Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

27 January – 2 February 2014

Flash PMI indices for European economies (including France) confirmed relatively good start of the year in terms of economic activity. On the other hand, PMI for China proved to be weaker (below 50), which spurred concerns about economic growth in emerging economies. Rising investors' worries that some of the developing countries may not be able to cope with weakening growth and reduction of stimulus by Fed, triggered a surge in risk aversion and initiated a wave of sell-off in those markets. Emerging markets' currencies weakened sharply. The scale of depreciation of Polish zloty and Czech koruna was quite small as compared to other currencies. Stock markets were hit by correction as well, while safe haven assets gained.

This week the most important event will be FOMC meeting (28-29.01). It cannot be ruled out that the Fed will continue reducing its asset purchases programme (by another $10bn) despite weaker December's data from the US labour market. Such decision is expected by the market, so its impact on the market may be limited. In the following days we will see GDP data releases (Poland, Spain, USA) and other activity indicators. The data may set the direction for markets in the short run. Approaching the moment of transferring OFE assets to ZUS (2 February) may add some volatility to the short end of the debt market at the end of the month.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 January)					
10:00	DE	Ifo index	Jan	pts	110	-	109.5
16:00	US	New home sales	Dec	k	458	-	464
		TUESDAY (28 January)					
14:30	US	Durable goods orders	Dec	%MoM	1.7	-	3.5
15:00	US	S&P/Case-Shiller home price index	Nov	%MoM	0.9	-	1.05
16:00	US	Indeks nastroju konsumentów	Jan	pts	77.5	-	78.1
		WEDNESDAY (29 January)					
20:00	US	Fed decision on monthly bond purchases		$bn	65	-	75
		THURSDAY (30 January)					
2:45	CN	PMI – manufacturing	Jan	pts	49.6	-	50.5
10:00	**PL**	**GDP**	**2013**	**%YoY**	**1.5**	**1.5**	**1.9**
14:30	US	Advance GDP	Q4	%QoQ	3.2	-	4.1
14:30	US	Initial jobless claims	week	k	330	-	326
16:00	US	Pending home sales	Dec	%MoM	0.2	-	0.2
		FRIDAY (31 January)					
14:00	**PL**	**Inflation expectations**	**Jan**	**%YoY**	**-**	**-**	**0.7**
14:30	US	Personal income	Dec	%MoM	0.2	-	0.2
14:30	US	Consumer spending	Dec	%MoM	0.2	-	0.5
15:55	US	Michigan index	Jan	pts	81.0	-	82.5

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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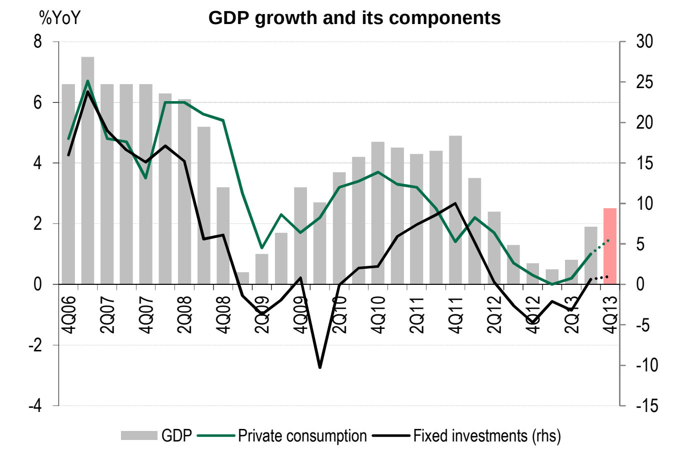
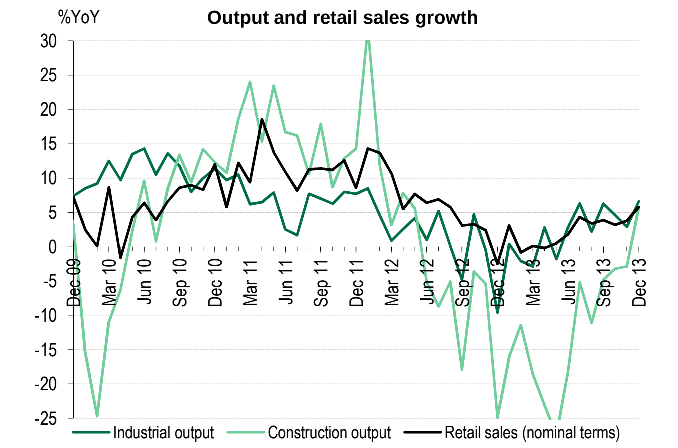
What's hot this week – Flash GDP data for 2013

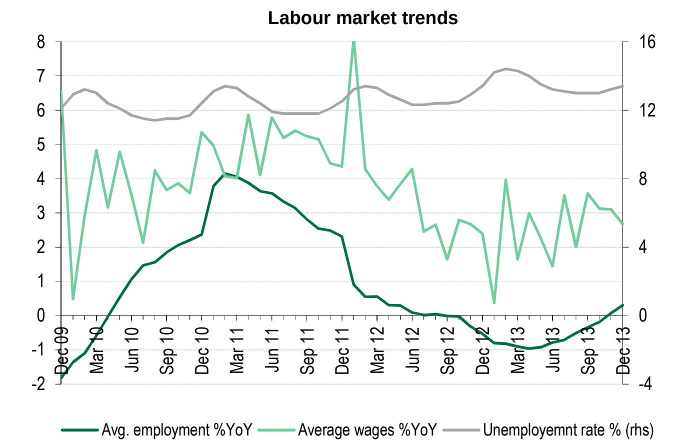


- Flash data for GDP in 2013 will be the only, yet important, domestic release this year. We are expecting GDP growth of 1.5% and this means that in the final quarter of 2013 the economy was expanding by ca. 2.5%YoY (we slightly revised this estimate downwards after December's weaker-than-expected releases of industrial output and retail sales (see below). Not only is the pace of growth important but also its structure. We are hoping to see a moderate acceleration of growth in private consumption and investment in the fourth quarter.
- Domestic data may to be overshadowed by events abroad. New data from the USA and the euro zone, but especially result of the Fed meeting, can affect investors' moods and their attitude towards emerging markets

Last week in the economy – Data on output and retail sales below expectations



- Industrial output expanded by 6.6%YoY in December and output in construction by 5.8%YoY. Retail sales advanced by 5.8%YoY. All three readings from the product market were below expectations, which undermined the optimism about GDP growth at the year-end.
- Data on retail sales, though below forecast, confirmed a further gradual recovery of consumer demand, which was supported by slightly faster-than-expected labour market improvement (see details below). Most striking development was the sharp rise in car sales (28.8%YoY – almost twice as fast as in November). At the same time, positive surprises appeared in data about sales of furniture and household appliances (10.6%YoY vs. 2% in November), press and books (5.2%YoY vs. 1.8% in November) and other sales (4.3%YoY vs. -1.4%).



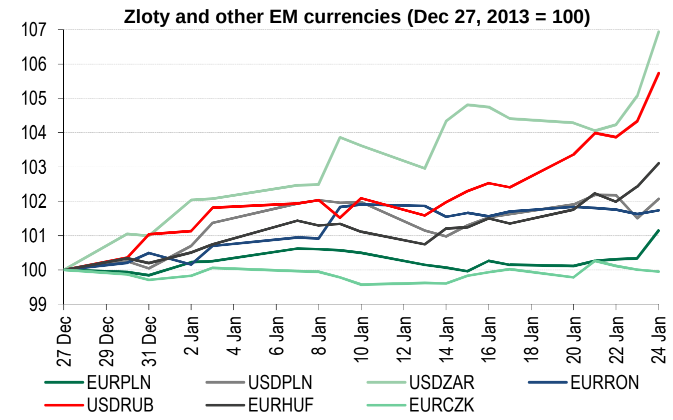
- In December 2013 average employment in corporate sector climbed by 0.3%YoY and wages rose by 2.7%YoY. On the other hand, registered unemployment rate increased less than expected, to 13.4%.
- Data showed a further improvement of labour market situation, supported by accelerating economic growth. We are expecting that in 2014 both wage growth and employment growth will accelerate, which will be supporting the private consumption.
- PPI inflation increased to -0.9%YoY and is still indicating no price pressure on producers.
- Weaker data from the product market encouraged us to lower of GDP growth forecast for Q4 to 2.5%YoY. Still, this does not change our expected path of economic recovery in the upcoming months.

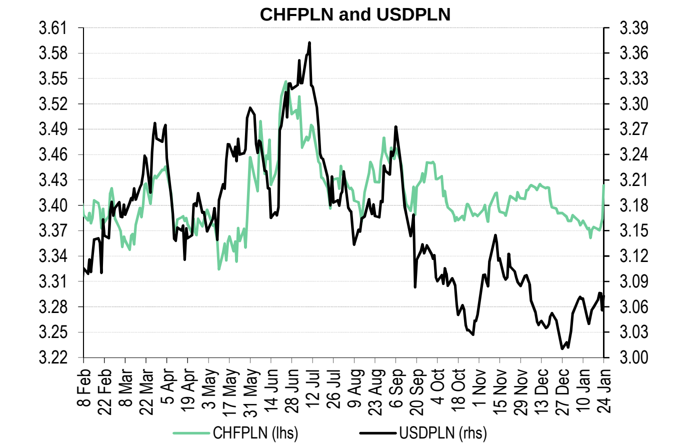
Quote of the week – Why should we tie our hands?

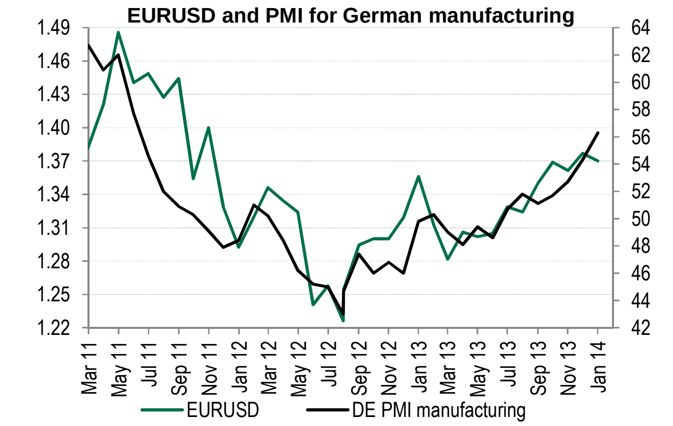
Andrzej Bratkowski, MPC member, 23.01, PAP
I still think that Q4 is the most probable timing of the first hike. At the same time I stress that risk balance indicate that hikes may rather take place sooner than later (…) Extension of this period (forward guidance) by one quarter does not give much. Why should we tie our hands?
Adam Glapiński, MPC member, 21.01, Reuters
I am supporting a stabilization of rates until the year-end. In my view, if acceleration will be gradual, then start of 2015 will be a good moment to hike rates (…) in mid-2014 we will start a discussion what to do with rates. July's projection will provide some help.
Elżbieta Chojna-Duch, MPC member, 23.01, Reuters
I would not rush with hikes due to interest rate disparity. I would wait with declaration of extension of forward guidance until March.

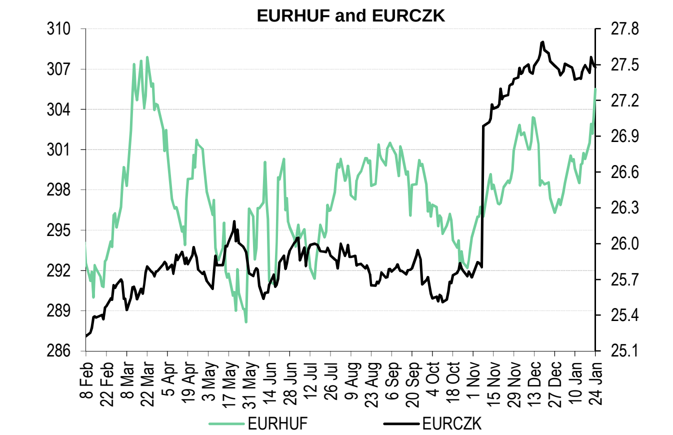
Over last months, the MPC was surprisingly unanimous as regards stabilization of interest rates until mid-2014. However, recently we have seen growing differences between MPC members. Andrzej Bratkowski who was the first one to cut rates (and to cut substantially), when economy was in a slowdown cycle, now is between those suggesting possibility of hikes. We think that he will not be alone – similar views may be shared by the MPC members expecting a soon narrowing of output gap (like Jerzy Hausner). March's MPC meeting will be a thermometer for MPC sentiments – if the Council does not extend its forward guidance by at least one quarter, it will be a suggestion of imminent rate hikes. Weakening of the zloty under influence of sell-off on the emerging markets brings us closer to monetary tightening scenario.

Foreign exchange market – Emerging markets under pressure









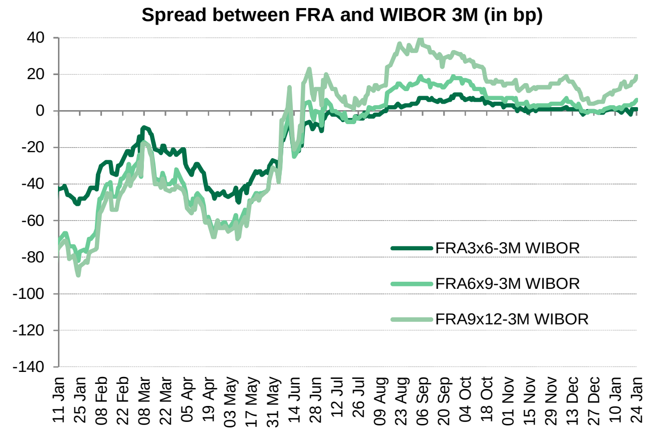
Visible depreciation of the zloty

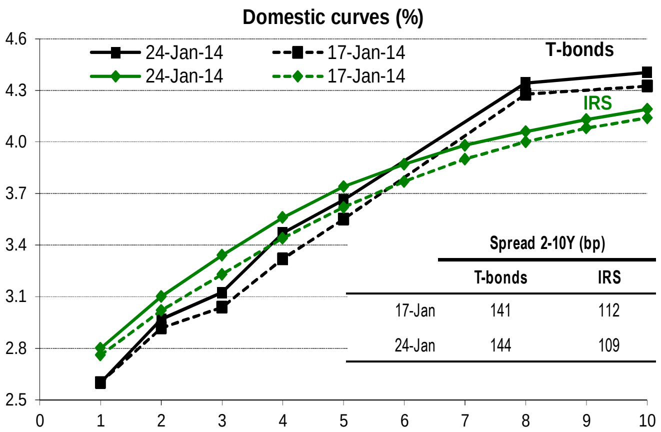
- Past week was a tough period for emerging market currencies, including the zloty. Investors worried that further tapering of QE3 by the FOMC may put negative pressure on counties addicted at least to some extent to inflow of foreign capital. Additionally, poor Chinese data (flash January's PMI for manufacturing below 50pts) and surprisingly strong figure from Europe (surge of German and euro zone's PMI) supported uncertainty that pace of economic rebound in EM will not be high enough to compensate for the risk related to investment in this countries. According to the IMF, this year the spread between GDP growth in developing counties vs. developed ones will be lowest since 2001.
- The factors mentioned above made the Turkish lira reach fresh all-time lows vs. the dollar several times last week, USDRUB reached highest level since March 2009, EURHUF broke 306 temporarily (highest level since March 2013) while EURPLN ended the week close to 4.20 (after hitting 4.22). The additional negative pressure on the forint was put by deeper than expected interest rate cut (by 15bp to 2.85% while 10bp cut was anticipated) and MNB's rhetoric saying there is still room for further monetary policy easing. The Polish currency was also hit by domestic data, which disappointed, in contrast to our expectations.
- We forecast, just like the market, that on Wednesday's evening the FOMC will decide to reduce QE3 by further $10bn. Such outcome of the meeting should not have significant impact on the zloty and other EM currencies. Meanwhile, suggestions about the pace of further tapering of stimulus shall be of particular importance. At the same time, local factors will still be vital for those currencies – outlook for more rate cuts may weigh on the forint, Turkish lira may be under pressure of unstable political environment and ruble may underperform due to poor Russian macro data. In such circumstances, it may be tough for the zloty to recover visibly.
- 4.22 is an important resistance for EURPLN (support at 4.18) and ca. 3.08 for USDPLN (support at 3.02).

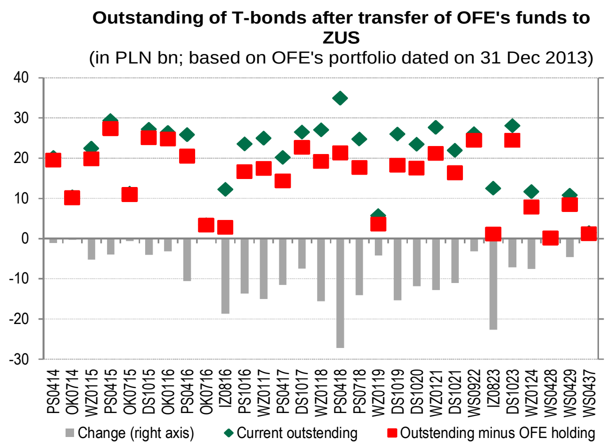
Euro zone's data support single currency

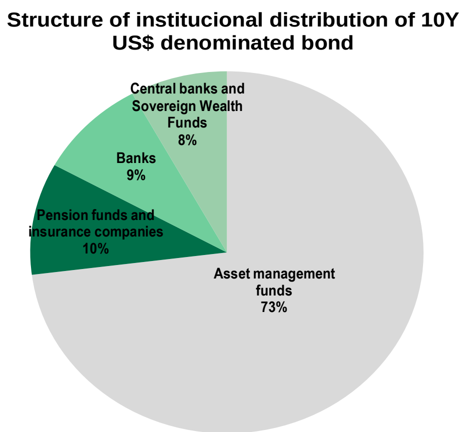
- Flash data on January's PMI for manufacturing proved most important driver of EURUSD during the last week. In case of Germany and euro zone, indexes increased already 4th month in a row and the monthly increase was highest since January 2013 and since July 2013, respectively. What is important, PMI for France improved after Decembers' disappointment. These releases have positive impact on the euro as worries over further monetary policy easing by the ECB faded. Consequently, at the end of the week EURUSD was close to 1.368 vs. 1.353 at the end of the previous one.
- Currently the exchange rate is close to level seen on the market a while after the FOMC tapered QE3 by $10bn in December. This decision was not broadly expected but the market saw high chances for this to happen. Bloomberg survey shows that reducing monthly bond purchases by next $10bn in January is expected by the vast majority of analysts. Thus, market reaction may be determined by FOMC statement, in particular comment to December's disappointing nonfarm payrolls numbers and pace of further cutting size of stimulus. The meeting will be governed by Janet Yellen for the first time.

Interest rate market – Yields under influence of risk-off mode









Money market - without any significant changes

- Situation on the money market did not change significantly last week. WIBOR rates were more or less stable as well as FRA rates up to 6 months.
- FRA rates for longer tenors (starting from 9 months horizon) have gradually increased in the first weeks of this year. Spread between FRA9x12 and WIBOR3M widened to 19bp (the highest level since mid-October 2013). Possibly to some extent this was caused by relatively hawkish statements of MPC members (Bratkowski, Hausner). We think that this trend should continue in coming weeks. Release of preliminary GDP data for 2013 might bring impulse to speed up current trend.

Sell-off at the end of week despite good auction results

- Last week brought increase in yields and IRS rates. Firstly, investors negatively reacted on information that Ministry of Finance would offer 10Y benchmark DS1023 at Thursday's auction. Consequently, yield of DS1023 slightly increased. Favourable auction results together with strengthening on core market stabilized situation on domestic debt market, but it was only short-lived. Yields and IRS rates increased considerably at the end of the week (in particular on mid and long end of curves) due to sharp weakening of the zloty.
- This week investors will focus on global markets, in particular on FOMC meeting (28-29.01). It is expected that Fed will continue gradual reduction of QE programme (with moderate scale). Such decision should not negatively influence core market, which strengthened more visibly last days due to increasing risk aversion. We expect domestic yields to depend on changes in global risk aversion (and may be vulnerable to news flow from "fragile" emerging countries). Flash GDP data for 2013 and approaching date of transferring funds from OFE to ZUS (3 February) might add some volatility to the debt market (in particular at the end of month).
- This week Ministry of Finance will present auction details for February – according to the 1Q issuance plan in February the ministry might offer T-bonds at two standard auction. It is likely supply will be well diversified, depending on market conditions and liquidity situation on the market after transferring funds by OFE to social security fund (ZUS). Therefore we do not exclude issue of 5Y benchmark PS0718 or other off-the-run papers.

High demand for Polish bonds still present

- Thursday's bond auction proved to be a success. Total demand amounted to PLN18.4bn, with WZ0119 (PLN5.9bn) and DS1023 (PLN5.3bn) as hits among investors. In due course, the Ministry sold papers worth PLN12.13bn in total (above upper border of offer at PLN10bn) with highest share of DS1023 (PLN4.1bn) with yield at 4.348%. Sales of new 2Y bond OK0716 reached ca. PLN3.4bn (by demand at PLN4.1bn) and yield was at 3.087%. According to the deputy finance minister, this was the highest bond sale ever.
- Data released by the Finance Ministry show that demand for USD-denominated bonds (placed on 16 January) amounted to ca. USD6.5bn. US investors bought the lion share of the issue (52%). Moreover, ca. 73% of the issue was purchased by asset management entities and 8% by central banks and fund managing public resources.
- After January the Finance Ministry covered over 50% of this year's borrowing needs (in our view ca. 54%). Realization at this level is making plan of 60% at the end of Q1 feasible, enhancing chances for a full coverage of needs until end of July.

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.