Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

3 – 9 February 2014

Investors' flee from the emerging markets continues. At the end of the week the EURPLN reached 4.25 (versus 4.20 one week earlier) and yields of 10Y Polish bonds reached 4.70% (versus 4.40%). Despite actions of the central banks (substantial rate hike in Turkey, less considerable in South Africa and India, FX interventions in Romania and Croatia), the sell-off was not halted, so the new week may open with choppy moods.

This week we will see important data from developed markets – final activity indices from manufacturing and services, US labour market numbers, which can affect the assessment of QE3 prospects, and hence investors' attitude towards emerging markets. Result of MPC meeting does not seem very interesting. But investors will be more focused on the ECB decision – after lower-than-expected flash inflation in January there are some expectations for another rate cut.

Economic calendar

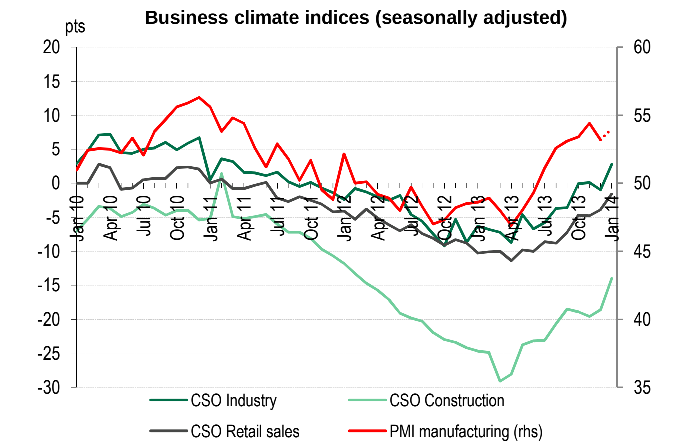
TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (3 February)					
9:00	**PL**	**PMI – manufacturing**	**Jan**	**pts**	**54.1**	**54.1**	**53.2**
9:53	DE	PMI – manufacturing	Jan	pts	56.3	-	54.3
9:58	EZ	PMI – manufacturing	Jan	pts	53.9	-	52.7
16:00	US	ISM – manufacturing	Jan	pts	56.1	-	57.0
		TUESDAY (4 February)					
16:00	US	Industrial orders	Dec	%MoM	-1.5	-	1.8
		WEDNESDAY (5 February)					
	PL	**MPC decision**		**%**	**2.50**	**2.50**	**2.50**
9:53	DE	PMI – services	Jan	pts	53.6	-	53.5
9:58	EZ	PMI – services	Jan	pts	51.9	-	51.0
14:15	US	ADP report	Jan	k	190	-	238
16:00	US	ISM – services	Jan	pts	53.7	-	53.0
		THURSDAY (6 February)					
9:00	CZ	Industrial output	Dec	%YoY	9.1	-	6.2
11:00	**PL**	**Bond auction**					
12:00	DE	Industrial orders	Dec	%MoM	0.2	-	2.1
13:00	CZ	Central bank decision		%	0.05	-	0.05
13:45	EZ	ECB decision		%	0.25	-	0.25
14:30	US	Initial jobless claims	week	k	338	-	348
		FRIDAY (7 February)					
8:00	DE	Exports	Dec	%MoM	0.8	-	0.3
12:00	DE	Industrial output	Dec	%MoM	0.4	-	1.9
14:30	US	Non-farm payrolls	Jan	k	185	-	74
14:30	US	Unemployment rate	Jan	%	6.7	-	6.7

Source: BZ WBK, Reuters, Bloomberg, Parkiet

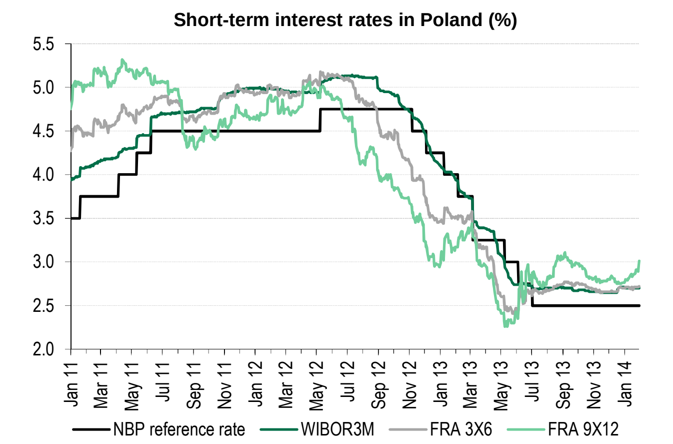
ECONOMIC ANALYSIS DEPARTMENT:
ul. Marszałkowska 142. 00-061 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin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

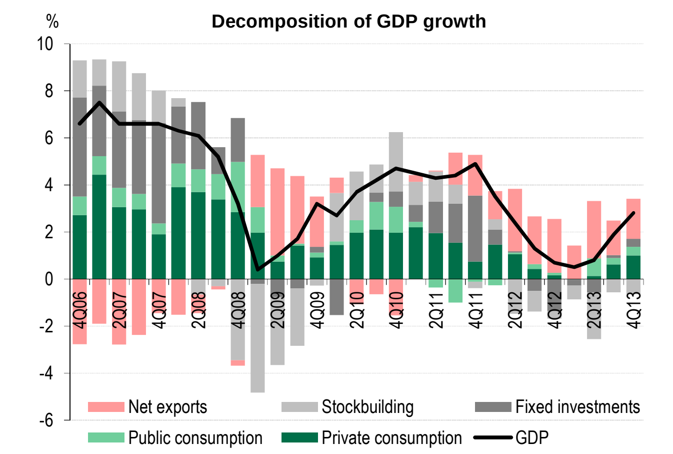


- PMI index for Polish manufacturing will be the first important hint on economic activity at the beginning of the year. We are expecting that after a corrective move in December, now the index will resume its upward trend, supporting expectations for a further acceleration of economic growth. Our view is supported by several factors:
- Firstly, flash manufacturing PMI in the euro zone and in Germany (but also German Ifo) posted robust gains in January, which suggests that inflow of new export orders to the Polish industry should be accelerating.
- Secondly, January's CSO business climate indices (in all sectors) recorded considerable improvement.
- Thirdly, weakening of the zloty is a statistically significant factor supporting moods in industry.



- Recent events on the emerging markets encouraged numerous banks to take decisive actions (interest rate hikes in Turkey, India, South Africa, currency interventions in Romania, Croatia, Russia).
- The MPC still has no reason to abandon its *forward guidance,* which assumes stabilization of interest rates at least until mid-2014. Outcome of the nearest meeting will probably be probably not very exciting again, and the statement is not likely to change considerably. However, it is increasingly likely that the March's meeting will be much more interesting, as the Council will be acquainted with results of new NBP projections. Improving prospects of economic growth and weakness of the currency reduce changes that *forward guidance* will be extended. If this is the case, it would be a signal for the market that chances for interest rate hike already in 2014 are rising.

Last week in the economy – Economic growth bottoming out as quickly as in 2009



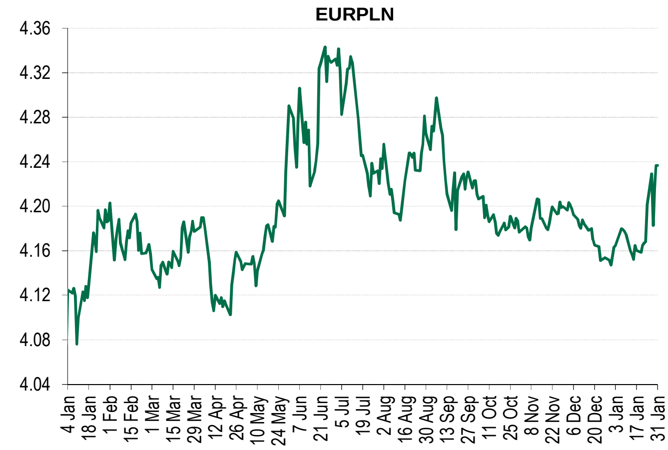
- GDP growth amounted to 1.6% in 2013 vs 1.9% in 2012. We estimate that in Q4-2013 the Polish GDP expanded by ca. 2.8%YoY and was considerably better than expected.
- The data are showing stronger-than-expected recovery of main components of domestic demand. Individual consumption advanced by 0.8% in 2013, and by almost 2%YoY in Q4. Fixed investment declined by 0.4%YoY in entire year, and this means they rose by ca. 1.3%YoY in Q4 alone. At the same, net exports were contributing strongly to the growth – this factor added 1.8pp in 2013 and 1.7pp in Q4.
- Pace of bottoming out of Polish economy is similar to the one observed back in 2009, when growth accelerated from 0.4% in Q1 to 3.2% in Q4 (currently: from 0.5% to 2.8%). At the same time, the recovery has broader and more solid fundamentals as the role of domestic demand is rising. We expect these tendencies to continue in coming quarters.

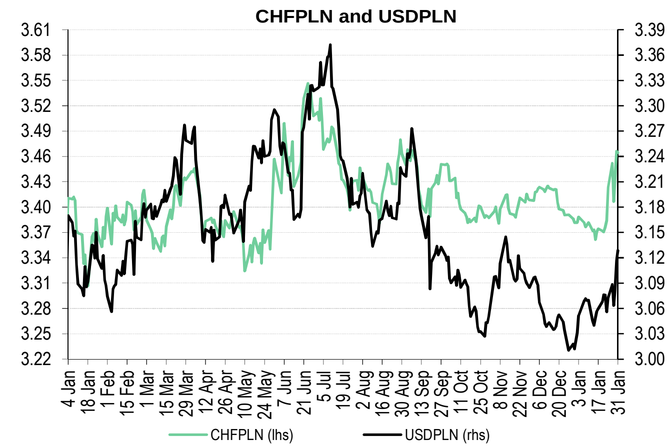
Quote of the week – The NBP is ready to take adequate actions

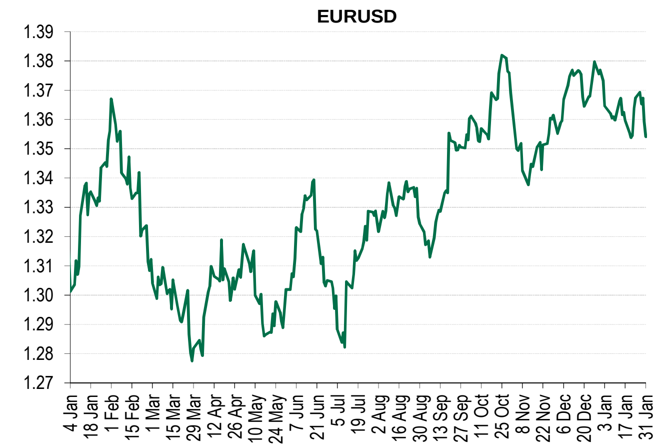
Eugeniusz Gatnar, MPC board member, 29.01, PAP
Market is nervous, investors are affected by their emotions and they are following a herding behaviour. However, our economic fundaments are strong, so there are no reasons here for the weaker zloty. But we are closely monitoring the situation. Excessive zloty volatility would be a negative event, but we see no reasons to feel distressed right now. I have to underline that our situation is safe, taking under consideration current level of our FX reserves versus short-term external debt. [Should the exchange rate become too volatile, the NBP] is ready to take adequate actions.

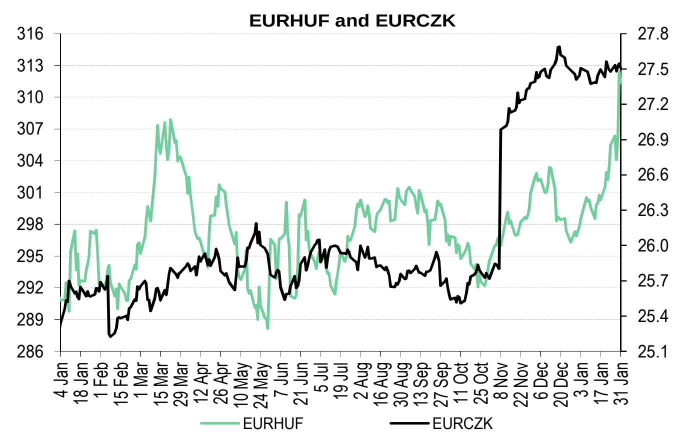
Central banks of the CEE region have acted differently when addressing the sell-off of emerging currencies. In Romania and Croatia we saw FX interventions, while governor of the Hungarian central bank did not rule out further rate cuts (!), which added more fuel the depreciation of the currency. In Poland we have seen only a verbal intervention so far. However, comment of the NBP representative is a clear hint that the central bank may appear on the market. We guess that questions regarding this subject may appear on the press conference. Let us remind, however, that in June the NBP intervened shortly after Marek Belka's comment during the MPC conference that zloty weakening is not worrying.

Foreign exchange market – Will the new data give respite for the market?









Zloty weaker, but fundamentals are still supportive

- Last week brought another wave of EM currencies sell-off, including the Polish zloty. Rate hikes by some EM's central banks (Turkey, the RPA, India) or NBP's verbal intervention did not improve market sentiment. What is more, Fed's decision to reduce its QE3 program supported weak mood, and consequently affected EM currencies. On the other hand better than expected Poland's GDP growth for 2013 was ignored by market players. At the end of the week volatility on the market increased due to weak data from China, further forint and ruble depreciation and also sharp sell-off on domestic debt market by foreign investors. As a consequence EURPLN tested 4.26 (the highest level since early September 2013) during the session, ending the week close to 4.24.
- Zloty depreciated also against other main currencies. In weekly terms domestic currency lost the most against the US dollar (by 1.8%) and the CHF (by 1.2%), while depreciation against the EUR and the GBP amounted to 0.8%. In monthly terms zloty depreciated by 3.9% against the US dollar, 3.3% against the British pound and slightly above 2% against the euro and Swiss franc.
- Depreciation trend of the zloty (with some breaks, and intensification in the second half of January) mainly comes from global factors. In our opinion fundamentally such zloty depreciation is not justified. Therefore we think that cooling down current global mood may support zloty strengthening. The US macro data (lower than expected non-farm payrolls might renew expectations on slower tapering by Fed) or ECB meeting (if bank decides to ease monetary conditions, but it is not our base-case scenario) may bring impulse to rebound. Potential activity of Poland's central bank on the FX market may also limit zloty fluctuation. Still important levels for EURPLN are 4.21 and 4.25.

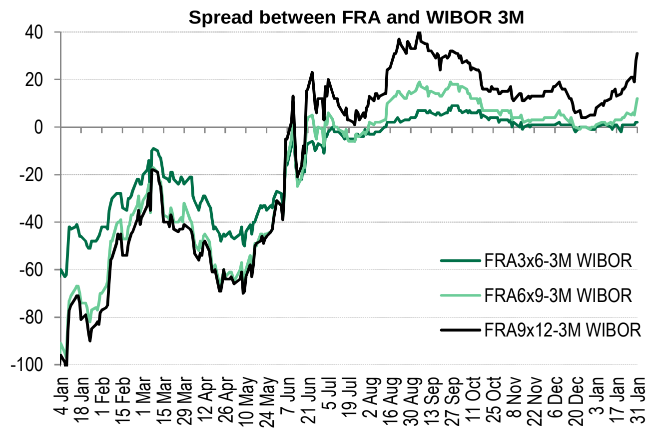
Dollar strengthening gradually

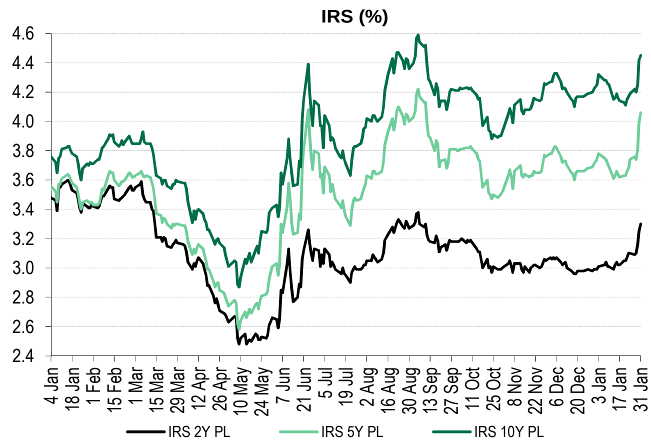
- Last week the US dollar was gaining in relation to main currencies. This was an effect of FOMC decision to reduce QE3 program further, but also the effect of relatively good macro data from the US economy. On the other hand, the single currency was losing due to rising expectations for more monetary policy easing in the euro area after weak data on M3 money supply and inflation. As a result, EURUSD slid to almost 1.35 at the end of the week.
- This week investors will focus on economic activity indices for the euro zone, on the ECB meeting and on the US labour market data. Confirmation of flash PMI readings (which showed rising optimism of produces) and keeping monetary policy parameters unchanged should be supportive for the single currency. As a result, EURUSD could return above 1.36. End of the week will be under influence of the US data, which can affect further Fed actions. Important support is at 1.35.

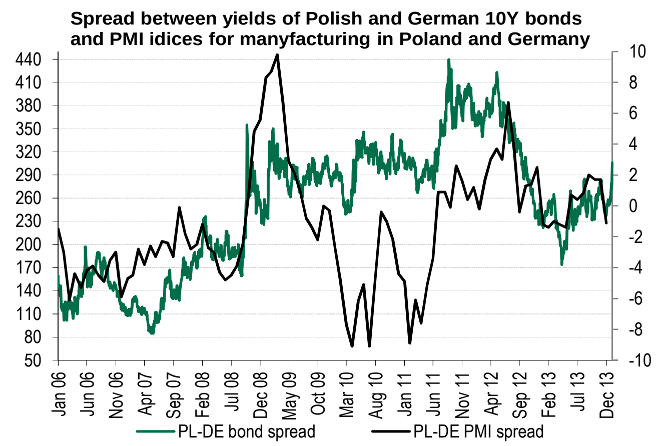
Forint under pressure, the koruna quite stable

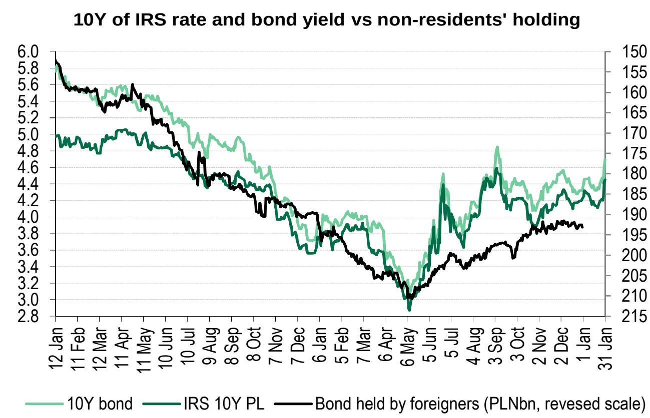
- The Hungarian forint was one of the EM currencies which depreciated most. This was due to comment of governor of the central bank, who confirmed that interest rates may be reduced further due to low inflation. In due course, EURHUF climbed to almost 314. The Czech koruna was more stable. Its relative robustness to swings in global moods may have been due to low engagement of foreign investors in the Czech debt market. Situation on these currencies will not change much in the course of the week.

Interest rate market – Important data from the USA, first bond auction with no OFE









WIBORs go slightly up

- WIBOR1-12M climbed by 1bp last week. This was accompanied by a strong upward move of FRA rates, mainly of 6x9 and 9x12 (by ca. 10bp and 15bp). Currently the market is pricing-in that WIBOR3M will go up by 30 bp in 9 months' time vs. expectations at 10bp at the beginning of the year and 4bp at the end of 2013. Investors began to price-in that, given actions of central banks (interest rate hikes aimed at supporting the currencies) and accelerating economy, chances for a tightening of domestic monetary policy before the year-end rise.
- We do not expect the MPC to change its rhetoric so outcome of the meeting should cause no additional upward pressure on WIBOR rates. Global sentiments will be crucial for the FRA market, in our view.

Considerable rise of IRS and weakening of bonds

- The high risk aversion, persisting on market for the second week in a row, exerted a clearly negative pressure on Polish debt and IRS. Moreover, bonds were losing while awaiting transfer of OFE-held bonds to ZUS (3 February). Yields of 2Y, 5Y and 10Y bonds climbed by 20-40bp and IRS with the same maturities by 20-30bp, to 3.29%, 4.05% and 4.45%, respectively (highest level since September in all cases).

Crucial data from the US, first bond auction without OFE

- This week final data for PMI-manufacturing for Germany and euro zone as well as Polish index are due to be released. Historical data suggests (see chart) that faster growth of Polish manufacturing vs. German sector usually lead to widening of 10Y Polish-German bonds spreads. Our Polish PMI forecast shows that in January the negative difference with German index widened further and this – according to the above pattern – should support narrowing of bond spread. However, global market sentiment remains highly negative and yields of Polish bonds surge as investors withdraw capital from emerging markets. Additionally, recent decisions of some central banks (that is hiking interest rates in order to support the currency) could enhance expectations that visible depreciation of the zloty may encourage the MPC to tighten monetary policy earlier than initially expected.
- However, the outcome of the MPC meeting shall not be the key driver for Polish bond market. We assume that the Council will refrain from any straightforward declarations or hints regarding any possible changes in monetary policy outlook and will wait for March meeting when fresh NBP projections will be available.
- Data from the US labour market (due to be released at the end of the week) may prove more important for the domestic bonds and IRS. As the next chart shows, suggestion of QE3 tapering – expressed by Bernanke for the first time in May 2013 – halted the inflow of foreign capital into the Polish debt market and lead to higher yields. US central bank pointed that pace of further cutting monthly bond purchases will rely on situation on the labour market and outlook for inflation. Thus, nonfarm payrolls data may have clear impact on investors' sentiment this week. December's number was very disappointing (partly to severe winter), but this did not prevent FOMC from reducing the size of QE3. If January's data surprises to the upside, then Polish debt may still be under pressure.
- Last bond auction without OFE will he held on Thursday. Given the recent changes on the market the results will be a good gauge of investors' perception of Polish 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 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.