

3-WEEKLY ECONOMIC UPDATE

23 December 2013 – 12 January 2014

FOMC decision to taper the QE3 programme was the main event of the week. In response, stock markets posted gains worldwide, while core bonds weakened. 10Y Bund yields reached peak from early December (1.89%), while Treasuries reached the highest level since early September (2.95%). The Polish debt was rather resistant to these events, while the zloty strengthened considerably at the end of the week. This was, however, due to activity of the state-owned BGK on the Polish foreign exchange market. The upcoming weeks may bring enhanced market volatility due to limited liquidity in Christmas-time, while at the same time a considerable number of economic data will be releases. As regards Poland, the MPC meeting in January will quite uneventful, even if the new MPC member (Jerzy Osiatyński) is going to attend it.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (23 December)							
10:00	PL	Retail sales	Nov	%YoY	3.2	3.7	3.2
10:00	PL	Unemployment rate	Nov	%YoY	13.2	13.2	13.0
15:55	US	Michigan index	Dec	pts	82.8	-	82.5
TUESDAY (24 December)							
16:00	US	New home sales	Nov	k	0.8	-	25.4
TUESDAY (31 December)							
14:00	PL	Inflation expectations	Dec	%YoY	-	-	0.7
16:00	US	Consumer confidence index	Dec	pts	74.0	-	70.4
THURSDAY (2 January)							
9:00	PL	PMI – manufacturing	Dec	pts	54.8	55.1	54.4
9:53	DE	PMI – manufacturing	Dec	pts	54.2	-	52.7
9:58	EZ	PMI – manufacturing	Dec	pts	52.7	-	51.6
14:00	PL	Balance of payments	Q3	€m	-	-2306	362
16:00	US	ISM – manufacturing	Dec	pts	57.0	-	57.3
MONDAY (6 January)							
16:00	US	Industrial orders	Nov	%MoM	-	-	-0.9
16:00	US	ISM – services	Dec	pts	-	-	53.9
WEDNESDAY (8 January)							
	PL	MPC decision		%			
14:15	US	ADP report	Dec	k	-	-	215
20:00	US	FOMC minutes					
THURSDAY (9 January)							
13:45	EZ	ECB decision		%	0.25	-	0.25
FRIDAY (10 January)							
14:30	US	Non-farm payrolls	Dec	k	-	-	203
14:30	US	Unemployment rate	Dec	%	-	-	7.0

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

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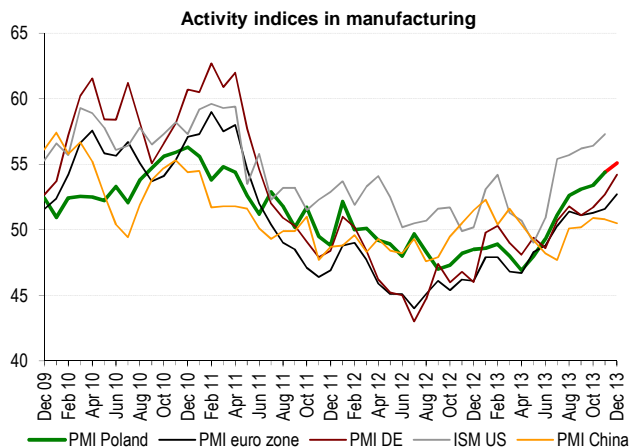
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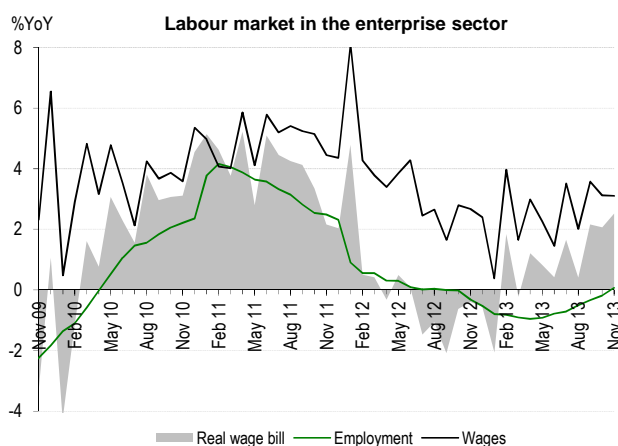
What's hot this week – Last November's numbers, PMI and MPC meeting

▪ We are expecting a slight increase in the registered unemployment rate to 13.2% in November, due to seasonal effects. Our forecast is in line with the estimate of the Labour Ministry.

▪ In our view, retail sales accelerated moderately in November, but our forecast is above market consensus.

▪ December's PMI index will probably show a further acceleration of the domestic economy in Q4, driven by external demand and strengthening domestic demand.

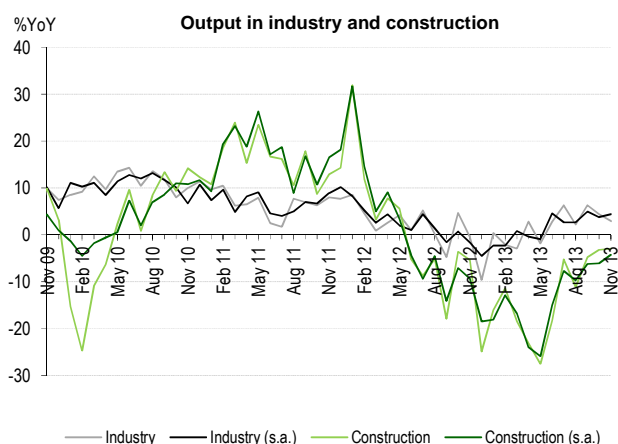
▪ In our view, the MPC will not change interest rates at its January's meeting. We are also expecting no crucial changes in the statement. This will be the first meeting, which will be attended by the successor of Zyta Gilowska, Jerzy Osiatyński.

Last week in the economy – Good labour market and output data, low inflation

▪ November was the seventh month in a row of gradual increase in employment in enterprise sector. In comparison with October number of work places increased by 1k, less than in previous month, but one should remember that traditionally the end of the year brings a decline in demand for labour due to seasonal effects. Consequently, the annual growth of employment in corporate sector increased above zero (for the first time in over a year), reaching +0.1%.

▪ Growth of wages in enterprise sector exceeded expectations and stabilised at October's 3.1%YoY. Taking into account the shorter worktime (number of working days in November was lower by two than in the same period of 2012), it was a pretty decent result.

▪ These data confirm that situation on domestic labour market keeps improving, which should support further acceleration of private consumption.



▪ Industrial production increased by 2.9%YoY, significantly above our and market expectations. The pace of growth was lower than in October (4.4%YoY), but it is worth to remember that in November we had two working days less than in the same month a year ago. Taking this into consideration, the release should be perceived quite positively.

▪ Construction output declined in November only by 2.9%YoY, which is the best result since May 2012. Probably, to some extent, this improvement was supported by favourable weather conditions. Nevertheless, signals of a recovery in this sector are getting more and more obvious for already several months.

▪ PPI inflation declined to -1.5%YoY, while core inflation excluding food and energy prices slid to 1.1%YoY. All other core inflation gauges also declined.

Quote of the week – Results of budget better than in the amendment

Ludwik Kotecki, chief economist of the Ministry of Finance, 19.12, Reuters

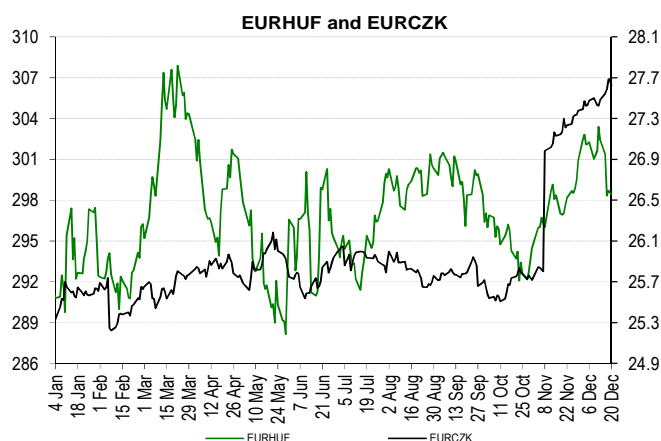
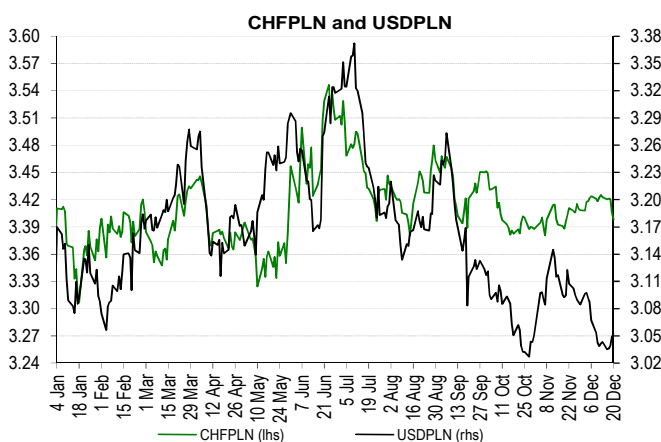
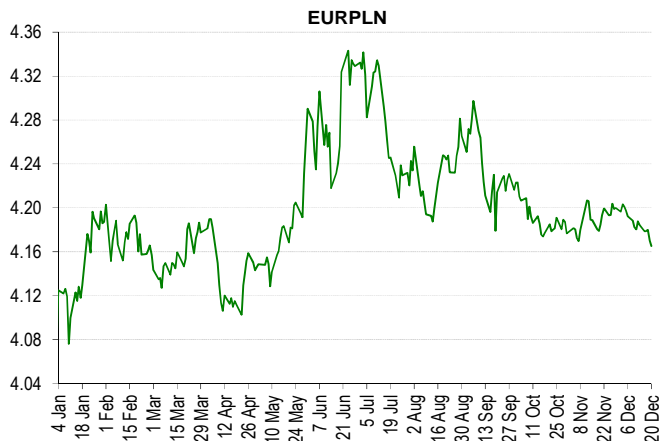
PLN8bn would be a surprise. But a part of this sum will surely be reached. We can say that the result should be better than assumed by ca. 0.5 % of GDP. Of course as regards the whole general government result, there is a question of local governments and their deficit. After three quarters they posted a surplus of PLN8bn. We will see what happens in Q4.

I think that GDP growth in 2014 will amount to 3%. This is more than the very secure forecast written in the budget, which assumes 2,5%. Revenue side of this budget is completely safe. Deficit will also be probably lower.

As we estimated a couple of months ago, budget deficit at the year-end can prove by ca. PLN8bn lower than expected in budget amendment (PLN51.6bn). The general government deficit can also prove better than assumed in the plan, provided that local governments managed to repeat the positive result from Q3.

Ludwik Kotecki is expecting that also next year's result can be better than expected, as the conservative forecast of economic growth gives a chance for better-than-expected budget revenues. However, let us note that while government's forecast of economic growth is below our (2.5% vs. 3.1%), the inflation rate will probably be lower than assumed by the government (2.4%).

Foreign exchange market – Fed did not affect the zloty, but the BGK is in action



Zloty strengthened slightly against the euro

▪ Last week the key event on the FX market was Fed's decision. Ahead of FOMC meeting the exchange rate EURPLN was traded in the narrow range of 4.17-4.19. Fed's decision to reduce QE3 programme (by \$10bn) did not negatively affect the domestic currency. The zloty strengthened against the euro, which among others came from the BGK's activity on the market. Consequently, EURPLN reached temporary 4.153, the lowest level since mid-November. However it ended the week slightly above 4.16.

▪ Changes in the zloty quotations against other main currencies were mixed. While zloty gained against the Swiss franc (by 0.7%) in weekly terms, it lost in relations to the US dollar and the British pound by 0.3% and by 0.4%, respectively.

▪ We do not exclude that zloty might slightly loss against the main currencies, increasing to 4.18 against the euro at the end of the year. Decline in investors' activity due to year-end will add volatility and result in more significant intraday changes of the exchange rate. On the other side, market volatility might be limited by the continuation of BGK's activity on the market. We would like to recall that in the justification to the 2013 budget amendment, the Poland's Ministry of Finance assumed higher income from selling FX sources straight on the market. The beginning of a new year may bring slight zloty strengthening – zloty should be supported by macro data (we expect further increase in PMI index for Poland's manufacturing sector).

EURUSD under pressure of Fed decision

▪ The single European currency was gaining while awaiting the December's FOMC decision, supported by the euro zone data. This provided an impulse for EURUSD to test 1.38. Fed decided at its December's meeting to begin QE3 from January 2014 onwards (contrary to expectations of most investors). The scale of reduction proved low (€10bn), which was positively interpreted by financial market. This can be due to the fact that interest rates may remain low for a longer time and FOMC is positive about the US economic prospects. Thus, EURUSD slid towards 1.36.

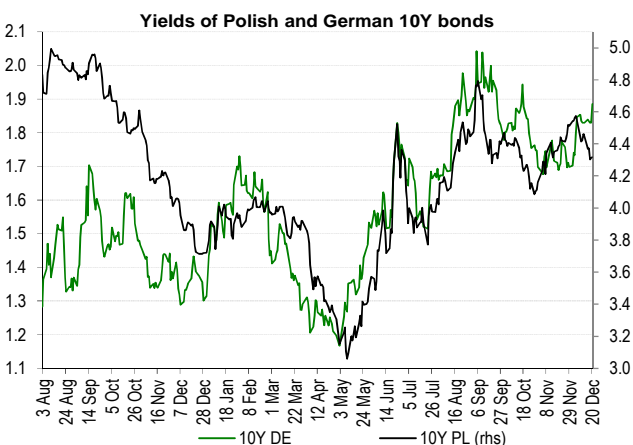
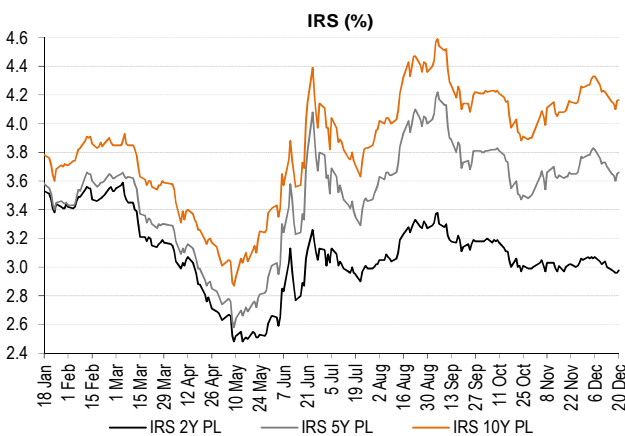
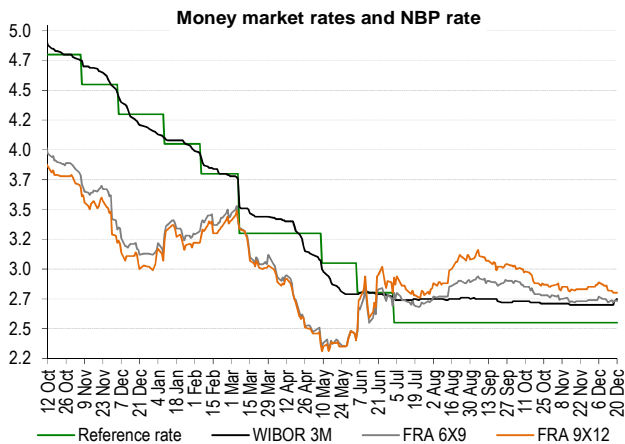
▪ In our view, the end of the year will bring no major changes in EURUSD. Nevertheless macro data, which will be released in this period, can fuel a moderate increase of the rate towards 1.37 at the year-end. At the beginning of January US labour market data will be crucial – these numbers should confirm the justness of December's Fed decision. On the other hand, the euro zone data (good readings of leading indicators) should confirm further gradual economic recovery, which can offset the effect of better readings from the US economy.

Calm turn of the year

▪ The Hungarian forint and the Czech koruna were under influence of central bank decisions. The Czech central bank declared that it will keep EURCZK at ca. 27.00 until 2015, which triggered a temporary weakening of the koruna (above 27.7). On the other hand, the forint gained versus the euro after news that the central bank may reduce the scale of future cuts or even limit the monetary easing cycle. The Hungarian currency was supported also by the Supreme Court decision on currency loans. As a result, EURHUF slid below 299.

▪ The end of the year should bring no crucial changes in EURCZK and EURHUF. Economic data releases, which will be shown at the beginning of 2014 should show that economies of the Czech Republic and of Hungary are recovering further, which should support the forint and stabilise the Czech koruna above 27 per euro.

Interest rate market – Polish bonds (as far) resistant to QE3 tapering



Visible changes of WIBOR

- The last week showed quite visible increase of 3M WIBOR. After 24 sessions of staying unchanged at 2.65%, it increased to 2.70% (highest level since mid-September) during three days. 1M rate moved up by 1bp (to 2.61%) and 6M advanced by 2bp (to 2.72%).

- The increase of WIBOR accompanied by some decline of FRA resulted in a visible limitation of future increase of rates expected by the market. FRA9x12-3M WIBOR spread declined from 12bp at the end of the past week (and even 40bp in early September) to 6bp, while FRA6x9-3M WIBOR spread reached 0bp vs. nearly 20bp in late September. Market expectations are below our forecast (we expect the first rate hike in September).

Domestic market resilient to weakening of core market

- Yields of Polish bonds plunged clearly during the past week. The move was still driven by data on surprisingly low inflation, positive impact on the Polish debt was provided also by information on carrying an unplanned repurchase auction of bonds maturing in 1H14 (see details below). The decline recorded in the case of IRS was clearly smaller and this led to the visible decline of the asset swap spreads – from 24bp to 10bp for 10Y and from 6bp to -10bp for 5Y. FOMC decision (and surging stock exchanges) had very visible negative impact on 10Y Bunds and Treasuries – yields of the former reached a peak from early December at 1.89% while the latter reached highest level since mid-September (2.95% vs. 2.84% at the beginning of the week). The Polish debt remained resilient to these changes.

- Two weeks ago we pointed out that both bond and IRS curves have clearly steepened. Since that time a correction was recorded of this trend, mainly in case of the debt market. 2-10 and 2-5 spreads plunged by c.30bp in case of bond curve and by nearly 10bp for IRS curve.

- In early December we showed that the spread between Polish and German long-term bonds widened to the highest level since September. In the following weeks we have observed the narrowing to nearly the lower band of the range, in which the spread stays since August.

- The Ministry of Finance bought back OK0114 bond for PLN4.6bn (vs. nearly PLN4.9bn offered for a buyback) and PS0414 for PLN3.2bn (vs. also nearly PLN4.9bn that investors were willing to sell). After the last week's auction, there is PLN13.7bn of OK0114 outstanding and PLN21.5bn of PS0414.

Core markets suggest weakening of debt

- Our forecast of November's retail sales is above market expectations and this may be the next signal – after data on industrial output – confirming the continuation of the economic recovery. However, we do not expect this data to put much pressure on the short end of the IRS and bond curves, that are likely to stay relatively stable thanks the declaration of the MPC.

- Upward trend of 5Y and 10Y yields – observed since May – has faded in recent weeks. In our opinion, changes observed on the core markets after the FOMC decision may indicate what sentiment will dominate on the debt markets in the nearest future – tapering of QE3 interpreted as a Fed's faith in the US economy and lower demand for risky assets may hit Bunds and Treasuries. This is likely to be reflected in higher Polish mid and long term bonds.

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