

# WEEKLY ECONOMIC UPDATE

20 – 26 January 2014

At the beginning of last week, the impact of weak Friday's data on US non-farm payrolls was still visible. These numbers supported hopes that the Fed will taper QE3 slowly. However, later on hawkish comments of FOMC members (Plosser, Evans, Lockhart), who said they supported a quick and decisive reduction of asset purchases program, introduced an elevated volatility on the markets. Assets of emerging markets proved especially vulnerable to this swing in moods, e.g. the Turkish lira reached the weakest level versus the dollar in history. Polish assets suffered less considerable losses (as opposed to the situation from the first days of the year).

Releases of economic activity indicators for Germany and the euro zone are the most important events abroad this week. These data will help to assess the persistence of economic recovery in the single currency area and financial markets' participants will analyze them in the context of ECB's monetary policy and risk of another interest rate cut. In Poland, we will see a row of figures for December, with information on industrial output being the most important. We see a downward risk for our forecast after SAMAR data on car sales, but the data should show a robust growth anyway. In our view, the general message of domestic releases this week will be hawkish, suggesting a further strengthening of economic recovery.

## Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (20 January)</b>							
14:00	PL	Wages in corporate sector	Dec	%YoY	3.2	2.7	3.1
14:00	PL	Employment in corporate sector	Dec	%YoY	0.3	0.3	0.1
<b>TUESDAY (21 January)</b>							
11:00	DE	ZEW index	Jan	pts	35.0	-	32.4
14:00	PL	Industrial output	Dec	%YoY	10.5	11.6	2.9
14:00	PL	Construction and assembly output	Dec	%YoY	14.4	20.2	-2.9
14:00	PL	PPI	Dec	%YoY	-1.1	-1.0	-1.5
14:00	HU	Central bank decision			2.9	-	3.0
<b>WEDNESDAY (22 January)</b>							
No important data releases							
<b>THURSDAY (23 January)</b>							
2:45	CN	Flash PMI – manufacturing	Jan	pts	50.5	-	50.5
9:28	DE	Flash PMI – manufacturing	Jan	pts	54.6	-	54.3
9:58	EZ	Flash PMI – manufacturing	Jan	pts	53.0	-	52.7
11:00	PL	Bond auction					
14:00	PL	MPC minutes					
14:30	US	Initial jobless claims	week	k	300	-	326
16:00	US	Home sales	Dec	m	4.95	-	4.9
<b>FRIDAY (24 January)</b>							
10:00	PL	Retail sales	Dec	%YoY	6.8	7.3	3.8
10:00	PL	Registered unemployment rate	Dec	%YoY	13.6	13.5	13.2

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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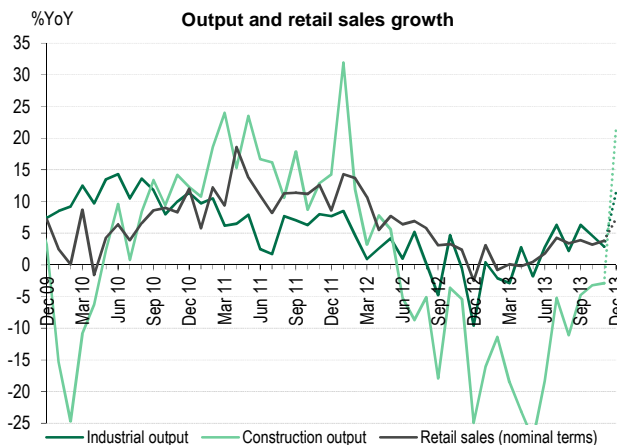
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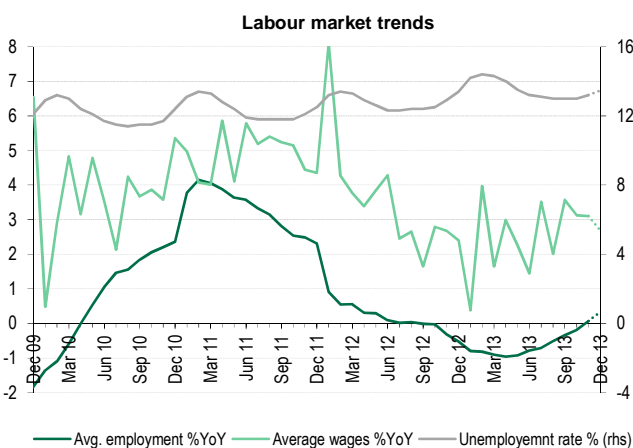
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**What's hot this week – Strong data at the year-end**

- Data on industrial and construction output in December should show much higher increases than in earlier months. This will be supported by several positive effects: apart from general recovery in these sectors, also by working day effect (one more than one year ago), statistical base effect (economic cycle in industry reached a trough in December 2012) and weather effect (December 2013 was mild, while December 2012 was relatively cold).

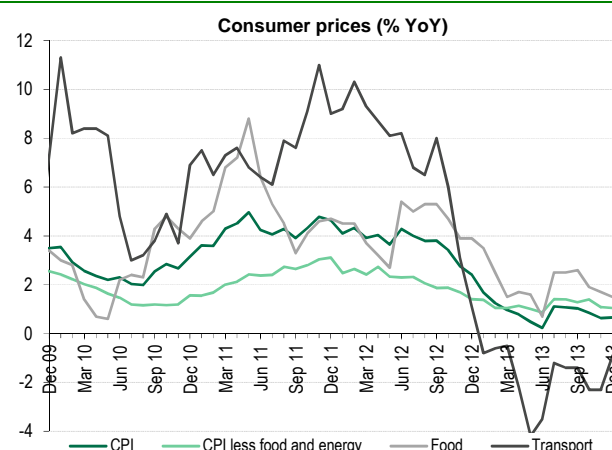
- Optimistic forecast of construction output is supported by information about high production and sales of cement in December. On the other hand, SAMAR (car market analyst) data suggested that December's car output was a disappointment (-13.4%YoY despite low base of December 2012), which is a risk factor for our above-consensus forecast. Still, we still believe that industrial output will show a decent growth rate.



- Data on retail sales – apart from improving labour market situation and consumer sentiment – will be also supported by low base effect. In December 2012 purchasing power of farmers' households was undermined by a delay in payments of direct subsidies (usually disbursed before the year-end). That is why we are expecting a strong reading.

- Data on output and sales will help to revise GDP estimates for 4Q2013. We are currently estimating that growth amounted to 2.6%YoY.

- As regards labour market numbers, we are expecting a moderate wage growth and further acceleration of annual employment growth (yet, number of workplaces in December will be lower in November due to seasonal effects). Unemployment rate probably recorded a slight seasonal growth.

**Last week in the economy – Slight increase of inflation, current account deficit**

- CPI Inflation rate rose slightly in December 2013, to 0,7%YoY. During the month prices climbed by 0.1%MoM, mostly in case of food and non-alcoholic beverages (0.7%MoM) and fuels (0.4%MoM). Prices in other categories were stable or slightly decreased. This caused a decline of core inflation excluding food and energy prices to 1.0%YoY from 1.1%YoY in November. Inflation data show that a gradual revival of private consumption, which is observed since mid-2013, is still too weak to allow retailers to start rising prices.

- Current account deficit widened in November to €984m from €213m in October. Higher deficit resulted from seasonal effects, but was lower than predicted by us and by the market, mainly due to low imports. Cumulative 12M current account deficit fell at the end of November to 1.7% of GDP and we expect that a downward trend will be continued in the following months. The data did not affect the financial market.

**Quote of the week – Narrowing of negative output gap may encourage the Council to hike****Jerzy Hausner, MPC member, 17.01, PAP**

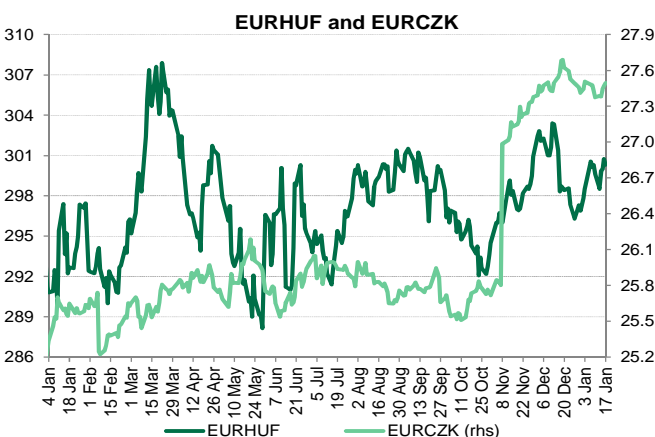
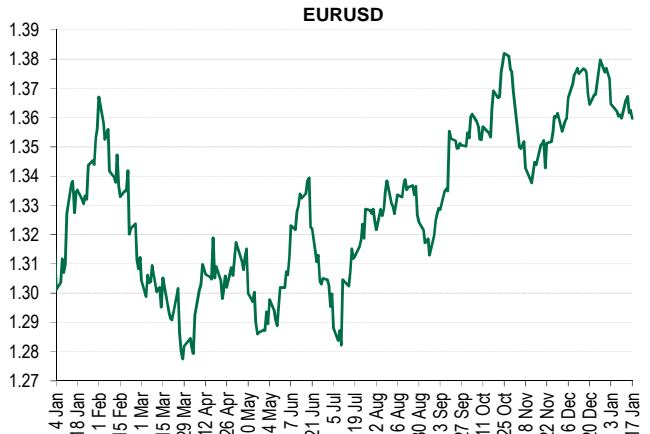
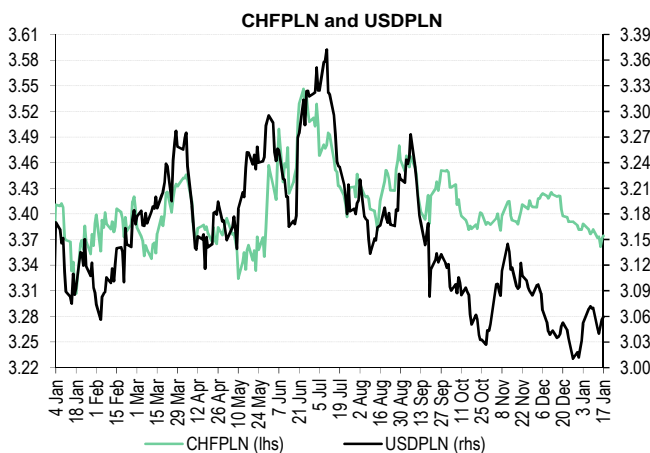
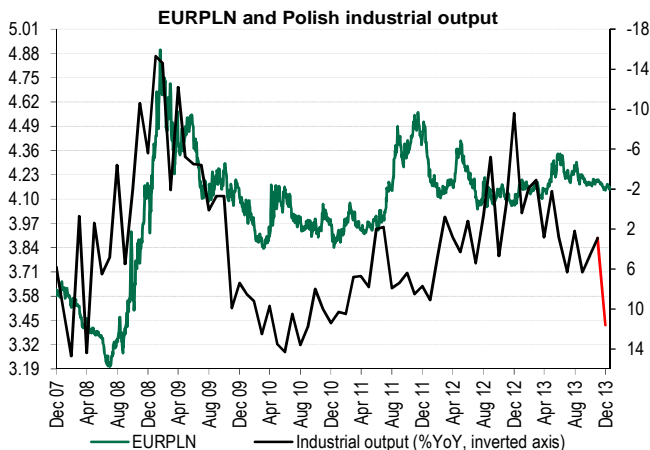
The length current flat-rate period will be probably depended on GDP growth rate. If it will surprise to the upside and will be substantially higher than potential growth rate (currently estimated at 2.6%), then the tendency of narrowing output gap will become visible soon. And this can encourage the Council to tighten monetary conditions.

**Jerzy Hausner, MPC member, 17.01, Reuters**

IN 2014 as a whole the GDP growth will be above three per cent, and may reach four per cent in 3Q2014 (...). I see no reasons why inflation should stay at a low level assumed in NBP projections.

According to our estimates, GDP growth reached 2.6%YoY (which, according to Hausner, corresponds currently to Poland's potential output growth) already in 4Q 2013. Next quarters will see further acceleration and thus a gradual closing of negative output gap. Even if GDP growth in 3Q 2014 will not reach 4%, the MPC's inclination to start interest rate hikes will be growing, in our view. Obviously, this is under assumption that inflation will be gradually converging towards the central bank's target (2.5%). Current level of main NBP rate (2.5%) was set in the environment of nearly zero inflation and nearly zero GDP growth. Amid GDP growth above 3% (and trending upwards) and CPI probably above 2%, keeping interest rates on hold would be effectively relaxing monetary policy conditions.

## Foreign exchange market – Will better macro data strengthen the zloty?



### Zloty under pressure of global factors

▪ The beginning of week was very promising as zloty continued appreciation trend after weaker than expected the US labour market data. As a consequence EURPLN temporary decreased to 4.138. However, next days brought increase in the exchange rate (to 4.17) due to deterioration of global moods (decline in EURUSD), but also due to weakening of other emerging market currencies. Zloty slightly rebounded at the end of the week, but it was only short-lived.

▪ Zloty was also volatile against other currencies. At the end of the week exchange rates were below closing levels from the previous week. However, as compared with the beginning of the week zloty depreciated the most against the US dollar and British pound (by 0.5% on average).

▪ Last days clearly show that zloty has remained under pressure of the US macro data, which determine further Fed's decision about QE3 tapering. These data overshadowed domestic ones as impact of balance of payment data for zloty was negligible. This week another part of domestic macro data will be released (including industrial output and retail sales data), which might influence the zloty's quotations. Expected acceleration of both output and retail sales growth should support zloty. One should notice that EURPLN is in downward trend, which started in the last months of 2013. Support and resistance levels at 4.14 and 4.18, respectively, are still valid.

### Euro is weaker and weaker against the US dollar

▪ Last week EURUSD was traded in relatively narrowed range between 1.355 and 1.370, depending on data flow from the US and euro zone. What is more, speeches of central bankers from Fed and ECB added more volatility to the market. The US macro data releases have shown mixed picture of economy, which stabilised EURUSD near 1.36. Industrial output figure for the US was in line with expectations, but after release EURUSD slightly declined. As a consequence emerging market currencies depreciated.

▪ The first two weeks of January show that EURUSD has consolidated in a narrow range, waiting for stronger impulse. Risk of another government shutdown in the US disappeared after approval of the 2014 budget law by the US parliament. Therefore, investors will concentrate on central banks' action and upcoming macro data will be interpreted in this context, especially due to approaching date of the January's FOMC meeting (28-29.01). Strong support for EURUSD is at 1.355 (this year's minimum).

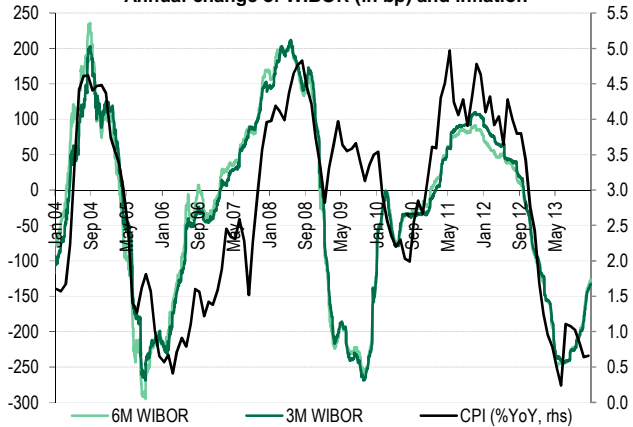
### The forint under pressure of MNB meeting

▪ CEE currencies (mainly the Hungarian forint), similarly as the zloty, lost in relation to main currencies. The forint may have been weakened by inflation data (December's inflation amounted to 0.4%YoY, the lowest level in 43 years), which supported expectations for further rate reductions. However, rebound of other CEE currencies came earlier than in case of the zloty. Still, in weekly terms the forint and the Czech koruna weakened by 0.4% in relation to the euro.

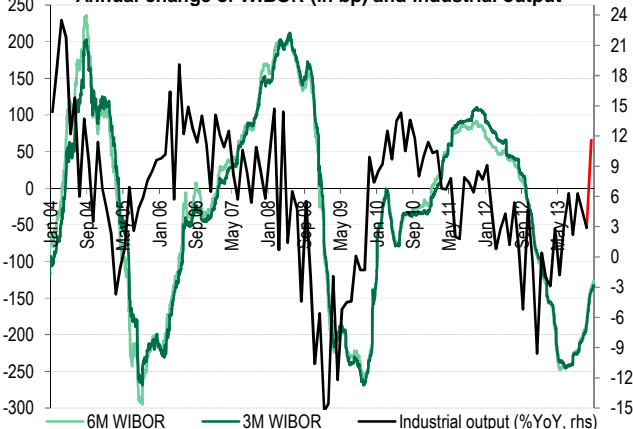
▪ This week investors will focus on the Hungarian central bank. After release of inflation data, expectations for another rate cut strengthened, but we should rather expect a less considerable scale of cuts than in the final months of 2013 (probably by 10bp). A deeper reduction can contribute to a weakening of the forint and negatively affect the zloty and the koruna.

## Interest rate market – Bond auction and European data in the spotlight

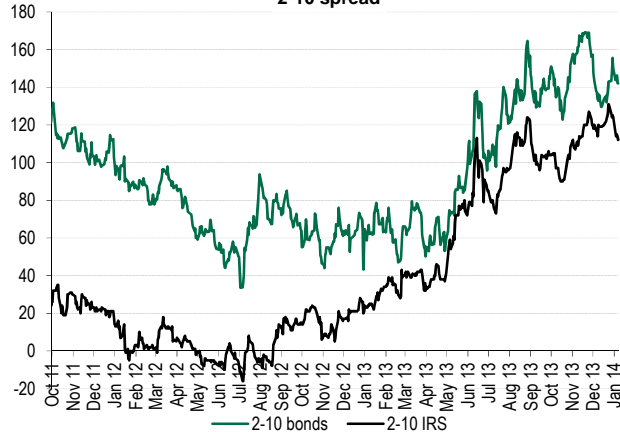
Annual change of WIBOR (in bp) and inflation



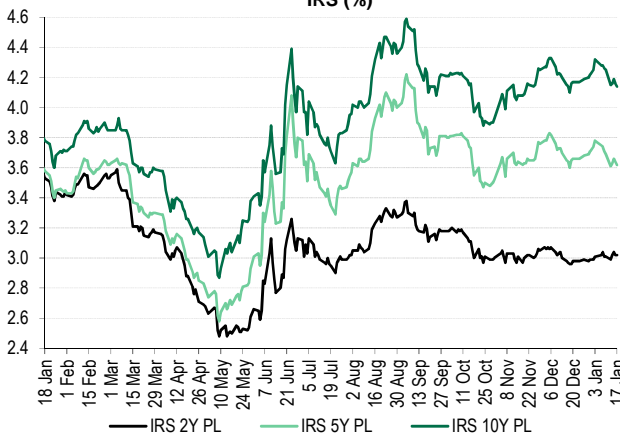
Annual change of WIBOR (in bp) and industrial output



2-10 spread



IRS (%)



## Low inflation constrains increase of WIBOR

During the last week 1-12M WIBOR rates did not change, the longest rate remains stable at 2.75% already since late September, for already 78 sessions. It seems that MPC rhetoric prevents the potential for an upward move of these rates. Also low inflation in Poland has an impact on this fact (this is clearly visible on the first chart). FRA rates also remained relatively stable in recent days.

This week data on December's industrial output is due to be released. Similar chart to the first one shows that ongoing economic rebound should push WIBOR rates higher. In our opinion, however, it seems that MPC rhetoric and low pace of price growth dominates on the market. Thus, even expected quite solid rebound of output may not have vital impact on the money market rates (at least in the short run).

## IRS and bond curves flatter

In case of IRS and bond curves the short ends remained relatively stable again at ca. 3.0% and just above 2.9%, respectively. Weak data from the US labour market released at the end of the past week continued to have positive impact on the middle and long end of the Polish curves. After quite visible steepening recorded recently, a correction of this move was observed during the last few sessions – 2-10 spread declined from ca. 125bp to 115bp for IRS and from 150bp to 140bp for bonds. Domestic market showed no visible reaction to Polish data, strengthening of Bunds proved much more important. The trade volume in Poland was rather low.

## Bond auction and European data will show the direction

We expect that Polish data released this week will be moderately hawkish. Our forecast of retail sales is above market consensus, just like in case of industrial output (though here we some downward risk) and construction output. After a week of market focus on the US data and changes in market assessment on the future of QE3, during the coming days investors' attention will shift to Europe where, among others, flash PMI for manufacturing is due to be released. December's data were interpreted quite negatively as they showed still deep divergences in paces of recovery (weak result for France).

On Thursday the Finance Ministry will conduct a bond auction, where it will offer – depending on market situation – papers out of basket consisting of OK0716 (new 2Y bond), WZ0119 and other "old" benchmarks. Auction results will be supported by inflow of PLN15bn from OK0114 buyback (PLN13.7bn) and coupon payments from WZ series (PLN1.6bn). It seems that an offer of new 2Y benchmark would be a true test for the market sentiment. We do not rule out that in reaction to 10Y bond approaching December's trough (4.28% vs. 4.35%), the ministry may offer long-end bond. Such a change can put a pressure on this sector. In December the ministry decided to sell old benchmark (PS0416), but auction was not successful. Despite high coupon (5%), only PLN2bn were bought. Such actions are aimed at improving the old bonds' liquidity, as they will be partially transferred from OFE to ZUS. The FinMin data showed that at the end of November OFE held 19% of the whole PS0416 issue. OFE were more involved in other series (40% of PS0418, 28% of PS1016, 27% of PS0417 – two last with coupon of 4.75%), which can be offered by the ministry this time.

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