Bank Zachodni WBK

Weekly economic update

18 – 24 February 2013

Last week the global markets moods stayed under influence of comments of central bankers on exchange rates and releases of GDP data for 4Q2012. Representatives of the G7 countries issued a common statement, which reads that fiscal and monetary policies of particular countries should be aiming at meeting domestic objectives, not at influencing exchange rates. Single currency was supported, among others, by words of Bundesbank governor Jens Weidmann, who discarded FX intervention to weaken the euro. GDP data releases showed that the last quarter of 2012 brought a deeper-than-expected slowdown of European economies, which undermined the single currency. Polish data on balance of payments (higher-than-expected current account deficit) and deep decline of inflation in January (to 1.7%) caused a weakening of the zloty. Inflation figures amplified investors' hopes for a rate cut in March, markedly supporting the domestic debt.

This week we will see a row of data from Poland and from abroad. Figures from the domestic industrial sector should confirm its weakness, thus underpinning the domestic debt and negatively influencing the zloty. Message behind the labour market data will also be unfavourable, providing further arguments for interest rate cut in March. Release of minutes of MPC's January meeting can shed some light on members' views about suggested pause in easing cycle. Global market moods will be under impact of leading indicators for the European economy. These data can (similarly as one month before) surprise to the upside, which should support the single currency and risk appetite (and thus the zloty). Still, on the other hand worries about results of elections in Italy can cap the euro's appreciative potential.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 February)					
14:00	**PL**	**Wages in corporate sector**	**Jan**	**%YoY**	**1.0**	**1.2**	**2.4**
14:00	**PL**	**Employment in corporate sector**	**Jan**	**%YoY**	**-0.9**	**-1.3**	**-0.5**
		TUESDAY (19 February)					
11:00	DE	ZEW index	Feb	pts	35.0	-	31.5
14:00	**PL**	**Industrial output**	**Jan**	**%YoY**	**-2.8**	**-3.5**	**-10.6**
14:00	**PL**	**Construction and assembly output**	**Jan**	**%YoY**	**-19.7**	**-15.2**	**-24.8**
14:00	**PL**	**PPI**	**Jan**	**%YoY**	**-1.1**	**-1.5**	**-1.1**
		WEDNESDAY (20 February)					
14:30	US	House starts	Jan	k	925	-	954
14:30	US	Building permits	Jan	k	918	-	909
	US	Fed minutes					
		THURSDAY (21 February)					
	CN	Flash PMI – manufacturing	Feb	pts	-	-	52.3
9:28	DE	Flash PMI – manufacturing	Feb	pts	50.5	-	49.8
9:58	EZ	Flash PMI – manufacturing	Feb	pts	48.5	-	47.9
14:00	**PL**	**MPC minutes**					
14:30	US	CPI	Jan	%MoM	0.1	-	0.0
14:30	US	Initial jobless claims	week	k	355	-	341
16:00	US	Home sales	Jan	m	4.9	-	4.94
16:00	US	Philly Fed index	Jan	pts	1.0	-	-5.8
		FRIDAY (22 February)					
10:00	DE	Ifo	Feb	pts	105.0	-	104.2

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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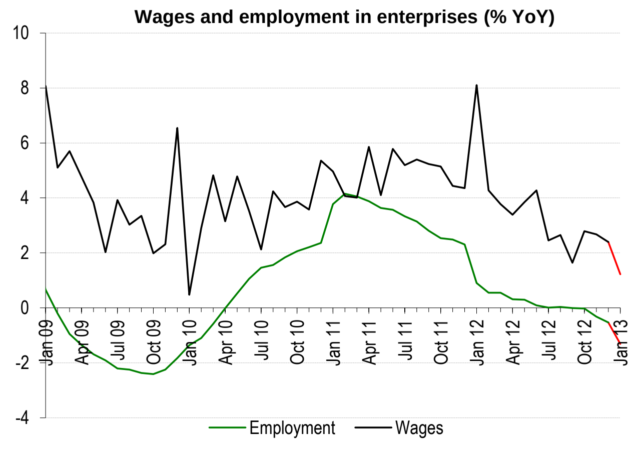
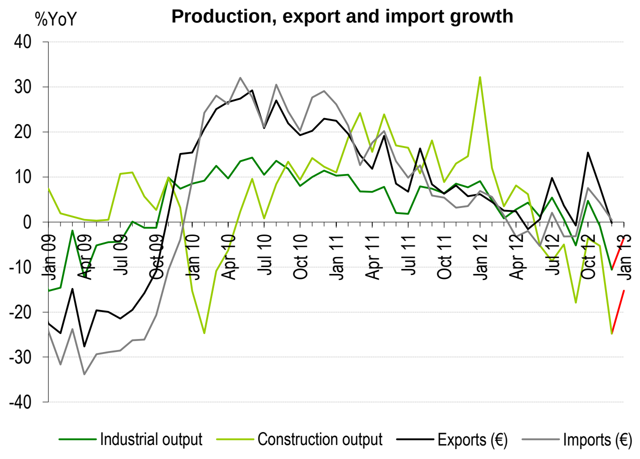
What's hot this week – Weak data on output and labour market



▪ We are expecting another bunch of dovish data from the Polish labour market and industry in January.

▪ In our view wage growth decelerated in January to 1.2%YoY. This result was strongly affected by high base effect from January 2012, but also by generally weak situation of the domestic labour market, due to economic slowdown.

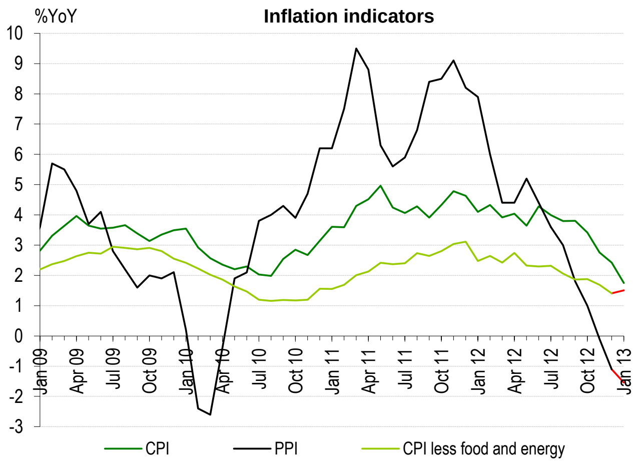
▪ We are predicting a decline of average employment in corporate sector by 1.3%YoY (our forecast is below market consensus), among others due to annual rebalancing of statistical sample of enterprises surveyed by the CSO. Still, it is worth noting that effect of this change is difficult to estimate, thus the January's forecast is highly uncertain.



▪ Growth rates of industrial and construction output recorded probably some rebound in January, mainly due to favourable working days effects (one working day more than year before, while there were two days less in December). Still, both industry and construction again posted a negative growth (-3.5%YoY and -15.2%YoY, respectively), confirming that situation in these sectors still remain weak. Construction and assembly output was additionally undermined by severe weather conditions in January (low temperatures, heavy snows).

▪ According to our forecasts, PPI inflation recorded another drop in January (-1.5%YoY), confirming the lack of cost pressure on the domestic companies.

Last week in the economy – Inflation below 2%, higher current account deficit



▪ CPI inflation fell in January to 1.7%YoY, i.e. more considerably than expected. This decline was underpinned by one-off factors (cuts of gas and communication prices), but primarily it is an effect of general lack of inflationary pressure given weak economic growth. We estimate core inflation at ca. 1.5%. In the upcoming months CPI and core inflation will continue declining – they may slide below 1.5% in Q2.

▪ Current account deficit was higher than expected in December and amounted to over €1.2bn. This was primarily due to a deeper decline of exports than of imports (which were actually under influence of one-off factors).

▪ In January money supply M3 growth stabilized at 4.5%YoY. Data show that both deposits and credit have continued to slow (with an exemption of households' loans, which accelerated slightly).

Quote of the week – Pause is not a given

Marek Belka, NBP President, obserwatorfinansowy.pl, 14.02
I did not say that pause is a given (…) It is a good moment to think over not only what to do at the March meeting, but also in longer perspective.

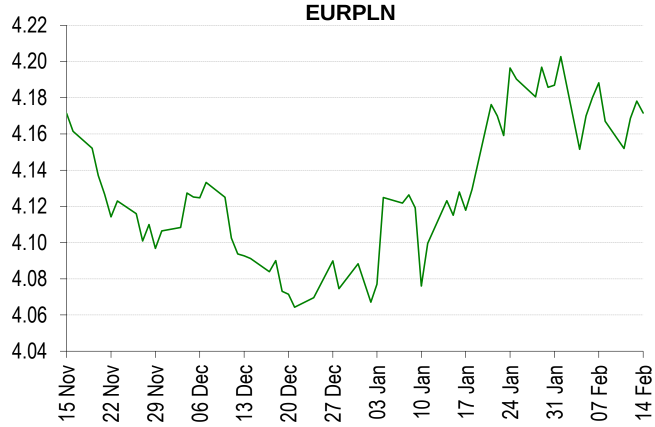
Elżbieta Chojna-Duch, MPC member, Reuters, 11.02
Council is late, but it is not a good idea to chase it, as circumstances have changed, now we focus on future. **(TVN CNBC, 15.02)** We should cut rates either once but deeper or continue gradual cuts to 3.00-3.25%.

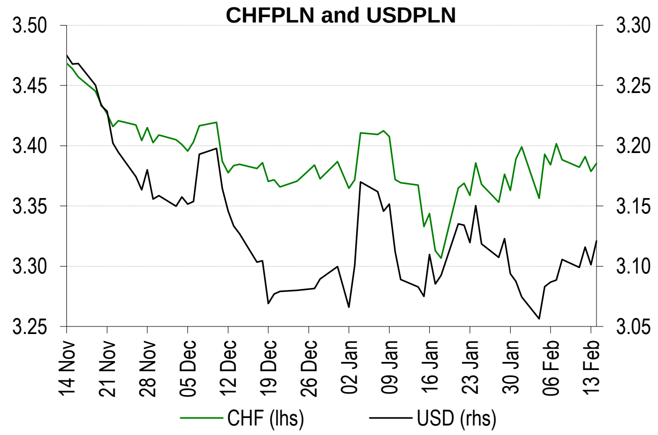
Anna Zielińska-Głębocka, MPC member, PAP, 15.02
I am supporting gradual interest cuts. They should be concentrated in time. I think that such a decision should be taken at March meeting, but we will see what will happen.

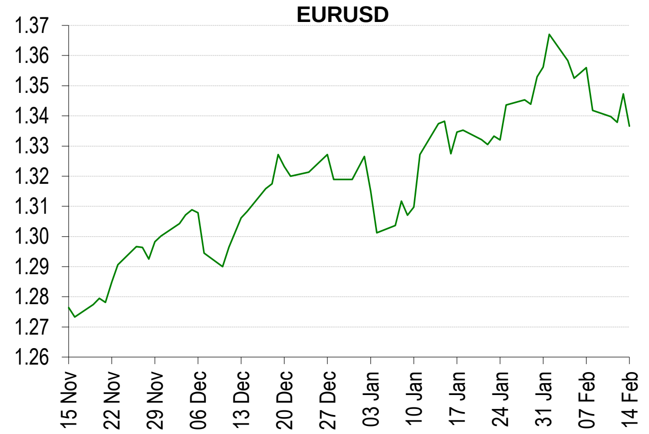
Adam Glapiński, MPC member, Bloomberg, 14.02
"Wait-and-see" mode should be announced in March.

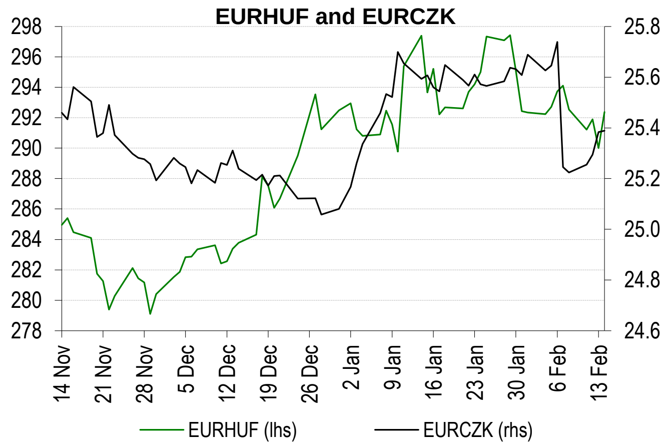
Court did not find Jan Winiecki guilty of libel, so he will not be forced to leave the MPC and balance of powers in the Council will not change in the upcoming months. As regards decision in March, we think that a motion for a 25bps cut will be supported by Belka, Bratkowski, Chojna-Duch and Zielińska-Głębocka. This means that one more vote is needed to build a majority for a cut, and this vacancy can be filled by Gilowska, Hausner or Kaźmierczak (in our view other members will be against). We know that some MPC members find current inflation figure crucial, so January's decline of CPI is supportive for a cut. At the start of the week Elżbieta Chojna-Duch admitted that Council is late with cuts, but should not be "chasing inflation" (and we interpreted this comment as a confirmation that she does not support cuts deeper than 25bps). Surprisingly, only a few days later, after lower-than-expected release of CPI, Chojna-Duch again supported a deep, one-off cut.

Foreign exchange market – Polish zloty under influence on data from real economy









Zloty has remained at elevated level

▪ The beginning of last week was relatively calm due to lack of important macro data. In following days volatility on the market had increased significantly. Zloty negatively reacted not only to higher than predicted December's C/A deficit (it amounted to €1.2bn), but also to deeper decrease in GDP in Q4 2012 in Germany and in the euro zone. Consequently, the EURPLN, after decline to 4.15, increased above 4.18 and stayed near this level till CPI inflation release. Higher than predicted drop in consumer prices (to 1.7%YoY from 2.4%YoY in previous month) caused the EURPLN growth above 4.19 in short run.

▪ The USDPLN was under influence on tendencies on the EURUSD. The EURUSD decline towards 1.33 after weaker than predicted GDP data for the European economy caused the USDPLN increase to 3.14, up from below 3.10. The Q4 2012 GDP data release also resulted in the zloty weakening in relation to other main currencies (CHF, GBP). Summing up, in weekly terms zloty lost 1.1% against the US dollar and 0.5% against the CHF. On the other hand zloty gained 0.6% in relation to GBP.

▪ Last week did not bring any significant changes on the EURPLN chart. The exchange rate remained in the channel between 4.14 and 4.21, oscillating near the upper limit of the range due to expectations on interest rates cut in March. We think that domestic data from real economy, which should confirm weakness of the economy at the start of the year (labour market, industrial output) might cause the EURPLN to test 4.20.

Data on Q4 2012 GDP hit the euro

▪ Since the beginning of the week the euro was gaining gradually due to, among others comment of Bundesbank governor (who rejected a possibility of interventions aiming at weakening of the euro) and decent results of peripheral debt auctions. Consequently, the EURUSD increased slightly above 1.35. Still, after the weaker than expected data on Q4 2012 GDP for the euro zone the exchange rate retreated back to ca. 1.33.

▪ During the past week also the SNB was in the spotlight. The governor of the Swiss National Bank said the floor for EURCHF will be maintained at 1.20 (established in September 2011). Still, he added that Swiss franc is overvalued and if there is such need, the central bank may take further action to reach its aim. After this comment the EURCHF surged above 1.23 and stayed there until the end of the week.

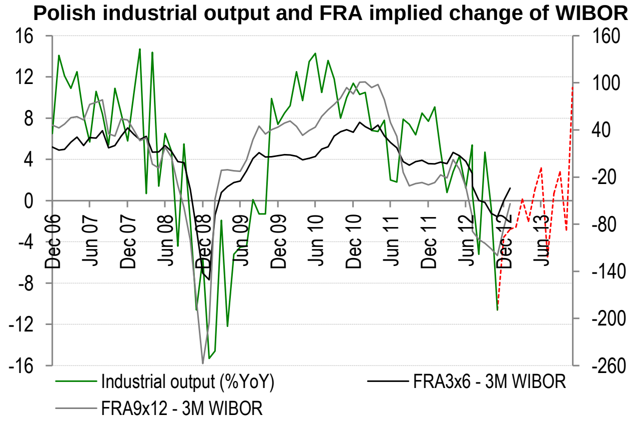
▪ The EURUSD stays in the range of 1.33-1.35. During this week the exchange rate may be under impact of data releases (flash PMI, ZEW). If data proves better than expected (just like a month ago) then the euro should gain and the EURUSD may head towards 1.35. Uncertainty regarding the outcome of Italian elections may constrain the potential for increase of the EURUSD.

... and CEE currencies

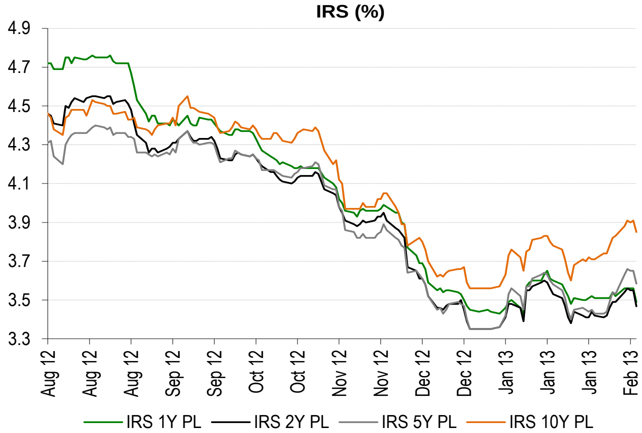
▪ Data on Q4 GDP for Czech Republic and Hungary were also weaker than expected and this hit currencies of those countries. EURHUF surged again above 292 while EURCZK reached over 25.4. The Czech koruna was under an additional pressure as minutes from February's meeting of the central bank showed that currency interventions are possible.

Interest rate market – Data and Italian elections in the spotlight

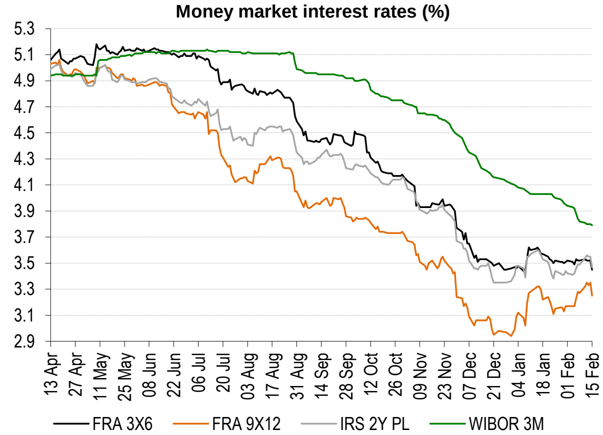
Polish industrial output and FRA implied change of WIBOR



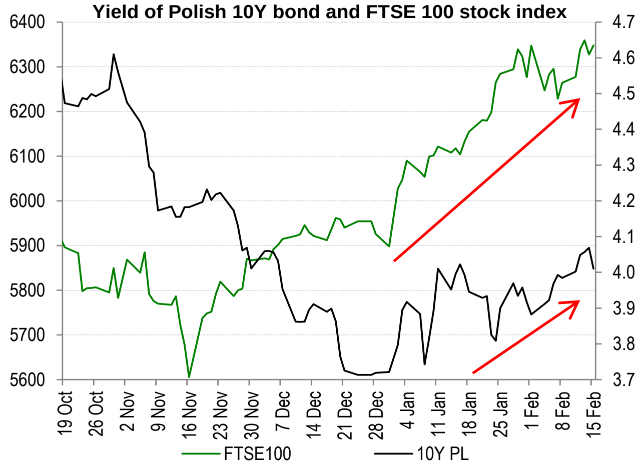
IRS (%)



Money market interest rates (%)



Yield of Polish 10Y bond and FTSE 100 stock index



3M WIBOR lowest in history

▪ WIBOR rate declined during the past week by 3-4bps. For two weeks since when we had suggested the room for further decline of FRA is limited (first chart shows our rationale) FRA3x6 remained stable around 3.5% (our target for main NBP rate) while FRA9x12 increased by 8bps (though before today's data on CPI this was already 18bps). We suggested also that money market rates will continue to decline and since then they dropped by 14-15bps. Consequently, 3M WIBOR reached all-time low at the end of the week at 3.79% (previous record at 3.80% was established in August 2010).

▪ We expect the downward trend of WIBOR to be continued while next domestic data may support the downward correction of FRA initiated by CPI data (though the room for decline of longer FRAs is limited).

High volatility on the bond market

▪ The comment of Elżbieta-Chojna Duch (saying that it makes no sense to chase falling inflation with interest rates) constrained market expectations for deep rate cuts and this (together with rising yields on the core market and weakening of the zloty) put negative pressure on domestic debt. Yield of 10Y bond reached temporarily 4.10% (highest level since November 2012). IRS curve also moved clearly up (6bps for 2Y, 12bps for 5Y and 8bps for 10Y). Still, it was only Friday's release of the CPI data that triggered complete switch of the situation and helped bonds to pare more than initial losses. IRS rate also declined by ca. 7-10bps.

▪ At auction the Ministry of Finance sold OK0715 bond for PLN3.9bn (amid demand at PLN6.9bn and yield at 3.456% - close to market level) and WZ0124 for PLN611.6m (amid demand at PLN1.97bn). This was already third auction this year when the Ministry collected cash below the upper band of planned supply, but results of the auction did not trigger any market reaction. It seems the Ministry reached its target of having covered 50% of 2013 borrowing needs in February. This may constrain the supply and this should support bonds.

Data and Italian elections in the spotlight

▪ In coming days vital domestic and foreign data will be released. We expect deeper than market consensus contraction of January's industrial output. This publication, together with last CPI data may drag yields of bonds and IRS further down. Still, the room for decline is limited by MPC's rhetoric on possible pause in monetary easing cycle in March.

▪ Data from biggest European economy are likely to have biggest impact on 5Y and 10Y bonds and IRS. Since establishing record low levels in late 2012, the yields of long term bonds were rising amid higher stock prices and weakening of Bunds. This tendency was fuelled by, among others, data on ZEW, Ifo and flash PMI released in late January. If this week the same set of data also surprises to the upside, then weakening of German bonds may hit Polish long-term debt. Still, we do not expect much increase of yields of domestic bonds. Data from Poland will support expectations will support expectations for rate cuts and uncertainty regarding the outcome of Italian elections will constrain the potential for weakening of German debt.

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