Bank Zachodni WBK

Weekly economic update

11 – 17 March 2013

Last week the central banks' meetings were the most important events on the financial market. In line with expectations, Bank of Japan, ECB and Bank of England kept rates on hold, while Polish Monetary Policy Council took the markets by surprise cutting the main interest rates by 50 basis points, bringing the reference rate to 3.25% (the lowest level in history). Official statement reads that this move has complemented the easing cycle started in November 2012. During the press conference governor Marek Belka said that the Council adopted "wait and see" mode. A possible continuation of easing cycle was signalled as likely only provided that medium-term scenario for Polish economy deteriorates considerably. In our view this condition will not be fulfilled, which means that the MPC's easing cycle is over. First market's reaction to the decision was significant, the zloty weakened to ca. 4.165 per euro, while short end of yield curve gained (with rates falling by ca. 10bps on average). Adjustment to new monetary environment was also visible on the WIBOR curve, which returned to upward slope and steepened. Decline of market rates continued also in the following days, but its scale was not that considerable. At the end of the week, among others due to data from the USA, the zloty pared almost all losses against the euro suffered after the MPC meeting.

At the start of the new week the investors will focus on release of new "Inflation Report", which will shows details of the fresh CPI and GDP projections until 2015. However, release of the CPI data may be the most important event on the domestic financial market. We will see inflation figures for January and February, recalculated according to new weights. We are expecting that the annual pace of growth of consumer prices will approach the lower end of tolerance band against the NBP target and will show 1.6%. Inflation data will also be released in the euro zone and in the USA. Domestic financial market will be still under influence of MPC decision, while inflation figures should underpin the short end of bond and IRS curves and gradual decline of WIBORs. The zloty will probably stay under pressure, while EURPLN exchange rate will be oscillating in wide range 4.12-4.17.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 March)					
8:00	DE	Exports	Jan	%MoM	0.5	-	0.3
9:00	**PL**	**Publication of „Inflation report – March 2013"**					
		TUESDAY (12 March)					
		No important data releases					
		WEDNESDAY (13 March)					
11:00	EZ	Industrial output	Jan	%MoM	-0.1	-	0.7
13:30	US	Retail sales ex autos	Feb	%MoM	0.6	-	0.2
		THURSDAY (14 March)					
13:30	US	Initial jobless claims	week	k	350	-	340
14:00	**PL**	**CPI**	**Feb**	**%YoY**	**1.5**	**1.6**	**1.7**
14:00	**PL**	**Money supply**	**Feb**	**%YoY**	**5.0**	**5.4**	**4.5**
14:00	**PL**	**Current account**	**Jan**	**€m**	**-1 547**	**-1 693**	**-1 204**
14:00	**PL**	**Exports**	**Jan**	**€m**	**11 999**	**12 237**	**10 640**
14:00	**PL**	**Imports**	**Jan**	**€m**	**12 475**	**12 633**	**11 852**
		FRIDAY (15 March)					
11:00	EZ	HICP	Feb	%YoY	1.8	-	1.8
13:30	US	Core CPI	Feb	%	0.1	-	0.3
14:15	US	Industrial output	Feb	%MoM	0.4	-	-0.1
14:15	US	Capacity utilization rate	Feb	%	79.3	-	79.1
14:55	US	Flash Michigan	Mar	pts	77.4	-	77.6

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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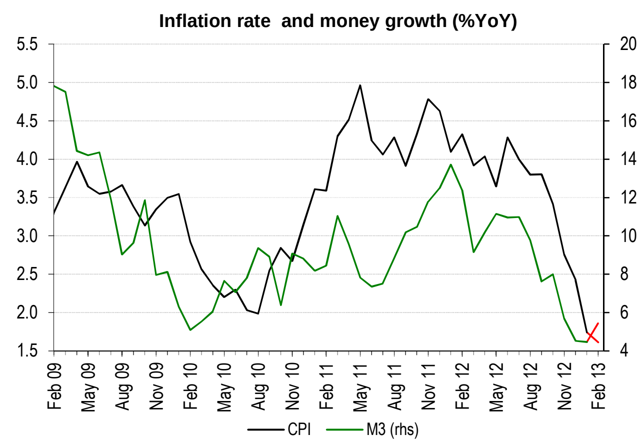
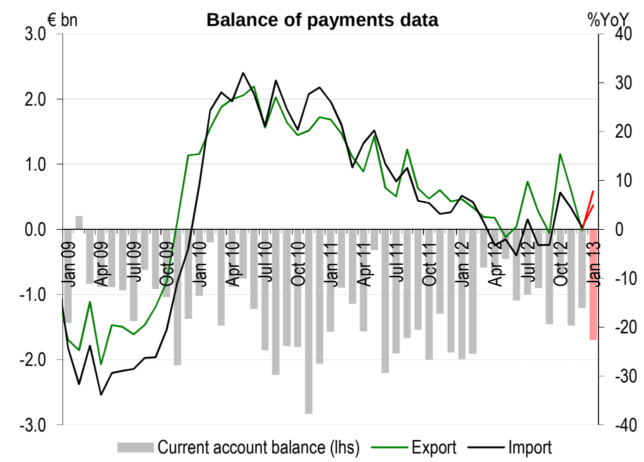
What's hot this week – NBP projection and series of monthly data



▪ Start of the week will be light as regards macro releases, both in Poland and abroad. That is why the market's focus will shift to new NBP projection, which encouraged the MPC to a surprisingly deep interest rate cut.

▪ Still, data on CPI inflation will be the most important domestic event this week. We are expecting further decline in February, but not as strong as in January – from 1.7% to 1.6%YoY – which was among others due to hike of fuel prices. Market expectations sit slightly lower (1.5%). We are predicting further fall of inflation in the upcoming months, to almost 1% in Q2.

▪ The impact of annual reweighting of CPI basket on the inflation figures in the nearest months should not be large (we are estimating that this revision may raise the headline inflation by ca. 0.02 percentage points).



▪ We are expecting a rebound in growth rates of exports and imports in January, to 7.8%YoY and 4.9%YoY, respectively, accompanied by narrower trade deficit but higher current account deficit (mainly due to weaker inflow of funds from the European Union). Our predictions are close to market consensus.

▪ In our view tendencies drawn in January (rebound in exports and imports, lower trade deficit) will be valid for the whole 2013, which will help the foreign trade to remain the engine of economic growth in Poland.

▪ Data on M3 money supply will show a continuation of tendencies observed in the previous months, i.e. paltry growth of deposits and loans. Loan market may be supported in the upcoming months by lower level of interest rates and easing of Recommendation T.

Last week in the economy – This is the end

NBP projections in subsequent *Inflation Reports*

	GDP growth			
	Mar 12	**Jul 12**	**Nov 12**	**Mar 13**
2013	1.1-3.5	1.0-3.2	0.5-2.5	0.6-2.0
2014	1.9-4.4	1.7-4.2	1.1-3.5	1.4-3.7
2015	x	x	x	1.9-4.4
	CPI inflation			
	Mar 12	**Jul 12**	**Nov 12**	**Mar 13**
2013	2.2-3.6	2.0-3.4	1.8-3.1	1.3-1.9
2014	1.2-3.0	1.0-2.7	0.7-2.4	0.8-2.4
2015	x	x	x	0.7-2.4

▪ The Monetary Policy Council surprised market players, cutting main interest rates by 50bps, bringing the NBP reference rate to 3.25%, the lowest level in history.

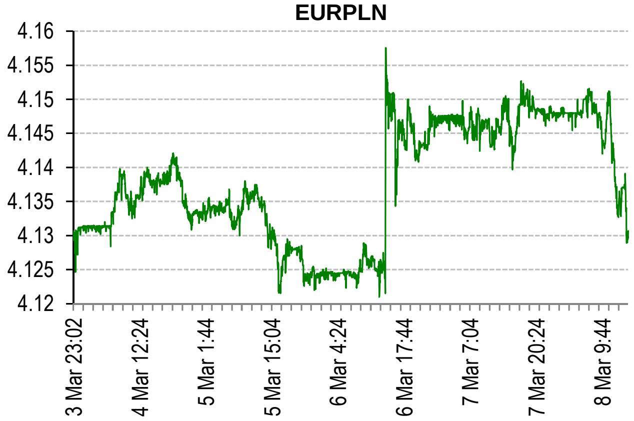
▪ The statement clearly suggests the termination of rate cuts. Also during the press conference NBP governor Marek Belka confirmed that by cutting the rates by 50bps the Council wanted to end the easing cycle, while the new projection justified such an approach and made room for safe reduction of rates more significant scale than before. Inflation is predicted to run below the official target in the medium term and a gradual pick-up in economic activity poses no risk to price developments. We are expecting rates to remain on hold at least until the year-end. Cuts are possible only provided that economic growth turns out to be considerably lower than shown in the projection.

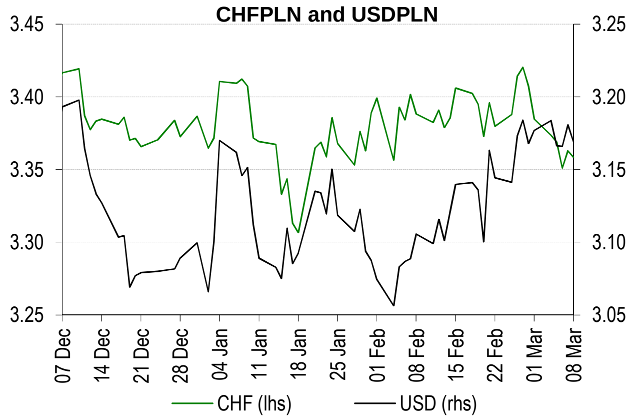
Quote of the week – Full stop to the easing cycle

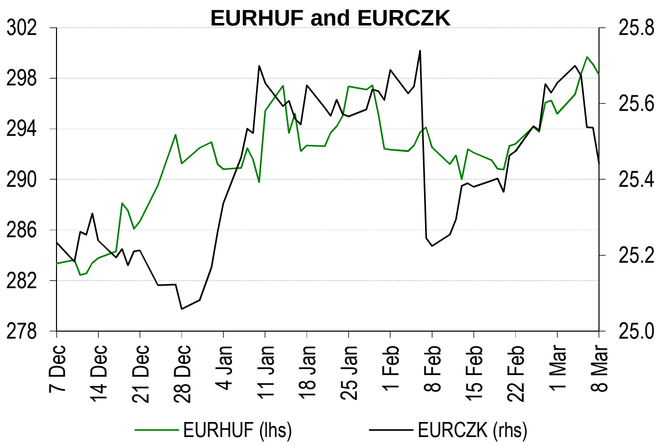
Marek Belka, NBP president, MPC press conference, 06.03
We have been given a projection, which showed that there is a room to reduce interest rates safely. We wanted this reduction to be condensed in time. Council decided that such a one-off cut by 50bps is an appropriate answer to projection and to our willingness to finish this round of cuts (…) today we stress that the cycle was complemented, so treat this as a full stop to the easing cycle (…) We do not definitely shut the door (for rate cuts) but it seems that such a move demands economic scenario diverging strongly from the projection we presented today.

After numerous months of observation of MPC actions one cannot be sure of anything (apart from the fact that it is surely not boring). Still, we think that this time, after such a strong declaration of concluding the monetary policy easing cycle, it is hard to imagine that another rate cut will be implemented in the upcoming months. This can be the case only under scenario diverging strongly from current expectations (of the Council). And we do not mean upcoming inflation reading (CPI may fall even below 1%), but rather prospects of economic recovery. If it turns out that it is not arriving or is much slower than expected, than the Council may implement more easing. But this is not our baseline scenario for the time being.

Foreign exchange market – Little room for stronger zloty







Sudden weakening of the zloty after MPC decision…

▪ Global data releases had positive impact on the zloty since beginning of the week and pushed the EURPLN below support indicated by us (4.14). The domestic currency gained temporarily to 4.12 per euro, but it was the Wednesday's decision of the MPC that had biggest impact on the zloty. We expected the rate cut may hit the domestic currency and the surprising decision of the MPC triggered considerable surge of the EURPLN. After the statement that suggested the end of the easing cycle, the exchange rate declined from 4.164 to 4.14. Despite higher volatility – also in case of the USDPLN – no breaking changes occurred on the Polish FX market.

▪ The MPC pointed quite clearly that March move was the end of the easing cycle and this continued to support the zloty in the following days. Consequently, the domestic currency pared nearly all losses suffered versus the euro after the decision of the MPC. This was also largely due to expectations for good data from the US labour market.

▪ Our forecast of February's CPI is slightly above consensus but the risk related to release is bigger than usually due to the annual change of weights in inflation index.

▪ The EURPLN remains close to support area at 4.114-4.12. However, we expect more data from Poland supporting the rate cut expectations (MPC left door open for this option) and this may prevent zloty from gaining further. Just like in recent months, the EURPLN may not be too sensitive to global events.

… and euro appreciation after the ECB meeting

▪ The decision and press conference of the ECB had large impact on EURUSD. Only slight downward revision of the GDP forecasts for the euro zone and lack of clear suggestion on possible rate cut in the nearest future backed the euro versus the dollar. EURUSD climbed temporarily just above 1.31, highest since late February. Additionally, the single currency was supported by successful Spanish bond auction. At the end of the week deep plunge to 1.295 was recorded after much better than expected US payrolls numbers. The release supported worries that Fed will limit or terminate QE3 this year. However, stock exchanges surged after the data. If optimism persists on the market, then the euro may stop loosing vs. the dollar and positive correlation between the EURUSD and level of optimism may return on the market.

▪ Interestingly, daily increase of the EURUSD in late Thursday (on the day of the ECB meeting) was highest since January 10th 2013. On the latter day the euro was also supported by lack of ECB rate cut and successful Spanish debt auction.

▪ Vital levels for this week are 1.295 and 1.31. The room for higher EURUSD will be limited by US payrolls data. Next support is at 1.29.

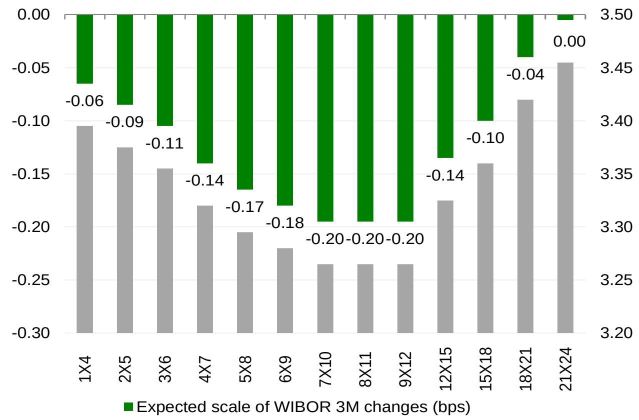
Forint weakest since October 2012

▪ During the past week EURHUF and EURCZK followed the opposite directions. Forint lost versus the euro amid uncertainty persisting on the market on the direction of the monetary policy under new central bank governor. Investors were worried that former economy minister will conduct lax monetary policy to support the economy. The EURHUF broke the level of 300 for the first time since October 2012.

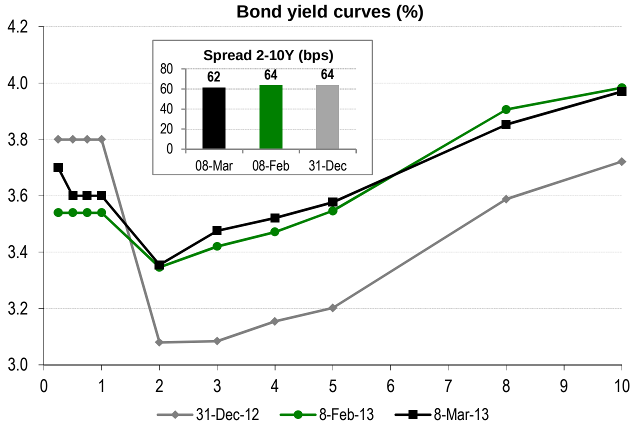
▪ The Czech koruna gained slightly more than 1% versus the euro due to quite good market sentiment persisting on the global market.

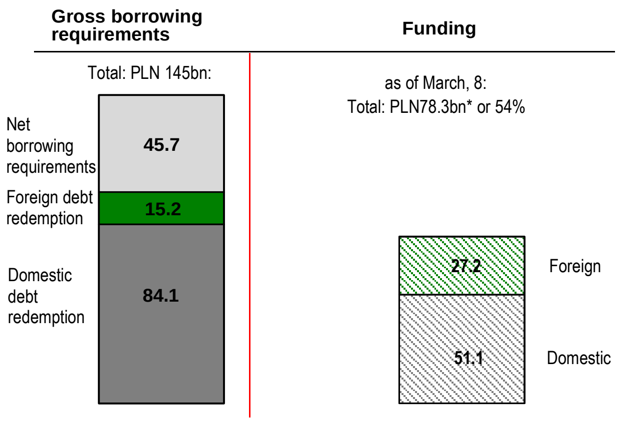
Interest rate market – The March's decision and upcoming macro data are still crucial for market

Expected changes in WIBOR 3M rate
(date on March, 8 2013)

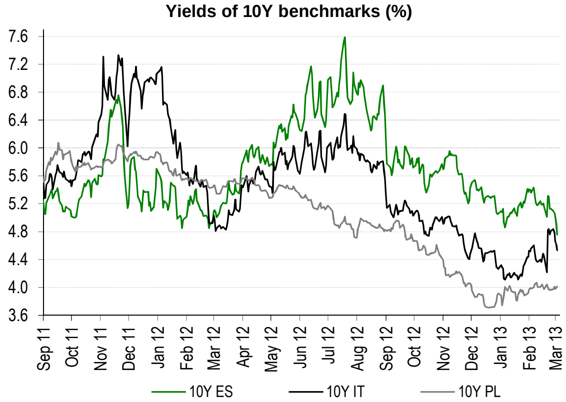


Bond yield curves (%)





Yields of 10Y benchmarks (%)



WIBOR curve changed shape after the MPC's decision

▪ Last week the most important event for the market players was the MPC meeting. The Council surprised the market, delivering interest rate cut by 50bps (some investors had expected the MPC to keep rates unchanged). Consequently, after the decision announcement FRA 1x4 and 3x6 declined significantly by 29bps and 22bps respectively, while rates for longer terms fell by 8-13bps. FRA contracts have continued decline till week-end, however, the scope of change was much smaller.

▪ Situation on WIBOR market has changed significantly, but adjustment to new environment took place one day later. WIBOR 1M and 3M fell sharply, which resulted in returning to positive slope of the curve. While at the beginning of March and even before the MPC's meeting WIBOR 6M was 7bps below 3M rate, now it is 3bps higher than 3M. It shows market expectations that the easing cycle has just finished.

▪ Deeper than we expected rate reduction caused that we revised downward our forecasts of WIBOR rates in upcoming months. We expect that WIBOR 3M may move towards 3.40% by the end of March, and reach 3.49% on average this month.

MPC's decision supportive for short end of the curve…

▪ Investors' mood was nervous ahead of the MPC's rate decision, especially that some investors started doubting the Council will cut rates this time due to better than expected reading of macro data. As a consequence before the decision yield of 2Y increased above 3.50%, while 2Y IRS grew towards 3.60%. The Council's decision caused significant decline in yields/rates on the front end of curves (by 10bps on average), while scope of changes on mid and long end of the curve was much lower. Consequently, yield curves (both bonds and IRS) become steeper. Additional factor, which limited strengthening on the long-end of the curve, was situation on core markets (yields of safe haven assets increased after the ECB's meeting and better than expected macro data in the US.

▪ The switch tender attracted strong demand, which concentrated mainly on floating rate paper WZ0124. The Ministry sold WZ0124 worth PLN2.3bn, which accounted for nearly 50% of total sale. Auction results were very good for the Ministry, after the tender this year's borrowing requirements are completed in 54%.

… similarly as the upcoming data

▪ This week we will see further releases of domestic macro data, with CPI inflation for February as the most important one. In our view consumer price growth decelerated again and it may run only slightly above the lower border of tolerance band around the NBP target. These data, together with figures from the real economy, due for release at the beginning of the next week (showing weakness of industrial sector) should be supportive for the short end of the curve

▪ Situation on the middle and the longer end of the bond curve will be dependent on core market sentiment. Continuation of rise of German bond yields will be putting a negative pressure on domestic 10Y paper. First support for 10Y benchmark is at 3.95%, resistance at 4.05%.

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