Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

16 – 22 December 2013

Macroeconomic data released last week were mixed. Weak data from the euro area fuelled hopes that the ECB may decide to relax monetary policy further. Meanwhile, the data from the US did not change substantially expectations concerning the start of QE3 tapering, although the agreement between Republicans and Democrats increased probability that the first move may take place already in December. In Poland, the biggest surprise was drop of inflation rate (to 0.6%YoY), which increased chances that the moment of first rate hike will be postponed.

The week before Christmas will be full of important events and economic data releases. The FOMC meeting, with the release of new economic forecasts, will be on top of the agenda. If the Fed delays the start of QExit, it may support market moods.

Economic calendar

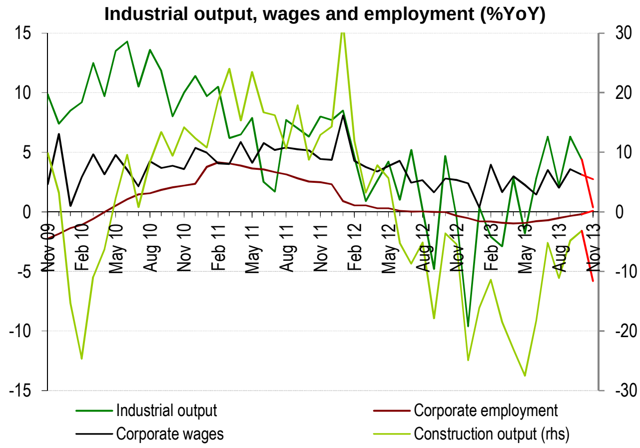
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 December)					
2:45	CN	Flash PMI – manufacturing	Dec	pts	50.9	-	50.8
9:53	DE	Flash PMI – manufacturing	Dec	pts	52.9	-	52.7
9:58	EZ	Flash PMI – manufacturing	Dec	pts	51.4	-	51.6
14:00	**PL**	**Core inflation**	**Nov**	**%YoY**	**1.4**	**1.0***	**1.4**
15:15	US	Industrial output	Nov	%MoM	0.6	-	-0.1
		TUESDAY (17 December)					
11:00	DE	ZEW index	Dec	pts	55.0	-	54.6
11:00	EZ	HICP	Nov	%YoY	0.9	-	0.9
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:00	**PL**	**Employment in corporate sector**	**Nov**	**%**	**0.1**	**0.1**	**-0.2**
14:00	**PL**	**Wages in corporate sector**	**Nov**	**%**	**2.9**	**2.7**	**2.9**
14:00	HU	Central bank decision		%	3.0	-	3.2
14:30	US	CPI	Nov	%MoM	0.1	-	0.1
		WEDNESDAY (18 December)					
10:00	DE	Ifo index	Dec	pts	109.5	-	109.3
14:00	**PL**	**Industrial output**	**Nov**	**%YoY**	**1.7**	**0.4**	**4.4**
14:00	**PL**	**Construction and assembly output**	**Nov**	**%YoY**	**-7.9**	**-11.6**	**-5.5**
14:00	**PL**	**PPI**	**Nov**	**%YoY**	**-1.2**	**-1.3**	**-1.3**
20:00	US	FOMC decision					
		THURSDAY (19 December)					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	355	-	368
16:00	US	Philly Fed index	Dec	pts	10	-	6.5
16:00	US	New home sales	Nov	%MoM	-1.4	-	-3.2
		FRIDAY (20 December)					
14:30	US	Final GDP	Q3	%QoQ	3.6	-	2.5

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

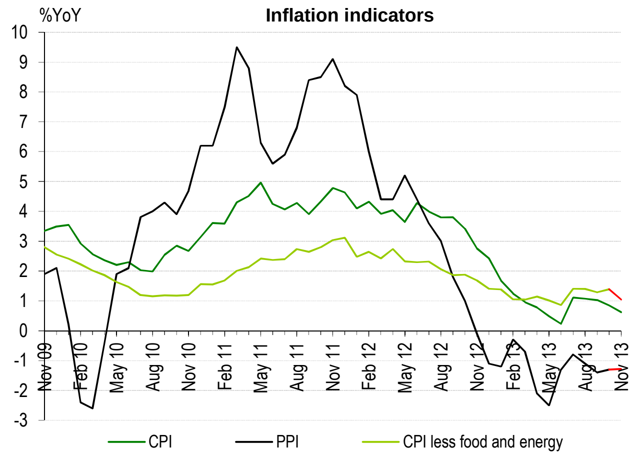
ECONOMIC ANALYSIS DEPARTMENT:
ul. Marszałkowska 142. 00-061 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

What's hot this week – Important data and minutes of MPC meeting

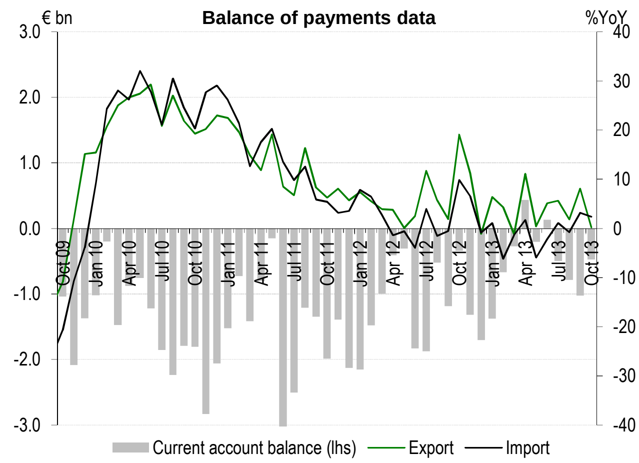


- We will see a row of important information from Poland this week. We are expecting that data on industrial and construction output to be considerably weaker than during last months. However, this will be mainly due to negative working day effect, while the underlying trend remains robust (as suggested by leading indicators).
- Data from the labour market can deliver a more optimistic message. We are expecting that average employment in corporate sector was higher than one year earlier. This could be the first positive growth rate since mid-2012. We are expecting that in the following months the situation in this sector and in the whole labour market will be improving further. We are expecting wage growth to oscillate near levels observed over the last months.



- We are estimating that core inflation excluding food and energy prices fell in November to 1.0%YoY, the lowest level since June (mainly under impact of lower prices on the mobile phone market), while PPI remained at October's level, i.e. -1.3%YoY.
- In general, the figures for November will show a further improvement of economic situation and at the same time they will be suggesting a lack of inflationary pressure.
- At November's MPC meeting the NBP President Marek Belka suggested that the Council will think about symptoms, which can encourage it to drop its declaration of stable interest rates. On the other hand, in December the NBP President stated that the Council will not present such information. It cannot be ruled out that minutes of the last MPC meeting will include some suggestions explaining this change of views.

Last week in the economy – Lower inflation, higher C/A deficit



- CPI inflation amounted to 0.6%YoY in November and was below market forecast. Decline of inflation was mainly due to low growth of food prices, but the most considerable surprise was delivered by prices of communication, which saw a decline by almost 5%MoM due to promotions on the mobile phone market. CPI data imply lower inflation path for the upcoming months, which stands for a higher risk that the first hike will be postponed.
- Current account deficit at €466m was higher than we expected, mostly due to a small surplus in foreign trade (imports rose more than exports, by 2.4%YoY and 0.2%YoY, respectively). What is interesting, income deficit was lowest for a number of months (€1.3bn versus average at €1.5bn in January-September). In general, the external stability of Polish economy is not threatened with 12M cumulated current account deficit in still at ca. 2% of GDP.

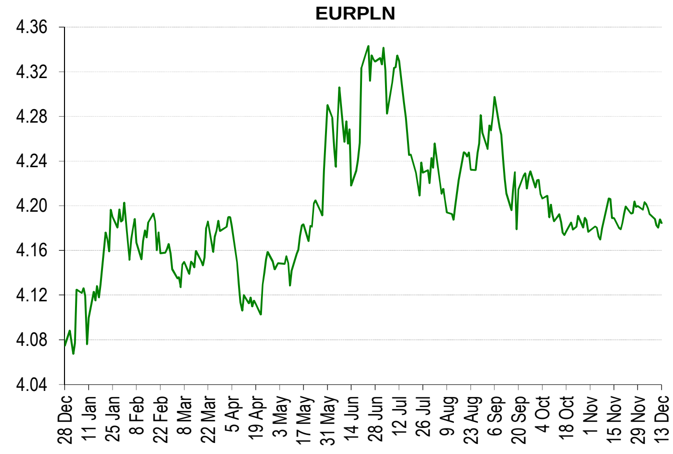
Quote of the week – First rate hike not in July

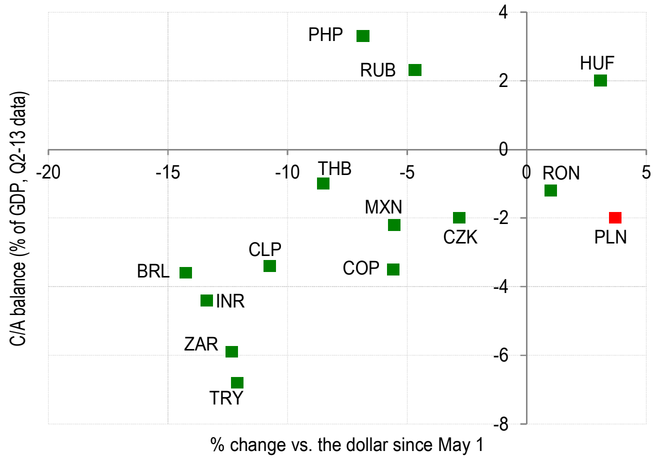
Marek Belka, NBP Governor, 12.12, Reuters
We pledged to keep interest rates stable until the middle of the year (2014). However, it does not mean that we will start changing rates already in July, it will depend on what happens with the economy and what happens with inflation. We will release next long-term projections of inflation and GDP, we will have forecasts reaching even until early 2016, which will probably give us more solid ground for making decisions.

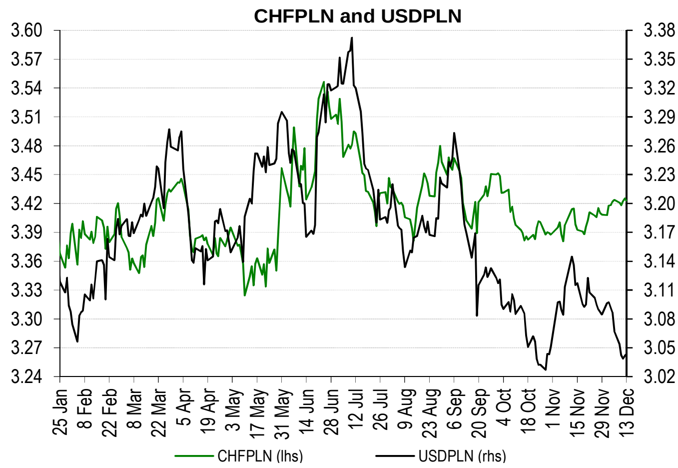
Andrzej Bratkowski, MPC member, 13.12, PAP
Interest rate cut would be a wrong signal for the market. There is no need to make nervous moves. (...) I think that (interest rate hike) is more likely when kids go to school; as regards the first half of the year, we are almost certain that nothing will happen.

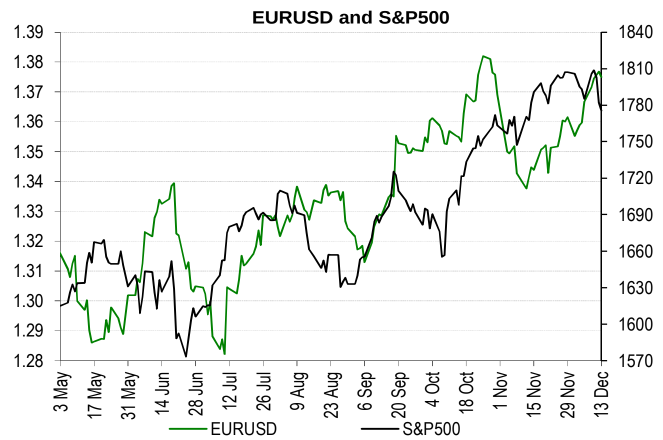
Andrzej Bratkowski's comment suggests that his opinion about the optimal moment of starting interest rate hikes has changed. Only few days ago Bratkowski was suggesting it may take place at the turn of 2014/2015, while now he mentioned the start of 4Q 2014 or even September. Meanwhile, Marek Belka's comment shows that key in this respect will be data about economic growth and inflation. The most recent data show upward surprises in economic growth and downward surprises in inflation, so their impact on monetary policy prospects is not straightforward. However, further reinforcement of economic growth, especially domestic demand, should start generating stronger inflationary pressure within next several quarters, thus convincing the MPC to support interest rate hikes. We expect two interest rate hikes in 2014, with the first one in September, in line with Bratkowski's suggestion.

Foreign exchange market – FOMC decision in focus









Zloty still awaits an impulse

- The past week was another consecutive one when EURPLN hovered around 4.19 and the range trading continued to narrow (to 4.175-4.19 in recent days). The zloty gained temporarily vs. the dollar (USDPLN reached nearly 3.02) thanks to further increase of EURUSD.
- Bloomberg survey from December 6 showed that 34% of analysts expect tapering of QE3 this month (compared to 17% in November). After an agreement on the US budget, which was reached last week, those expectations have surely increased. Given the last labour market data and information from the US Congress, trimming the size of QE3 in December should not be a surprise. If FOMC decides so, then the scale of reduction and pace of further scaling may be crucial for the market. However, if FOMC postpones tapering, then the market sentiment will depend on the suggestion when this process may finally begin (in 1Q14 or later).
- It is worth to notice that when in May it was suggested for the first time that QE3 may be tapered already this year, the zloty gained versus the greenback while other emerging currencies – like Brazilian real, Mexican peso and Turkish lira depreciated versus by a dozen of percent. In our opinion, better performance of the zloty may be to some extent explained by fast improvement of Polish external imbalance (C/A deficit as a percentage of GDP is lower than in case of many emerging countries). Thus, even if an overall market reaction is negative, a scale of zloty's depreciation may be limited and short-lived. We still see room for higher volatility in coming days, EURPLN may potentially test either 4.14 or 4.24.

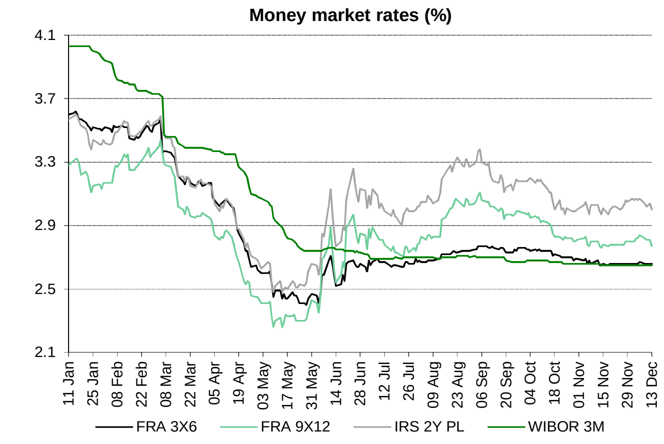
EURUSD higher despite worries over FOMC decision

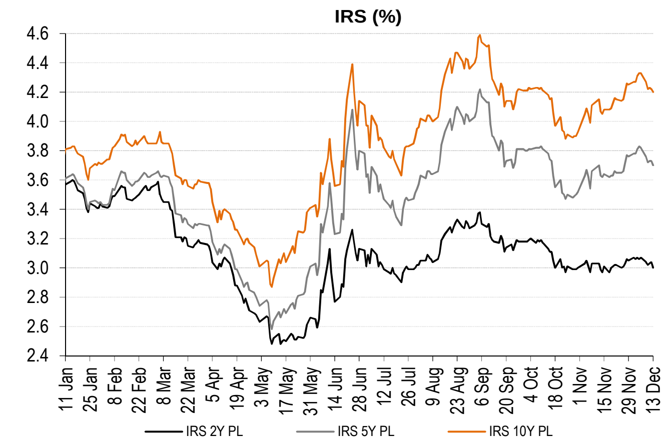
- Since the beginning of the week the euro continued to appreciate versus the dollar amid signals from the ECB that were taming expectations for further monetary policy easing. When US politicians reached an agreement on budget spending, expectations that QE3 tapering may be announced in December strengthened. Consequently, EURUSD stayed above 1.38 only temporarily.
- October's and November's US labour market data showed that non-farm payrolls added at least 200k workers. Despite that, EURUSD has climbed from 1.33 to 1.38 since the November's reading. Correlation of this rate with S&P 500 index between 8 November and mid-December amounts to ca. 70%, This clearly shows that hopes for continuation of an economic rebound (and improvement of companies' earnings) proved stronger than worries over trimming the monetary stimulus. As mentioned above, the market sees some risk that QE3 will be trimmed already in December, while reduction of asset purchases in Q1 seems to be priced-in be the market. Thus, FOMC communication will be crucial for EURUSD. Additionally, the FOMC will show new forecasts, which will help the market assess the US monetary policy prospects. Support and resistance for EURUSD is 1.36 (another at 1.353) and 1.383 (another at 1.40).

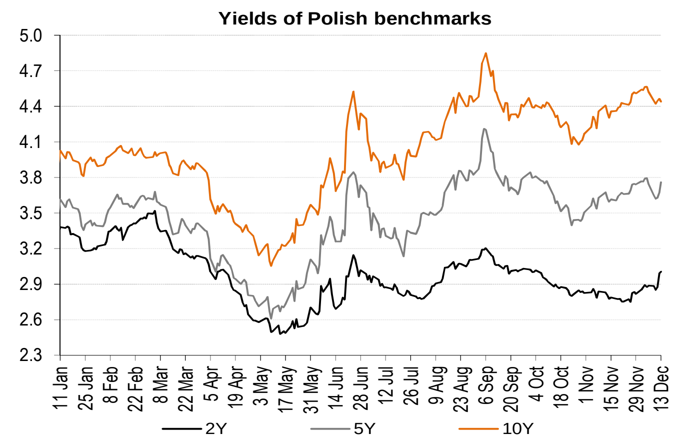
Apart from FOMC, focus on CNB and MNB

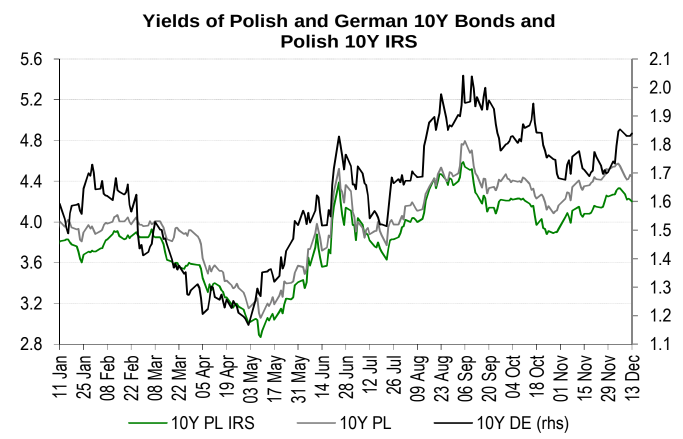
- Last week the forint and the koruna lost against the euro. EURHUF approached last week's peak slightly above 304, while EURCZK reached 27.58.
- This week, apart from FOMC decision, the market will focus on decision of the Czech and Hungarian central banks. Czech GDP for Q3 was weaker than expected and the CNB's comment concerning this matter can affect the koruna. As regards forint, it will be important if the MNB will leave door for further easing open.

Interest rate market – Lower inflation supported debt market









Inflation data supported money market …

- Strong declaration from the MPC that official rates remain stable at least till mid-2014 together with comments from the Council's members (including the NBP's governor M. Belka) and CPI inflation reading cause WIBOR rates to stay well-anchored. WIBOR rates have remained stable for several (for 1M, 3M, 6M) or a dozen (for 9M, 12M) of weeks. Situation on FRA market also did not change significantly. FRA rates up to 9 months suggest gradual increase in WIBOR. Market is still expecting the first hike in one year period (FRA12x15 is stabilizing near 3%).
- This week we expect money market rates to remain relatively stable. Domestic macro data, which will be released later this week might add some volatility on FRA market, while WIBOR rates should remain unchanged.

… but also the front end of both IRS and T-bond curves

- Last week brought gradual rebound in market sentiment. In the first part of week IRS rates and T-bond yields declined and then rates and yields again shifted up (mainly on mid and long end of curves) due to yields increase on core market. The front ends of curves were more or less stable, supported by comments from the MPC members (Bratkowski, Belka). The November's CPI reading was additional supportive factor for debt market (inflation was lower than our and market forecasts). After the headline CPI publication yields declined across the board by 3-5 bp (with the highest drop for 2Y sector).
- As we expected last week yields curves slightly flattened as 2Y sectors underperformed instruments on mid and long end of curves. 2-10Y spread narrowed to 120bp for IRS and to 143bp for T-bond, mainly due to spread narrowing for 2-5Y.
- Deputy finance minister Wojciech Kowaczyk presented issuance plan for 1Q 2014 – the Ministry of Finance is planning to conduct two T-bond auctions a month. What is more, deputy minister of finance also said that Poland will have financed 100% of its next year's borrowing needs at the end of July 2014. In our opinion this plan is realistic to achieve, in particular taking into account that financial resources at the end of 2013 should be higher due to lower than expected budget deficit realization by ca. PLN8bn.

Fed in the spotlight

- During the pre-Christmas week the FOMC meeting (Dec 17-18) will be the most important event. After better-than-expected data from the US labour market, expectations for starting reducing the size of QE3 in December strengthened. This scenario is partly priced in. If the Fed postpones tapering until 1Q, then core markets may gain and this should have a positive effect on the Polish debt.
- Series of Polish macro data releases (industrial output, labour market data) may be overshadowed by developments taking place on the core market. Investors care less about domestic data after the MPC declaration on keeping interest rates unchanged at least until mid-2014. Day after day, investors' activity is likely to fade due to coming Christmas and lower liquidity may add some volatility.

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 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.