

Weekly economic update

4 – 10 February 2013

Last week was rather choppy as regards financial market's sentiment. Although the euro was gaining substantially against the dollar, most stock markets were pointing south, especially in the second half of the week. Macro data releases did not give any clear hints about prospects for global recovery: together with rising activity indices in the euro zone manufacturing and Germany and rising personal income in the USA, we have seen disappointing data on US GDP and housing market, German retail sales and Japanese output. Domestic data on GDP for 2012 were not as pessimistic as we feared, but they showed further deceleration of economic growth and a decline of consumption – the first one since mid-90s. Improvement of Polish PMI index at the beginning of the year proved substantially weaker than in most European economies, confirming our forecast of low industrial output in the upcoming months.

This week the decisions of central banks will come to the fore. According to the *Parkiet Daily* survey, market analysts are unanimously expecting a cut by 25bps by the Monetary Policy Council, and most of them are predicting the same move to be implemented in March. Hence, the rate cut should not affect the market reaction, while statement and press conference will be crucial. We are expecting some the MPC to ease its rhetoric given recent weak data and to leave door for further cuts open. The NBP governor Marek Belka, who was very clear while announcing a pause in cutting cycle at the last meeting, said during last week's testimony before the Senate that we are currently "In monetary policy easing, and it will be continued".

Apart from the MPC, decisions on rates will be taken by the Czech central bank, the ECB and the Bank of England. Decisions on these key monetary policy parameters should not surprise, so, similarly as in case of the MPC, post-meeting statements will be of highest importance. The Czech bank may again suggest a possibility of FX intervention aimed at weakening the koruna, while the ECB may acknowledge the improvement of the European market and in economy, similarly as one month ago. That comment has positively affected the global moods in January. If this is the case this time, then potential of domestic bonds from the middle and the longer end of the curve to strengthen in reaction to MPC statement may be limited by rising core debt yields. PLN's potential for appreciation against the euro is still limited and tone of the MPC statement may negatively affect the domestic currency.

Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST | | LAST VALUE |
|-------------------------------|-----------|------------------------|--------|----------|-------------|-------------|-------------|
| | | | | | MARKET | BZWBK | |
| MONDAY (4 February) | | | | | | | |
| 10:30 | EZ | Sentix index | Feb | pts | -3.0 | - | -7.0 |
| 16:00 | US | Industrial orders | Dec | %MoM | 2.2 | - | 0.0 |
| TUESDAY (5 February) | | | | | | | |
| 9:53 | DE | PMI – services | Jan | pts | 55.3 | - | 52.0 |
| 9:58 | EZ | PMI – services | Jan | pts | 48.3 | - | 47.8 |
| 11:00 | EZ | Retail sales | Dec | %YoY | -1.3 | - | -2.6 |
| 16:00 | US | ISM – services | Jan | pts | 55.2 | - | 56.1 |
| WEDNESDAY (6 February) | | | | | | | |
| | PL | MPC decision | | % | 3.75 | 3.75 | 4.00 |
| 12:00 | DE | Industrial orders | Dec | %MoM | 0.9 | - | -1.8 |
| THURSDAY (7 February) | | | | | | | |
| 11:00 | PL | Bond auction | | | | | |
| 12:00 | DE | Industrial output | Dec | %MoM | 0.2 | - | 0.2 |
| 13:00 | GB | BoE decision | | % | 0.50 | - | 0.50 |
| 13:45 | EZ | ECB decision | | % | 0.75 | - | 0.75 |
| 14:30 | US | Initial jobless claims | week | k | 360 | - | 368 |
| FRIDAY (8 February) | | | | | | | |
| 6:30 | CN | CPI | Jan | %YoY | 2.0 | - | 2.5 |
| 8:00 | DE | Exports | Dec | %MoM | 1.3 | - | -3.4 |
| 14:30 | US | Trade balance | Dec | \$bn | -46.0 | - | -48.7 |

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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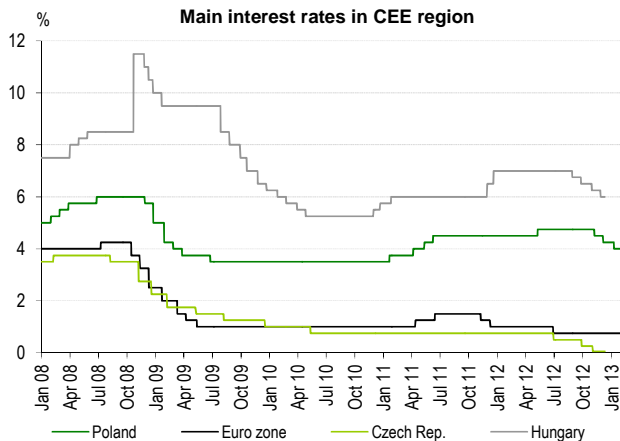
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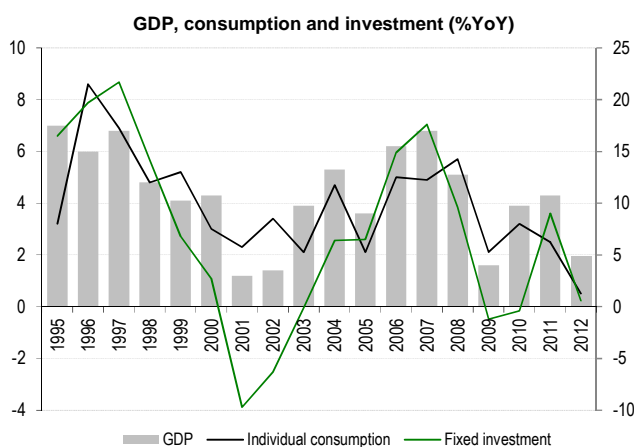
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What's hot this week – There will be no pause in cuts

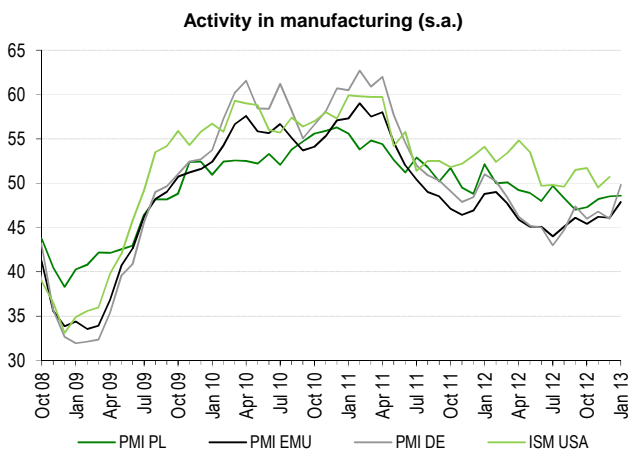


- In spite of a clear suggestion of the NBP governor after the last rate-setting meeting, that a pause in cutting cycle is close, a cut by 25bps in February does not seem less probable than the cut in January seemed to be. This is confirmed by the MPC members' comments (see details below). Cut is also supported by data showing deepening deceleration of economic growth and a quick decline of inflation.
- As for the market players, the tone of the communiqué and message of the post-meeting conference will be most important. We think that door for further monetary easing will remain open. Maybe the Council may make a pause in cutting cycle conditional on results of new NBP projection. In our view both the projection and upcoming data will support more easing.

Last week in the economy – Slowdown, but not that bad



- GDP grew in 2012 by 2.0%. Domestic demand advanced by a mere 0.1%, individual consumption by 0.5% and fixed investments by 0.6%.
- Based on these data, we estimate that GDP growth in Q4 decelerated to ca. 1%YoY. Even though investments declined less considerably than we feared (-0.4%YoY), a major disappointment was delivered by consumer demand, as it fell by ca. 1%YoY at the year-end. However, it is probable that this was due to delayed farmer subsidies payments, as a bulk of them (ca. PLN3bn) was postponed till January. This means that some rebound of private consumption is likely in 1Q2013.
- We are still expecting that the economy will bottom out in 1Q2013 and then recover gradually in the later part of the year, without bringing any inflationary threats.



- PMI index for Polish manufacturing posted in January a slight, lower than expected, increase to 48.6pts. Its value still runs substantially below 50pts, which is indicating that activity in manufacturing is still declining, but at slightly slower pace.
- It is worth noting that output and new export orders indicators improved (both are close to neutral level of 50pts). Still, declines of domestic orders deepened. This result seems to support our forecast, assuming that industrial output growth remained negative in January, but not as low as in December.
- Scale of employment reductions declared by firms increased in January. Downward tendency of cost pressure also maintained. Producers were reducing output prices at the highest pace since February 2010.

Quote of the week – February's cut is probably a done deal

Marek Belka, NBP President, testimony in Senate, 30.01

We are in monetary policy easing cycle. One can expect that this development will be continued. (...) This Council is consciously pursuing a policy of relatively stable interest rates – between 3.5% and 4.75%.

Jerzy Hausner, MPC member, Polskie Radio 3, 29.01

Cuts are justified, when inflation slides below the lower border of tolerance band, i.e. 1.5% annually and that is when I will be supporting cuts.

Elżbieta Chojna-Duch, MPC member, Reuters, 29.01

Monetary policy easing should be continued. It seems that currently it is too late for a deep reaction so the adopted model of gradual steps should be followed also in the upcoming months.

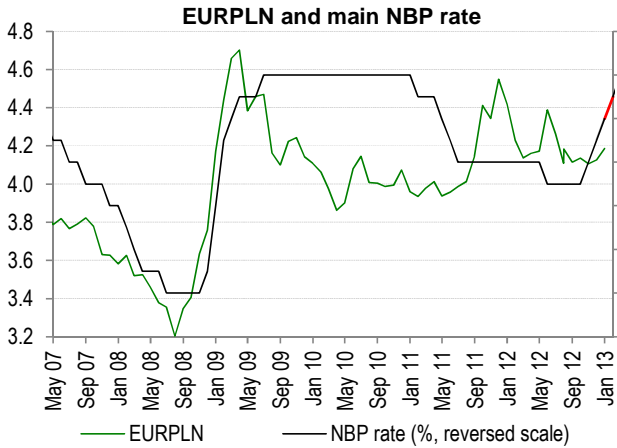
Anna Zielińska-Głębocka, MPC member, Reuters, 29.01

It seems that the February's cut is probably a done deal.

Recent comments of the MPC members support our opinion that interest rate cut is almost certain in February. Our belief that the Council will stick to small moves by 25bps was also underpinned. This was shown by results of MPC vote in December, when governor M. Belka and A. Zielińska-Głębocka recalled their support for 50bps cut (probably the November's decision of cut by 25bps encouraged them to follow suit and not to distort the cycle) and by comment of E. Chojna-Duch, according to whom it is already too late for a deep reduction.

Marek Belka said that the MPC is consciously pursuing a policy of "relatively stable interest rates". However, we do not view this as a merit. Scale of adjustment of the macroeconomic policy should correspond to expected business cycle volatility, and the latter is quite considerable recently. Otherwise policy will be pro-cyclical.

Foreign exchange market – Central banks' meetings important for PLN and EUR

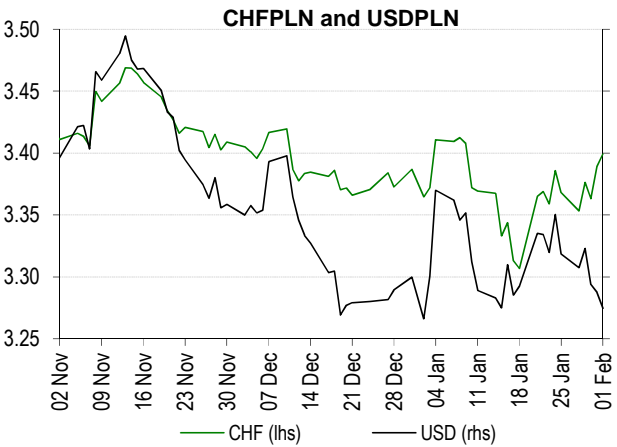


Zloty may temporarily gain after the MPC decision

▪ Last week the zloty continued to lose against the euro, but less considerably than earlier. The domestic currency was weakening given fears that GDP data for 2012 will disappoint and will amplify expectations for further monetary easing. There was no major reaction to the release itself, but the fact that economic activity deteriorated noticeably over the year (and supported further NBP interest rates cuts) was putting a negative pressure on the PLN in the following days of the week. As a result, EURPLN surpassed temporarily 4.21, but fell to 4.17 at the end of the week after PM Tusk's announcement that debate on Polish accession to the euro zone will start in two weeks.

▪ PLN did not appreciate against EUR, but gained against USD thanks to dynamic increases of the EURUSD rate. In due course, USDPLN fell to 3.05 from 3.13 over the week.

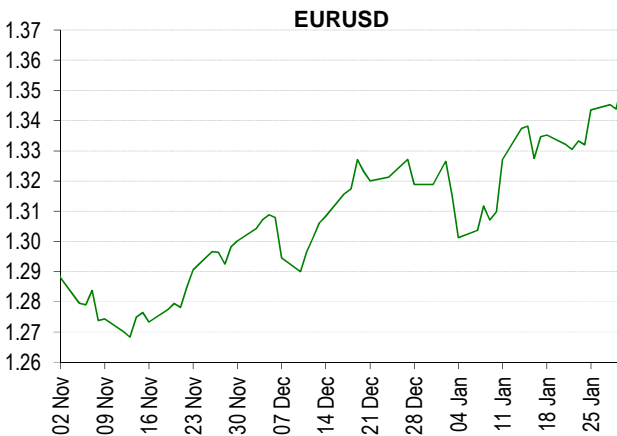
▪ Depreciation of the zloty during the last two weeks, when global trade was passing in quite sanguine sentiment, supports our suggestions that PLN is currently driven rather by domestic, not by foreign factors. In the recent weeks the zloty stayed under pressure of weak data, which strengthened market's expectations that there will be no pause in monetary easing cycle in February. We think that the Council will not suggest a pause so explicitly as the last time, given recent weak data. A possibility of interest rate cut in March can further underpin market expectations for cuts later in the year. EURPLN may reach 4.16 thanks to words of Tusk, but potential for further strengthening is rather limited. If EURPLN breaks the recent peak at 4.214, then, as technical analysis is suggesting, another resistance is at 4.23-4.24.



Increases of EURUSD may continue after the ECB

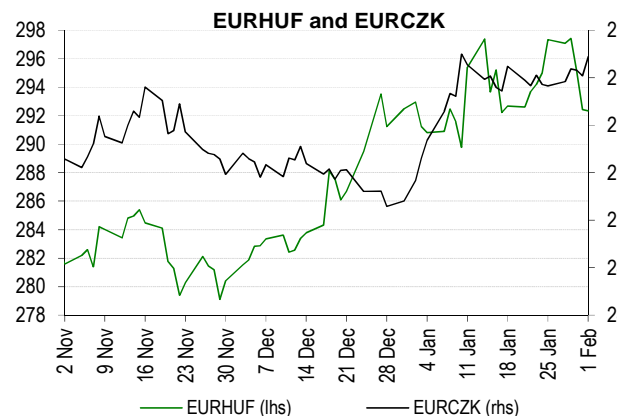
▪ Last week was the second one in a row when the euro was gaining against the dollar. The single currency was supported by data from Germany (ZEW, PMI, Ifo) and higher-than-expected sum paid back by the euro zone banks to the ECB from means borrowed during the 3Y LTROs (which was interpreted as a sign of improvement in the banking system). Moreover, the market was taking positions ahead of the Fed meeting (while expecting QE3 to be continued in the upcoming months). As a result, over the week the EURUSD reached temporarily almost 1.364, i.e. slightly below resistance at 1.365.

▪ Recent data from Europe will be probably mentioned in the upcoming ECB meeting statement. Last month the ECB's acknowledgement of some normalization of situation has positively affected the euro and this can be the case this week as well. At the end of the week the rate aggressively tested resistance at 1.365. Another resistance is 1.373 on daily chart, 1.380 at weekly chart. Support is at 1.36.

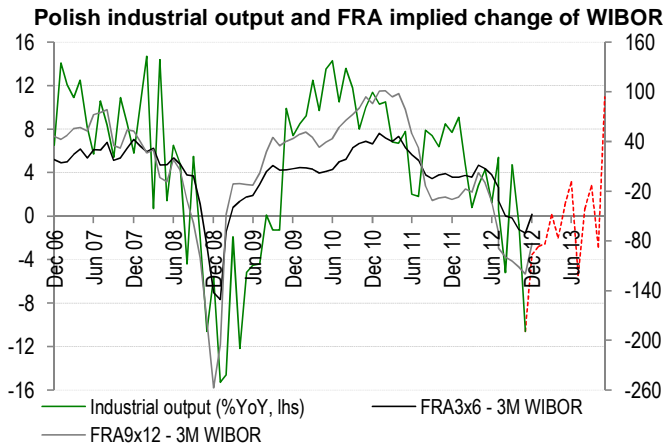


Signals from the central bank weigh on the CZK

▪ Apart from the zloty, the Czech koruna and the Hungarian forint were also losing at the beginning of the week. Weakening of the koruna may have been due to words of Czech central bank's deputy governor on possible interventions aiming at weakening the CZK versus the EUR. The EURHUF exchange rate approached resistance at 300, but failed to break it. Since mid-week, quotations of the forint have headed in the opposite direction that these of the zloty and Czech koruna. The Hungarian currency managed to trim some losses from the previous weeks and appreciated to 292 versus the euro. On Wednesday the Czech central banks decides on interest rates. No change of rates should be expected (as it runs currently at the lowest level ever: 0.05%), but another suggestion of intervention is possible.

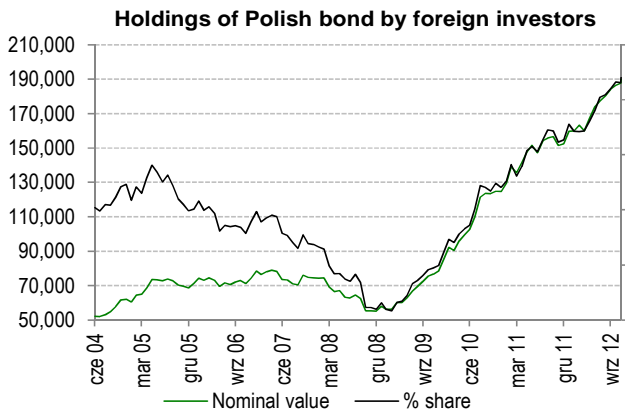


Interest rate market – The MPC statement can support the debt market



Money market rates are declining faster

- One week ago we indicated that pace of decline of WIBORs slowed after the January's MPC meeting. The much worse-than-expected data on retail sales and GDP release, clearly supporting further monetary easing, have fuelled the downward trend of money market rates. Last week WIBORs fell by 8bps for 1M and 4-6bps for other rates.
- Even though we are expecting further declines of WIBORs with further cuts of NBP interest rates, the downward potential of FRAs is limited (3x6 rate is close to 3.50%, i.e. the NBP interest rate expected by us after March meeting). As the MPC is late with rate cuts, the market can soon begin to price-in some recovery in the economy, even if the Council maintains dovish bias.



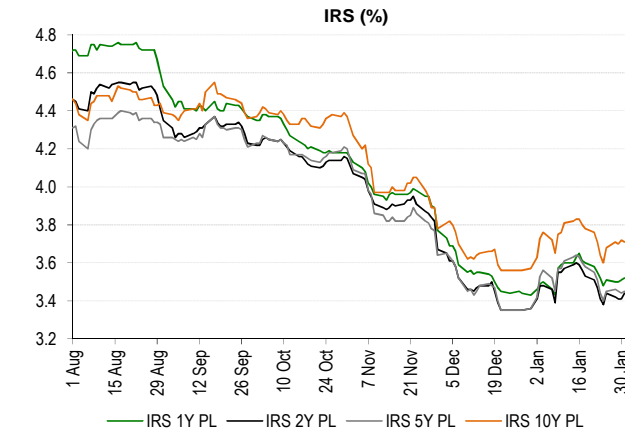
No breakthrough on the bond market

- Last week no important changes occurred on the bond and IRS markets. On one hand, debt was positively affected by expectations for February NBP rate cut, but on the other a negative pressure was exerted by rising yields of 10Y Bunds. In broader context, after rises of yields at the beginning of the year, currently yields are oscillating between minimums from end of 2012 and local maximums from mid-January. A similar situation was observed on the IRS market.

- Director of Debt Department in the Ministry of Finance, Piotr Marczak, said that after January the Ministry has 44% of 2013 gross borrowing needs already covered. He added, that if market conditions are convenient, then after February the ratio may reach 50%, the level the Ministry wanted to achieve at the end of Q1.

- Marczak added that after yesterday's auction of 20Y euro denominated bearer bonds worth €300m the Ministry has foreign currencies sufficient to service foreign debt during the whole year. Thus, any additional supply of foreign debt may result in lower supply on the domestic market.

- Data released by the MinFin showed that at the end of December 2012 foreign investors held Polish marketable bonds worth PLN190bn (record high level established already 8th month in a row). Piotr Marczak added that in January the inflow of foreign funds was even higher than in the last month of 2012.

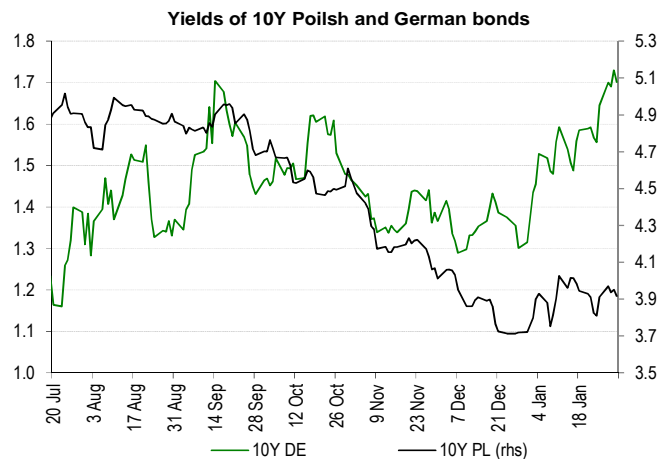


MPC statement may support debt market

- According to *Parkiet Daily* survey, all 22 institutions expect a rate cut by 25bps on Wednesday. Thus, the statement from the MPC meeting will be most important. We anticipate the Council will not signal a pause in rate cuts just like it did in January. Consequently, the tone of the statement may initiate downward move of yields of bonds and IRS. Still, the room for strengthening of mid- and long-term bonds will be limited by possible continuation of upward move of yields on the core debt market. Data from Europe released at the end of the week was again better than expected and this may limit demand for safe assets in the coming days.

- In general, in the nearest future we do not expect the yields of bonds to leave the trading range observed since record-low levels had been established in late 2012.

- This week the Ministry of Finance will again issue new 5Y bond. On the January's auction the demand for PS0418 was above PLN6.5bn and this time the auction may also be successful.



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