Council will cut rates also in February, in line with our expectations.
- Macro calendar for this week is very light as the most data have been already released. Investors may focus on minutes from January's MPC meeting. For investors the key information in the minutes will concern the voting. We do not rule out, that as well as in previous months, there were voted more significant than 25 bp changes in NBP's rates.
- Earlier, on Wednesday, the Ministry of Finance will offer a new series of 2Y bonds OK0715 and 5Y benchmark PS0418 worth PLN5-10bn in total (the final supply will be announced on Monday). High offer is not a surprise taking into account liquidity situation – on settlement date investors will receive ca. PLN10bn from OK0113 redemption and ca. PLN2.5bn from coupon payments from WZ series.
- Renewed expectations on continuation of easing cycle should also support auction, on which we expect solid demand. In the uncertainty period investors' interest should attract high demand for short-term bonds. We expect domestic investors to be more active on auction as they were passive on November's switch tender (in comparison with non-residents).
- The long-terms bonds will remain under pressure from core markets. Possibility of earlier repayment of LTRO (it take place on 31 January) might result in further increase in Bund yields, negatively affect Polish 10Y bonds.

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