Bank Zachodni WBK

Weekly economic update

18 – 24 March 2013

New, better than expected data from the USA and hopes for an enhanced monetary stimulus from Bank of England and Bank of Japan caused that US stock market indexes reached record high levels. Still, Polish market was mostly affected by domestic and regional events. The lower-than-expected inflation in February weakened the zloty in relation to the euro and pushed 2Y IRS to the all-time low (bonds also gained). Pressure on the zloty was also put by weakening forint. EURHUF climbed to the highest level since beginning of 2012 due to worries about too loose monetary policy of the new governor of Hungarian central bank.

Investors' attention will focus this week on the releases of numerous important data showing tendencies in the European and US economies. One month ago the manufacturing PMI showed some deceleration of activity growth in this sector, while ZEW and Ifo continued marked growths. Picture drawn by the indexes for March will be important for the markets. Recently a bunch of better-than-expected macro data was released in the US (including labour market figures or ISM index for manufacturing), which caused that ending/limiting the QE3 became more probable in investors' view. Thus, the communiqué from the FOMC meeting and central bankers' assessment of recent data will be crucial. Picture of the current economic situation will be supplemented by new GDP, inflation and unemployment rate forecasts, as well as by timing of interest rate hikes preferred by the members. Important data will be also released in Poland, with the industrial output probably in the fore (our forecast is below market expectations). This figure can trigger further decline of IRS and undermine the zloty. Even though the market can be pricing-in chances for NBP interest rate cut more aggressively, in our view cuts are possible only provided that lower inflation is accompanied by path of economic growth weaker than outlined in the last NBP projection. And we do not expect such a scenario for the time being.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 March)					
14:00	**PL**	**Wages in corporate sector**	**Feb**	**%YoY**	**2.7**	**3.4**	**0.4**
14:00	**PL**	**Employment in corporate sector**	**Feb**	**%YoY**	**-0.9**	**-0.8**	**-0.8**
14:00	**PL**	**Core inflation**	**Feb**	**%YoY**	**1.4**	**1.2***	**1.4**
		TUESDAY (19 March)					
11:00	DE	ZEW index	Mar	pts	47.5	-	48.2
13:30	US	House starts	Feb	k	920	-	890
13:30	US	Building permits	Feb	k	928	-	925
14:00	**PL**	**Industrial output**	**Feb**	**%YoY**	**-1.4**	**-3.3**	**0.3**
14:00	**PL**	**Construction and assembly output**	**Feb**	**%YoY**	**-9.8**	**-5.8**	**-16.1**
14:00	**PL**	**PPI**	**Feb**	**%YoY**	**-0.5**	**-0.4**	**-1.2**
		WEDNESDAY (20 March)					
11:00	**PL**	**Bond auction**					
19:00	US	Fed decision		%	0.0-0.25	-	0.0-0.25
		THURSDAY (21 March)					
2:45	CN	Flash PMI – manufacturing	Mar	pts	50.9	-	50.4
9:28	DE	Flash PMI – manufacturing	Mar	pts	50.5	-	50.3
9:58	EZ	Flash PMI – manufacturing	Mar	pts	48.2	-	47.9
13:30	US	Initial jobless claims	week	k	341	-	332
14:00	**PL**	**MPC minutes**					
15:00	US	Home sales	Feb	m	5.0	-	4.92
15:00	US	Philly Fed index	Mar	pts	-2.0	-	-12.5
		FRIDAY (22 March)					
10:00	**PL**	**Retail sales**	**Feb**	**%YoY**	**0.6**	**1.0**	**3.1**
10:00	**PL**	**Unemployment rate**	**Feb**	**%**	**14.5**	**14.5**	**14.2**
10:00	DE	Ifo index	Mar	pts	107.7	-	107.4

Source: BZ WBK, Bloomberg, Reuters, Parkiet * estimate after CPI data

Maciej Reluga Chief economist +48 22 586 8363 e-mail: ekonomia@bzwbk.pl

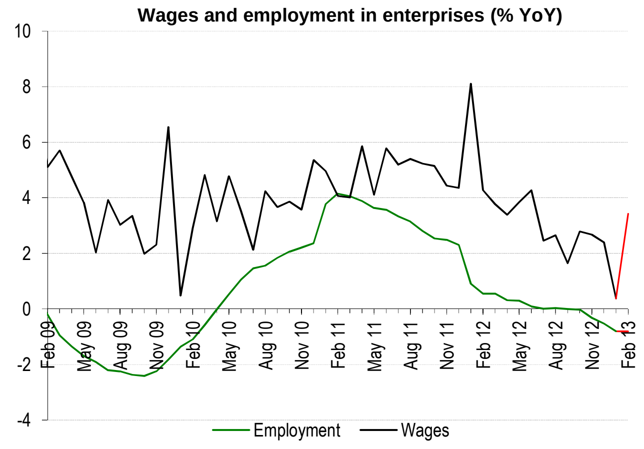
Piotr Bielski +48 22 586 8333

Agnieszka Decewicz +48 22 586 8341

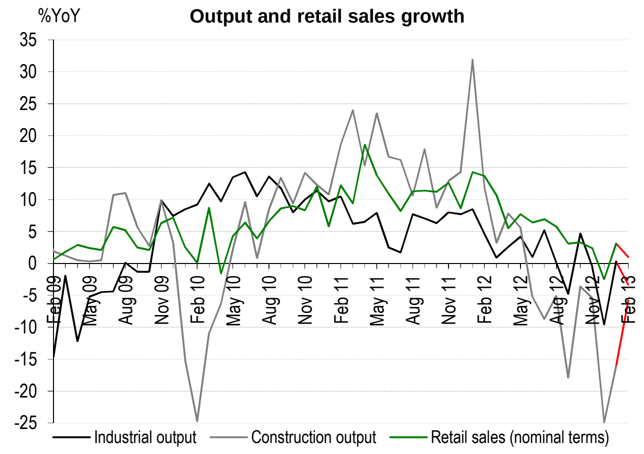
Marcin Sulewski +48 22 586 8342

Marcin Luziński +48 22 586 8362

What's hot this week – Labour market and output weaken, lack of inflationary pressure

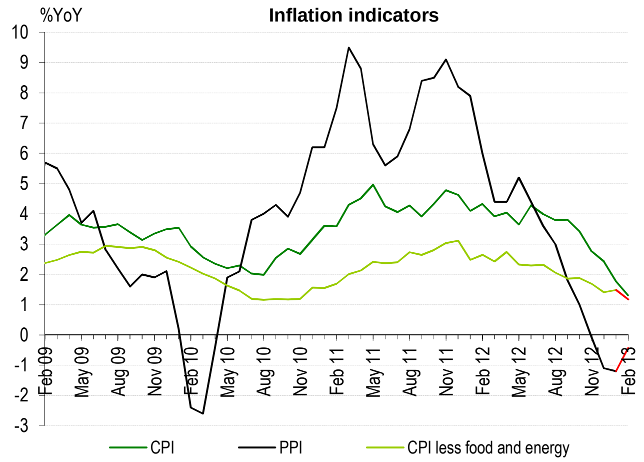


- We are expecting a rebound in wage growth to 3.4%YoY in February from 0.4% in January. This will be again a temporary distortion of trend, due to the fact that one year ago some components of salaries were paid earlier due to hike of disability contribution since February. This caused an effect of high base in January and low base in February. We are expecting that in the upcoming months wage growth will return to trend at ca. 2%YoY.
- Number of workplaces in enterprise sector probably declined in monthly terms again, so annual employment growth remained at level similar to this recorded in January. Signals of rising demand for labour will appear in H2 at the earliest.
- In our view registered unemployment rate climbed to 14.4% in February from 14.2% in January. This forecast is line with predictions of Ministry for Labour and Social Policy.



- After rebound of industrial output in January, due to higher number of working days, we will see a contraction again in February.
- We are also anticipating a deceleration of retail sales growth, after one-off jump in January due to, among others, delayed payment of farmers' subsidies.
- Only in construction the pace of output contraction may decrease, mainly due to low base effect (severe weather conditions one year ago).
- In general, the data will not confirm a considerable revival in Q1, which can amplify market's speculation about further rate cuts this year.
- We estimate PPI in February at -0.4%YoY, core inflation in January at 1.5%YoY and in February at 1.2%YoY. Figures will confirm lack of inflationary pressure.

Last week in the economy – Inflation lowest for six years



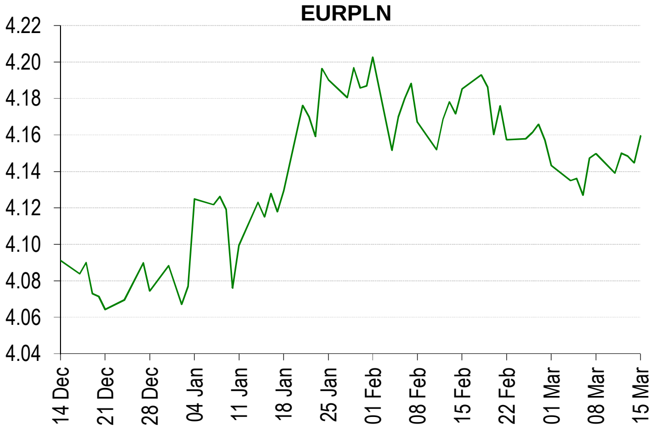
- Inflation plunged from 1.7%YoY in January to 1.3%YoY in February, the lowest level for over six years, being below expectations again. The revision of weights in CPI basket was only marginal and pushed inflation rate only slightly up (by ca. 0.02pp). We predict further decline of CPI inflation in the upcoming months, even below 1%YoY. This means that scenario of inflation path lower than the one expected in the NBP projections begins to materialize.
- Balance of payments data confirmed the expected rebound in exports in January, while imports proved lower than predicted. Improvement of trade balance will be the main driver of economic growth this year.
- In February M3 money supply rose by 5.6%YoY. Deposits and credits growth accelerated slightly in February (by 5.2%YoY and 3.8%YoY, respectively), as regards both households and enterprises.

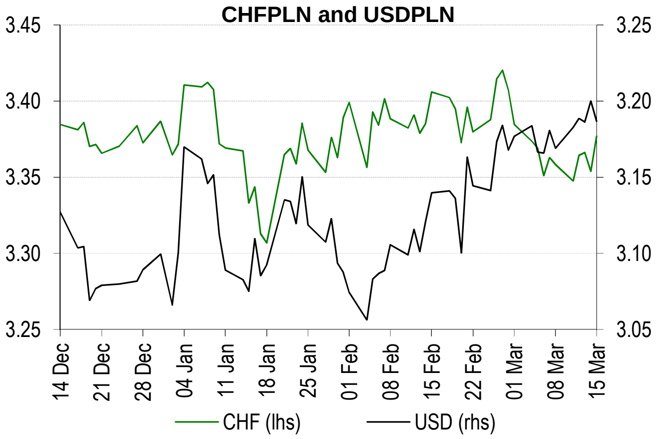
Quote of the week – We will see what is going to happen in the economy

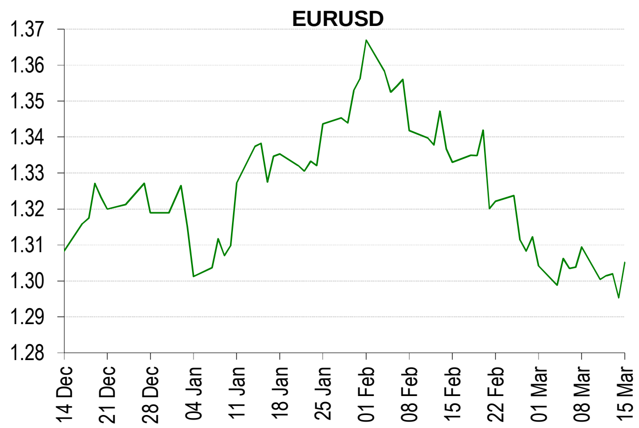
Zyta Gilowska, MPC member, Reuters, 11.03
No change in NBP interest rates in the upcoming months is a highly probable scenario.
Marek Belka, NBP president, Reuters, 12.03
I would not like to elaborate on further cuts today. This is not the right moment. We will see what is going to happen in the economy.
Elżbieta Chojna-Duch, MPC member, Reuters, 14.03
We should wait for the upcoming data to assess the persistence of the downward inflation tendency.
Anna Zielińska-Głębocka, MPC member, TVN CNBC, 14.03
As for the time being, I think that 3.25% is a level allowing for short-term "wait and see" mode.

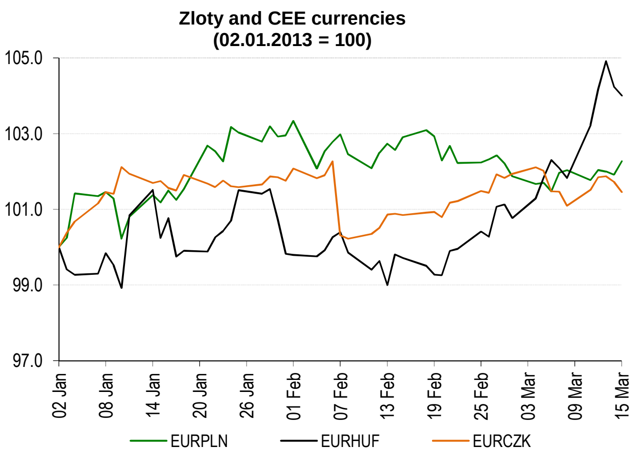
Comments of the MPC members are suggesting that NBP interest rates will remain on hold in the nearest months. Council wants to take a look at the economic situation before it makes further decisions. This means a pause at least until June (when GDP data for Q1 will be released) or until July (new NBP projection). The Council suggested that room for further cuts may appear, should the economic reality diverge strongly from the scenario outlined in the projection. Inflation path may actually be below the one expected by the NBP, but probably only temporarily, in nearest months. Additionally, in our view the situation in real economy will be more important, and we do not expect significant divergence in this case – we think that signals of GDP acceleration after bottoming-out in Q1 will begin to appear. If Council does not cut rates until July, then it is unlikely to do it in H2 as well.

Foreign exchange market – Domestic macro data put pressure on the zloty









Zloty weakened due to inflation data

▪ Last week the most important event on FX market was publication of February's CPI. Till Wednesday's reading the EURPLN was relatively stable, fluctuating between 4.12 and 4.15. As a consequence of lower than expected February's CPI figure the EURPLN temporary increased to 4.157.

▪ The USDPLN has remained more vulnerable to global investors' mood. The exchange rate climbed to 3.20 due to the EURUSD decline after better than expected data from the US. Additionally, domestic data about inflation rate caused the USDPLN increase above 3.21 (the highest level since the end of November 2012). However, it was only short-lived move and the rate ended the week below 3.18.

▪ This week's macroeconomic calendar is quite heavy. We think that the most important will be industrial output data. Our forecast is one of the most pessimistic on the market (we expect industrial production to fall by more than 3%YoY) and materialisation of our scenario might negatively affect the zloty. However, the consolidation channel between 4.12 and 4.18 is still valid.

The EURUSD has returned to 1.30 like a boomerang

▪ Better than expected macro data from the US suggest that condition of the US economy is improving faster than the European's one. As a consequence, the EURUSD declined towards 1.29 (last week's minimum was at 1.291), below the bottom level of consolidation channel at ca 1.296. However, it was only short-lived move and during Friday's session the rate has returned to 1.30 before the US data releases in the US. Positive auction results of peripherals debt also support the euro.

▪ Horizontal trend of the EURUSD between 1.296 and 1.316 is still valid. This week investors focus on important macro data from both the euro zone and the US (PMI indices for the euro zone, but also ZEW and Ifo for Germany), which might bring impulse for the EURUSD quotations. The most important could be Fed's meeting. Market players expect the FOMC to keep rates unchanged, but rhetoric of the statement (taking into account that some investors are expecting Fed to exit QE3 this year) might suggest trend for coming days/weeks.

▪ As expected, central bank of Switzerland left interest rates unchanged and once again confirmed its policy related to the CHF (keeping the EURCHF at 1.20). The EURCHF gained slightly, rising to 1.2370, but it was only short-lived.

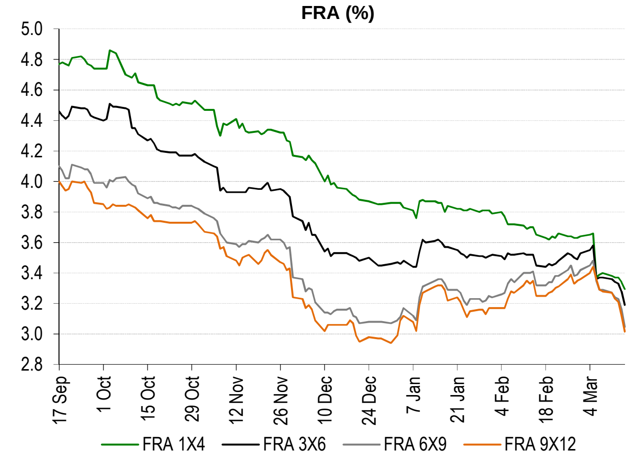
High pressure on the HUF weakening

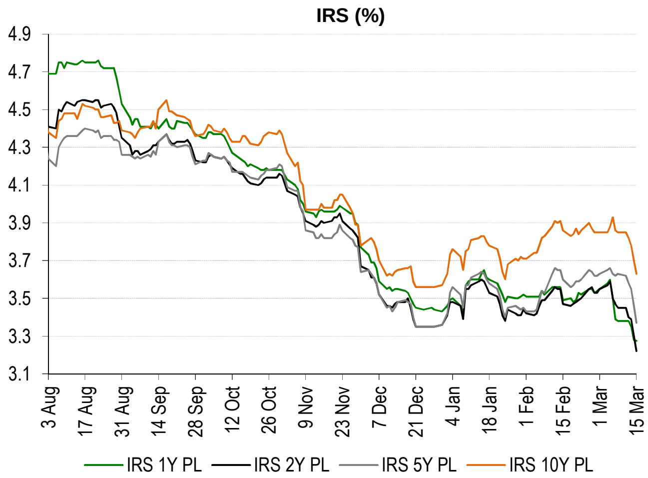
▪ Last week on the EURCZK market was relatively stable. The rate slightly fell to 25.5 due to better than predicted retail sales data. However, the Czech koruna strengthening was only temporary and at the end of the week the EURCZK returned to around 25.6.

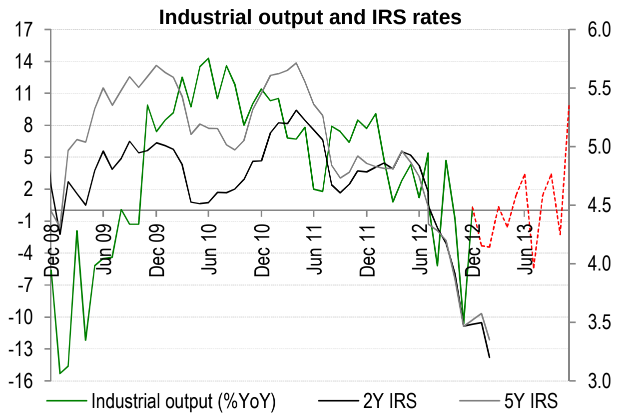
▪ Expectations on further monetary easing by the NBH, which significantly strengthened after February's CPI reading (CPI declined to 2.8%YoY, down from 3.7%YoY in January) and the government actions (in which plans to curb foreign banks' presence in Hungary) are the main factors of the HUF weakening. Consequently, the EURHUF increased above 307, the highest level since the beginning of January 2012.

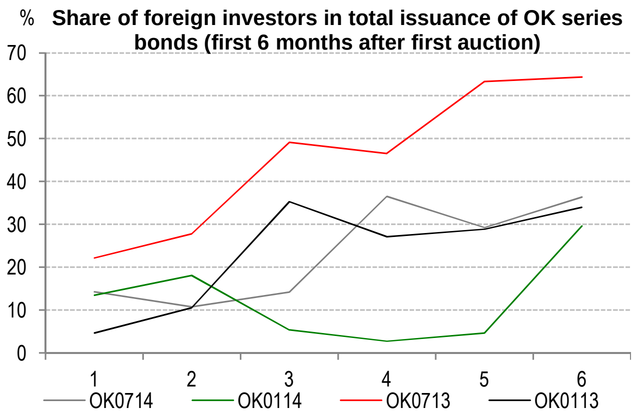
▪ The Hungarian currency has stayed the weakest among CEE (see chart). Pressure on HUF weakening might last in coming weeks, however, at the end of this week we noted some correction. Important support is between 300 and 302.

Interest rate market – Data on industrial output may drag yields further down









Low inflation shakes the interest rate market

- The release of lower than expected data on inflation had biggest impact on the domestic interest rate market during the past week.
- WIBOR rates from 1M to 12M after visible adjustment triggered by 50bps NBP rate cut in the following days were falling at pace seen before the MPC decision when the suggestions of nearing pause played first role. After inflation data WIBOR plunged in one day even by 5-6bps for 6-12M rates compared to 1bps declines (or stabilization) earlier in the week.
- FRA continued the downward trend initiated after MPC decision, daily pace of changes was quite visible – 3x6 plunged by 18bps while 6x9 by 25bps during the past week – main part of this move occurred after the CPI data. In our opinion in February the industrial output contracted slightly more than market expects and amid rhetoric of the MPC (suggesting room for more rate cuts) and inflation data this release may fuel the downward trend of FRA this week.
- Lower than expected inflation dragged the 2Y IRS to lowest level in history (to ca. 3.22% after a plunge by over 20bps on weekly basis). 5Y and 10Y IRS declined at similar scale – the former also reached all-time-low (3.37%, 3bps below record low level established in December 2012) and the latter is only 3bps above record low from late 2012.
- Clear plunge of yields was also recorded on the bond market and also after the CPI data. The middle-term bonds gained most (26bps versus 16bps for 2Y and 17bps for 10Y debt).

This week output may generate shock the market

- Upcoming week on the interest rate market is likely to be very interesting. Our forecast of the industrial output is below market expectations and may drag yields of IRS and bonds further down. The scale of move of IRS may be comparable to reaction to CPI data while the room for strengthening of short end of the bond curve may be limited by the outlook of debt supply.
- However, we assume the room for considerable decline of IRS in coming months will be limited. Inflation is likely to continue its fast downward trend, but publication of more and more signals of improvement in economy may be more important for the MPC and thus may weaken expectations for next rate cuts as the time goes by.
- On Wednesday the Ministry of Finance will carry last auction in 1Q at which bonds OK0714/PS0418/WZ0117 will be offered. Data of the Ministry show that at the end of January foreign investors held only 9% and 7% of total issuance of new 2Y and 5Y benchmarks, respectively. Last time so low starting holdings by foreign investors of 2Y debt after first issuance was recorded in October 2010 for OK0113. In the following months investors increased their holdings quickly despite strong acceleration of inflation. The demand at Wednesday's auction may be supported by data on industrial output, that will strengthen expectations for more rate cuts by the MPC.
- Short and middle term bonds are likely to be mainly under the impact of data and auction results, 10Y bonds will follow the developments on the core market. Numerous vital data publications on economic activity and the Fed's assessment of situation in the US may trigger higher volatility on the market.

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