Bank Zachodni WBK

Bi-Weekly economic update

29 April – 12 May 2013

April's business climate indicators for the euro zone disappointed again, reinforcing uncertainty concerning the timing and scale of economic recovery. At the same time, they strengthened expectations that the ECB may decide to cut main interest rate and apply other non-standard measures already at the nearest meeting. Domestic data about higher-than-expected fiscal deficit and lower GDP growth in 2012 did not trigger a significant market reaction, neither did the data on retail sales and unemployment for March, which were in line with forecasts. However, the scale of interest rate reductions priced-in by the market has increased, which was additionally triggered by dovish comment of MPC's Jerzy Hausner.

The upcoming week will be a period of lower market activity due to May holiday break. However, there are quite numerous macro releases and central bank meetings (Fed, ECB) scheduled for this week, which may bring elevated volatility, especially if results prove divergent from expectations. In the following week, when important data are less numerous, the MPC meeting will be the key event. The Council may consider a rate cut again, but we think that it will not gather majority this month, though a probability of cut in the upcoming months has increased.

Our next weekly economic update will be released on May 10th.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (29 April)					
14:30	US	Personal income	Mar	%MoM	0.4	-	1.1
14:30	US	Consumer spending	Mar	%MoM	0.1	-	0.7
14:30	US	Pending home sales	Mar	%MoM	1.0	-	-0.4
		TUESDAY (30 April)					
3:45	CN	PMI – manufacturing	Apr	pts	-	-	51.6
11:00	EZ	Flash HICP	Apr	%YoY	1.6	-	1.7
15:00	US	S&P/Case-Shiller home price index	Feb	%MoM	0.8	-	1.0
16:00	US	Consumer confidence	Apr	pts	59.8	-	59.7
		WEDNESDAY (1 May)					
	PL, GB, DE	**Market holiday**					
14:15	US	ADP report	Apr	k	150	-	158
16:00	US	ISM – manufacturing	Apr	pts	51.0	-	51.3
20:00	US	Fed decision		%	0.0-0.25	-	0.0-0.25
		THURSDAY (2 May)					
9:00	**PL**	**PMI – manufacturing**	**Apr**	**pts**	**48.0**		**48.0**
9:53	DE	PMI – manufacturing	Apr	pts	47.9	-	49.0
9:58	EZ	PMI – manufacturing	Apr	pts	46.5	-	46.8
13:45	EZ	ECB decision		%	0.50	-	0.75
		FRIDAY (3 May)					
	PL	**Market holiday**					
14:30	US	Non-farm payrolls	Apr	k	145	-	88
14:30	US	Unemployment rate	Apr	%	7.6	-	7.6
		MONDAY (6 May)					
9:53	DE	PMI – services	Apr	pts	-	-	50.9
9:58	EZ	PMI – services	Apr	pts	-	-	46.4
		WEDNESDAY (8 May)					
	PL	**MPC decision**		**%**	**-**	**3.25**	**3.25**
		THURSDAY (9 May)					
11:00	**PL**	**Bond auction**					

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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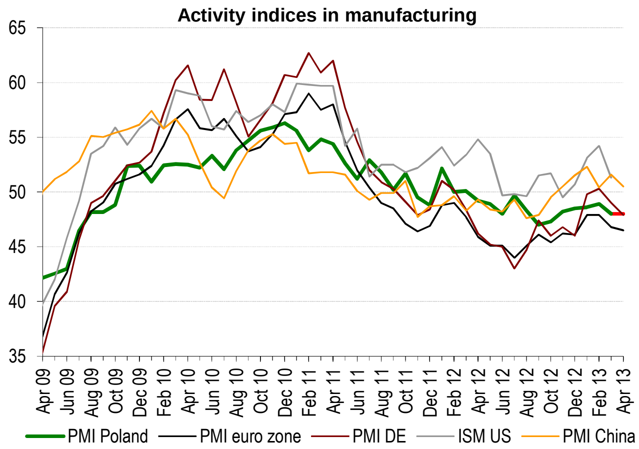
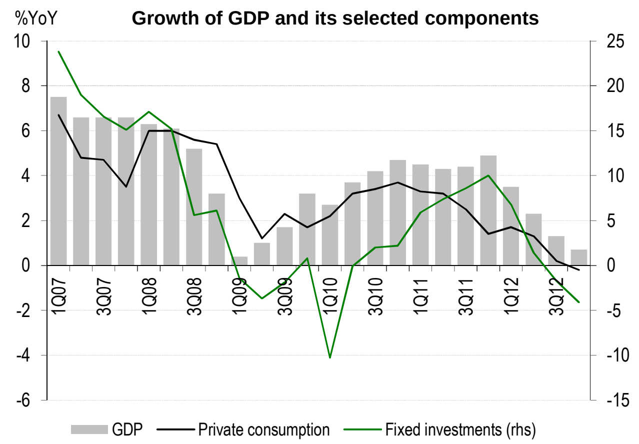
What's hot this week – The MPC under pressure of the data

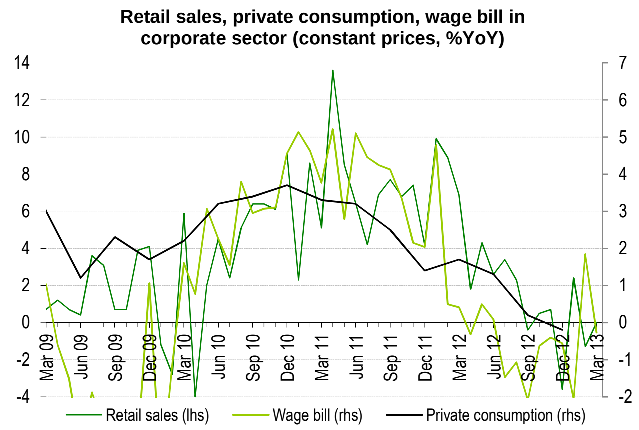


- We are expecting some stabilisation of April's PMI index for Polish manufacturing, after a significant fall in the previous month, despite the fact that this gauge for Germany and the euro zone as well as CSO climate index fell.
- Still weak data on economic activity and quick decline of inflation are putting pressure on the MPC, so a motion for a rate cut may appear as soon as in May. However, we do not think that there will be a majority in the MPC to support such a move. Still, upcoming months will bring further decline of inflation while uncertainty about scale and pace of economic recovery will remain in place. That is why rate cut by 25-50bps until July seems more and more likely. This is still considerably less than the market is pricing-in (ca. 100bps). It is worth reminding that the NBP Governor Marek Belka said during April's conference that ultra-low interest rates generate risks, which should be avoided.

Last week in the economy – Lower GDP growth, high fiscal deficit



- The CSO released revised data on GDP for 2008-2012, showing that economic growth in 2012 amounted to 1.9% rather than 2.0% estimated earlier. The most considerable correction was applied to results of 4Q2012 – GDP growth slowed down more considerably than estimated earlier – to 0.7%YoY (vs. 1.1%YoY in earlier release). Domestic demand plunged more than previously calculated – it posted a decline by 1.6%YoY, not by 0.7%YoY in 4Q2012. This was primarily due to lower growth rate of fixed investments, as they fell by 4.1%YoY vs. earlier estimates at -0.3%YoY. At the same time, individual consumption drop proved to be less severe and amounted to -0.2%YoY (not -1.0%YoY).
- The revision of GDP data does not prompt us to change forecasts for next quarters. We expect a gradual acceleration of pace of economic growth – from ca. 0.8%YoY in 1Q to ca. 2% in 4Q. In the entire 2013 we predict GDP growth at 1.2%.



- In 2012 the general government deficit reached 3.9% of GDP while public debt reached 55.6% of GDP. This is a too high level of deficit to expect that the excessive deficit procedure will be lifted by the European Commission.
- In March retail sales accelerated to +0.1%YoY from -0.8%YoY in February, in line with our expectations. This was however due to pre-Easter shopping and does not herald an improvement in consumer demand, which will probably remain in stagnation in the upcoming quarters.
- The registered unemployment rate fell in March to 14.3% from 14.4% in February, mainly due to intervention of the Labour Ministry, while demand for labour remains weak. In Q1 2013 unemployment rate reached the average level of 14.3%, being the worse Q1 since 2007.

Quote of the week – Is inflation below target forcing the MPC to act?

Jerzy Hausner, MPC member, 22 April, Dow Jones

When inflation is significantly below target, we are somehow forced to act, because these are rules of our monetary policy, approved by us all. It cannot be ruled out that we will continue with cutting rates. We will surely think about leaving them unchanged or reducing them in May. Even if we will not cut in May, we will consider such a move in June.

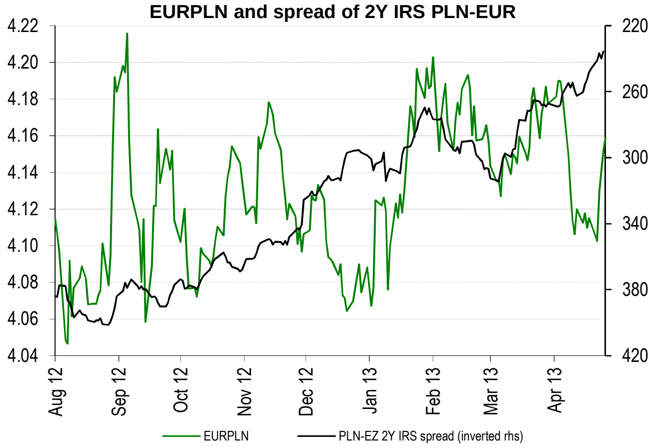
Andrzej Rzońca, MPC member, 19 April, TVN CNBC

The Council opened door to inflation's return to its target thanks to its earlier decisions.

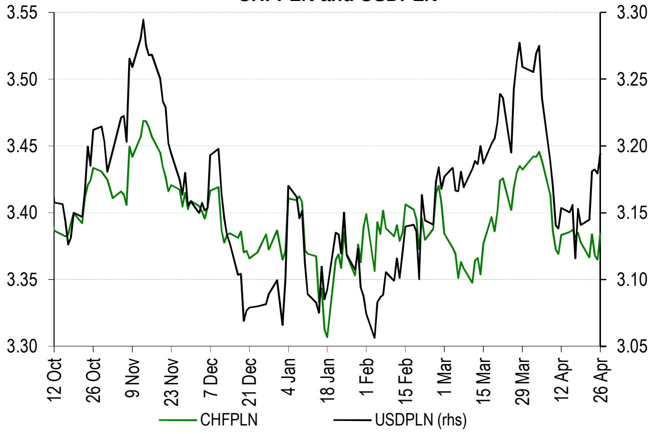
March's rate cut by 50bps passed thanks to vote of Marek Belka. He was joined by Andrzej Bratkowski, Elżbieta Chojna-Duch, Anna Zielińska-Głębocka and Jerzy Hausner. Minutes for the April's MPC meeting showed that no motion for a cut was filed in, and this was probably to maintain cohesion of the communication after the March decision (necessity to wait for upcoming data, which will determine inflation prospects). Recent comment of Hausner is suggesting that cuts will be considered again in May. He and Zielińska-Głębocka argue that current data on CPI will be important for the Council. This is somehow contradictory to wording of the NBP Governor after April's meeting, when he stated that medium-term prospects (not current data) are crucial. In general, it seems that vote of the MPC President may again prove crucial in the balance of forces.

Foreign exchange market – Zloty under influence of central banks' decisions

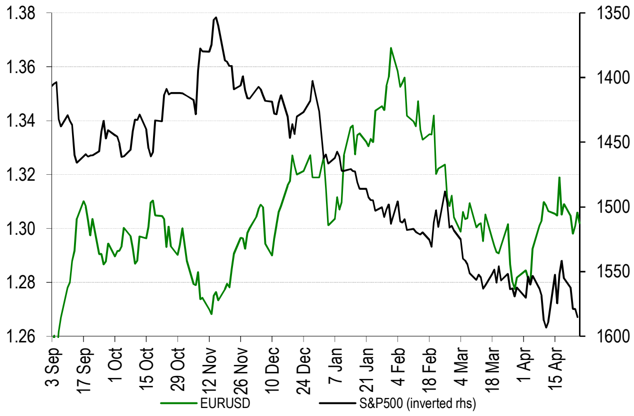
EURPLN and spread of 2Y IRS PLN-EUR



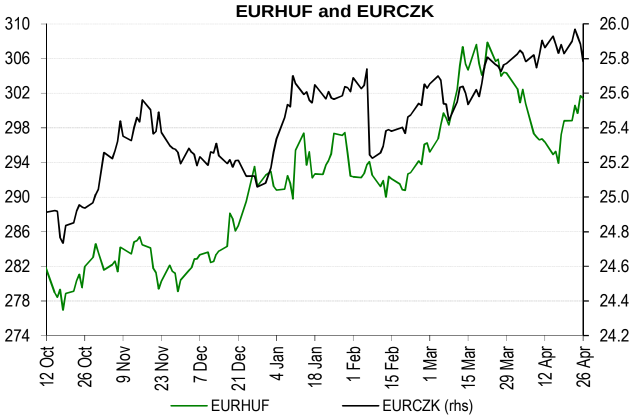
CHFPLN and USDPLN



EURUSD and S&P500



EURHUF and EURCZK



Zloty weakened due to data from Germany

▪ Our scenario, assuming a high move of zloty and breaking narrowed range of quotation between 4.093-4.12 per euro materialised last week. The EURPLN increase above the upper limit of channel came from disappointed releases of leading indicators for Germany (flash PMI, ZEW, Ifo). Additionally, the zloty weakening also resulted from domestic data (weaker than expected reading of the 2012 general government deficit) and regional reasons (forint weakening). Consequently, the EURPLN broke resistance level at 4.12 and increased gradually towards 4.16 during Friday's session.

▪ Zloty lost also against other main currencies. One should notice that the upward move of the USDPLN was effectively stopped by the resistance zone of 3.19-3.20. In weekly terms zloty depreciated the most against GBP (by 2.2%), and the less (by only 0.2%) against CHF (the CHFPLN increased again above 3.38).

▪ In coming two weeks investors will focus on central banks meetings (Fed, ECB, MPC). After weaker-than-expected data from Germany, expectations that the ECB will cut rates have renewed. If the ECB decides to reduce the refi rate, the pressure on the domestic MPC will also increase. Consequently, it might result in the zloty weakening towards 4.17 against the euro, which would open the door to further increase towards 4.20. This week, due to limited investors' activity as a consequence of May's long weekend, volatility on the FX market will be high, supporting such scenario.

EURUSD is still oscillating around 1.30

▪ Negative information from the euro zone, especially from Germany (weaker-than-expected leading indicators are suggesting that pace of recovery weakened markedly) was putting a negative pressure on the euro in the short-term. EURUSD, after temporary falls, was returning above 1.30. The lowest level was recorded at 1.295, while peak was set at almost 1.31. Despite weaker than expected Q1 2013 GDP data in US, the EURUSD has remained relatively stable.

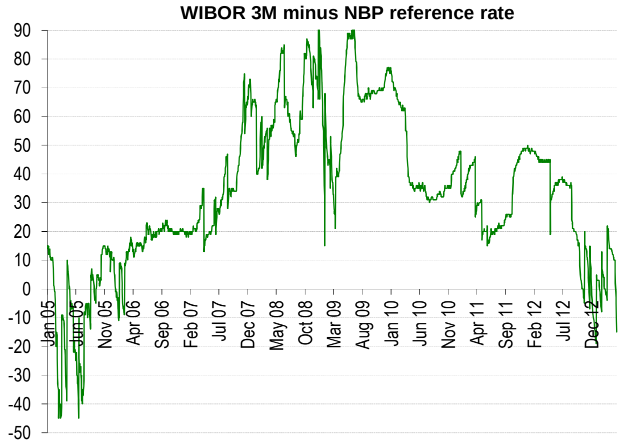
▪ Situation on the EURUSD chart remains with no major changes. Current oscillation range is at 1.295-1.32. We cannot rule out tests of these levels in reaction due the upcoming data or decisions of the central banks.

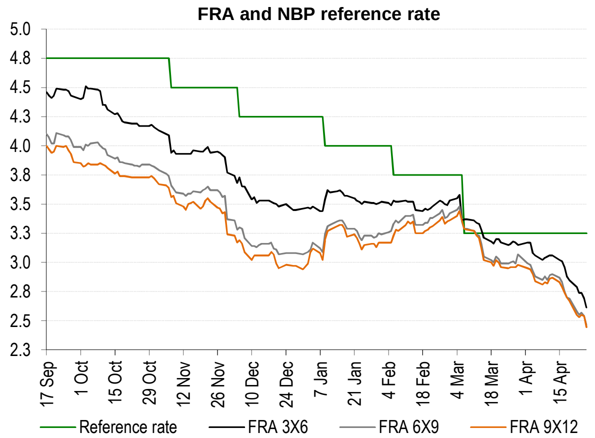
Mixed moods in the CEE region

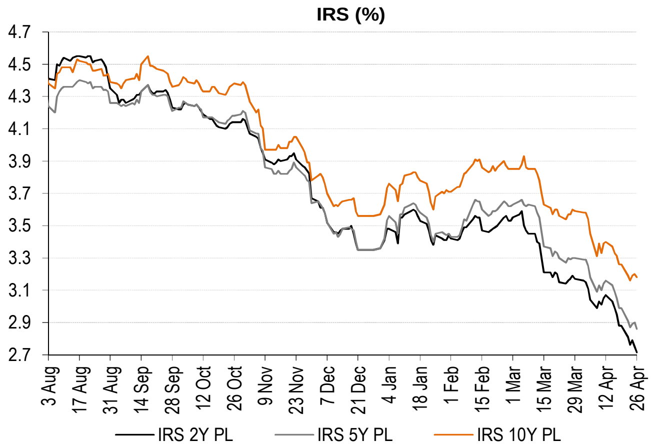
▪ Weak data from Germany caused a weakening of CEE region currency: the Czech koruna and the forint. The EURCZK exchange rate climbed towards 26 (the highest level since 2010), while EURHUF rose to ca. 302.5. The Hungarian currency was additionally supported by worries that the central bank will take some non-standard actions again. Decision of the Hungarian central bank to cut rates by 25bps (base rate fell to 4.75%) was in line with expectations, so given no additional measures a correction took place and the rate slid to 300. The weaker-than-expected data on labour market (higher increase of unemployment rate) again pushed the forint towards 301 per euro.

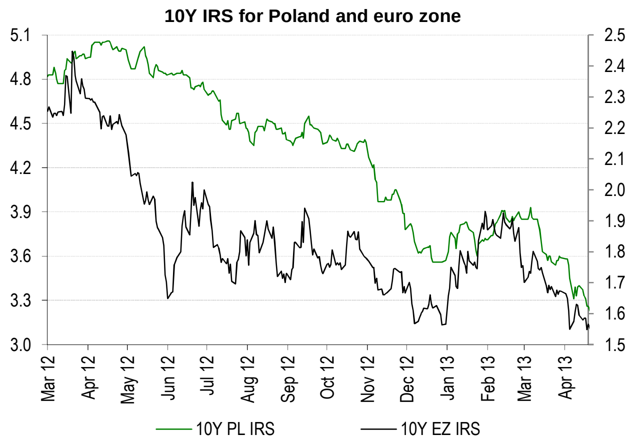
▪ End of the week brought a strengthening of the Czech koruna. This was mainly due to comments of the central bank representatives, who acknowledged some improvement of the Czech economy. Market interpreted this as an announcement of skipping central bank interventions.

Interest rate market – Decision of the ECB and the MPC crucial









WIBOR and FRA aggressively price rate cuts

▪ The dovish comment of MPC's Jerzy Hausner initiated sudden plunge of FRA and WIBOR rates. The latter dropped by as much as 6-10bps only on Thursday (the most in case of 12M rate, which is now at 3.05%).

▪ Since the end of August 2012 (when downward trend started after Q2 GDP data), 3-12M rates plunged by over 200bps (201bps for 3M, 207bps for 9 and 12M), while the NBP reference rate was cut by 150bps. The chart shows that the spread between 3M WIBOR and NBP rate hovers around lowest level since 2005.

▪ It is visible that possible adjustment of the NBP rates (that in our opinion will not exceed 50bps in coming 3 months) is already priced-in by WIBOR. Furthermore, FRA market expects additional decline of interbank cost of cash (decline of WIBOR 3M by 45bps in 3 months and by 60bps in 9 months is already pruced-in). This means the market prices in 100bps NBP rate cut and this seems quite aggressive. In our opinion, the rate at 2.25% could be perceived as an "ultra-low" level and the MPC stressed it wants to avoid such situation (Marek Belka mentioned this after April's meeting).

Steepening of IRS and bond curves

▪ The dovish statement of Hausner had also clear impact on the IRS market. Already at the beginning of the week rates along the curve reached fresh all-time lows (2.71% for 2Y, 2.85% for 5Y and 3.17 for 10Y), the scale of move was the biggest on the short end. Similar changes occurred on the bond market.

▪ The Ministry of Finance may perceive last bond auction as a success. The Ministry collected PLN11.8bn (including PLN10.5bn on the standard auction) amid total demand at PLN28.4bn – the upper band of planned supply was at PLN10bn. In contrast to the first April's auction, the demand for each of bonds (OK0715, PS0418 and WZ0117) was decent. At the auction yields of 2Y and 5Y benchmarks were the lowest in history. After this auction the Ministry has covered ca. 70% of 2013 gross borrowing needs.

Decision of ECB and MPC crucial

▪ Last week the bond 2-10 spread surged by nearly 15bps to ca. 70bps. Since October 2012 it stays in the range of ca. 45-80bps and in the coming days it may head towards the upper band of this range. Spread 2-10 for the IRS also climbed (from 38bps to 45bps), this tendency is observed already since July 2012. We see room for further steepening of both curves amid continuation of strengthening of the short end amid hopes for the MPC rate cut already in May (lack of reduction may trigger some correction). The pricing-in of such move may be fuelled if the ECB decides to cut rates this week.

▪ High uncertainty regarding the decisions of the ECB (the bank may also introduce some nonstandard measures suggested last month) and the MPC – combined with low liquidity due to long weekend – may generate higher volatility on the domestic interest rate 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