Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

10 – 16 February 2014

After sharp sell-off at the end of January, the start of February saw a rebound in emerging markets' currencies (with PLN leading the gains vs. the euro and dollar). However, it is still hard to say that investors' concerns about this part of the world are gone. Since the start of the year until 5 Feb the outflows from emerging market equity funds reached $18.6bn, exceeding those in all 2013. PLN has been supported by very strong rise in PMI index, suggesting a good start of the year for Polish industry. Neither MPC nor ECB made any changes to their monetary policies, waiting for March updates of economic forecasts.

In the first part of the nearest week the situation may depend mainly on global moods, as key domestic data releases (CPI, GDP) are scheduled for Friday. Inflation, if consistent with our forecast (and lower than expected by the market) may again delay the moment of first rate hikes priced-in by the market; especially, if zloty appreciation and improvement of moods in emerging markets continues.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (10 February)					
		No important data releases					
		TUESDAY (11 February)					
16:00	US	Speech of new Fed governor					
		WEDNESDAY (12 February)					
9:00	CZ	CPI	Jan	%YoY	0.3	-	1.4
11:00	EZ	Industrial output	Dec	%MoM	-0.3	-	1.8
14:00	**PL**	**Current account**	**Dec**	**€m**	**-1214**	**-1083**	**-984**
14:00	**PL**	**Exports**	**Dec**	**€m**	**11 550**	**11 400**	**13 594**
14:00	**PL**	**Imports**	**Dec**	**€m**	**12 091**	**11 900**	**13 587**
		THURSDAY (13 February)					
11:00	**PL**	**Bond auction (offer PLN2-5bn)**					
14:30	US	Retail sales ex autos	Jan	%MoM	0.2	-	0.7
14:30	US	Initial jobless claims	week	k	330	-	331
		FRIDAY (14 February)					
8:00	DE	Flash GDP	Q4	%YoY	1.4	-	0.6
9:00	HU	Flash GDP	Q4	%YoY	2.5	-	1.8
9:00	HU	CPI	Jan	%YoY	0.3	-	0.4
9:00	CZ	Flash GDP	Q4	%YoY	-0.2	-	-1.2
10:00	**PL**	**Flash GDP**	**Q4**	**%YoY**	**2.8**	**2.8**	**1.9**
11:00	EZ	Flash GDP	Q4	%YoY	0.4	-	-0.4
14:00	**PL**	**CPI**	**Jan**	**%YoY**	**0.9**	**0.7**	**0.7**
14:00	**PL**	**Money supply**	**Jan**	**%YoY**	**6.2**	**6.4**	**6.1**
15:15	US	Industrial output	Jan	%MoM	0.3	-	0.3
15:55	US	Flash Michigan	Feb	pts	80.5	-	81.2

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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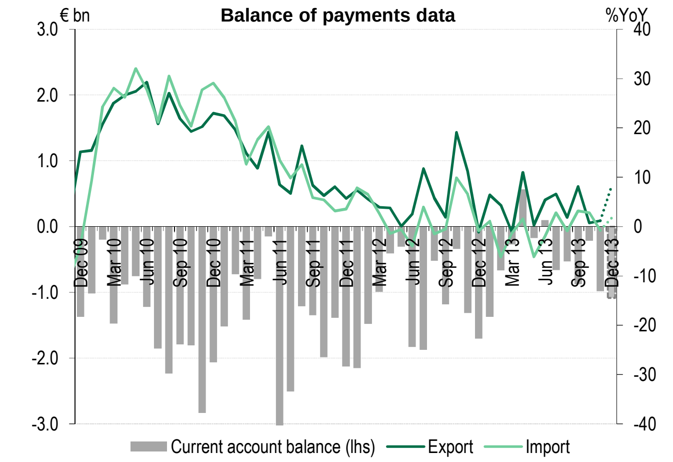
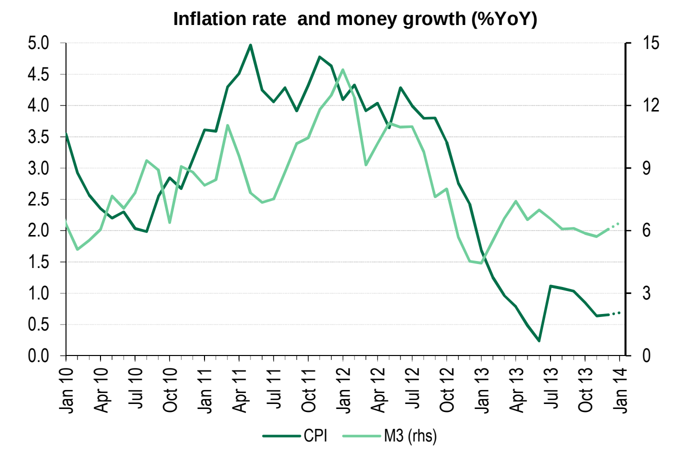
What's hot this week – Economy accelerating, inflation still low

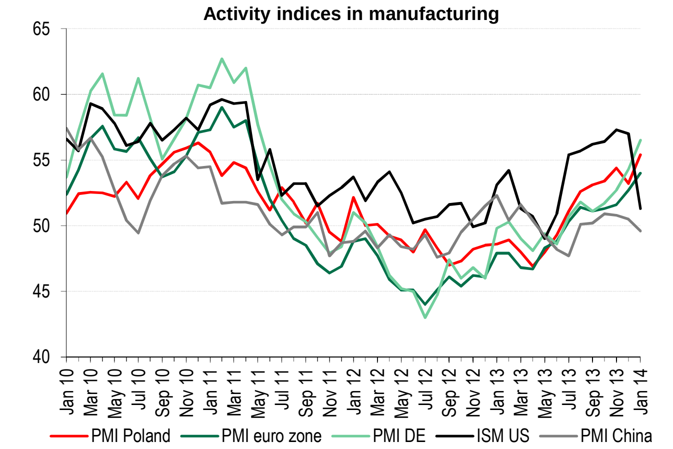


- In our view, December's data on balance of payments will show a substantial acceleration of exports' growth (in line with a faster increase of industrial output), but also the first deficit in goods account since March 2013, and the highest current account deficit since January 2013. However, these deficits will be still considerably lower than one year ago (and thus the relation of current account deficit to GDP will fall to the lowest level since mid-90s) and below median of market forecasts, so the numbers should not have negative impact on the zloty.
- Based on flash GDP data for 2013, we can estimate that the final quarter of the year showed a considerable acceleration of growth. However, the estimation error can possibly be substantial, so data on growth and its breakdown in Q4 will be still quite interesting. We are expecting a confirmation of stronger role of domestic demand – rising consumption and investment.



- Inflation data will be probably the most important release of the week. Wide range of analysts' forecast (0.7-1.2%) is indicating that the market reaction to CSO data might be substantial. Our estimates are showing that CPI growth remained unchanged in January, at 0.7%YoY, among other factors due to relatively slow increase of food prices, considerable decline of fuel prices and lower energy prices. However, this would mean that core inflation accelerated at the start of the year.
- As usually, data on money supply will have no market impact. However, it is worth paying attention if they confirm a continuation of accelerating loan growth, visible at the end of 2013. Recent NBP survey about credit market conditions indicated, among others, easing of lending criteria in SME segment and an expected considerable rise of companies' demand in Q1, among others for investment loans.

Last week in the economy – Strong start of the year in industry, interest rates unchanged



- Polish January's PMI for manufacturing surprised clearly to the upside. After the strongest monthly increase in two years the index reached 55.4pts, the highest level in 36 months. The report showed that acceleration of orders (also export orders) was accompanied by improvement in output. These positive tendencies – persisting for already several months – resulted in the highest ever (that is since 1998) pace of growth in employment in January. Interestingly, the subindex for costs of production remains at low level (lowest for seven months), which clearly shows that there is no inflationary pressure at current stage of an economic revival.
- In line with expectations, the Monetary Policy Council left interest rates unchanged, with reference rate at 2.5%. The meeting did not bring much important information regarding monetary policy outlook.

Quote of the week – We still have a lot of time

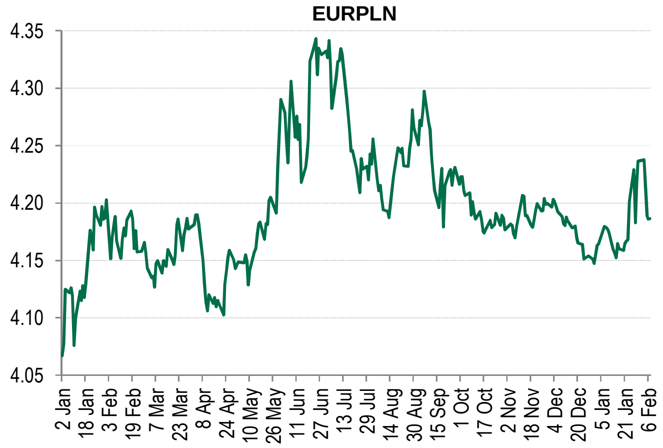
Marek Belka, NBP president, 05.02, MPC press conference

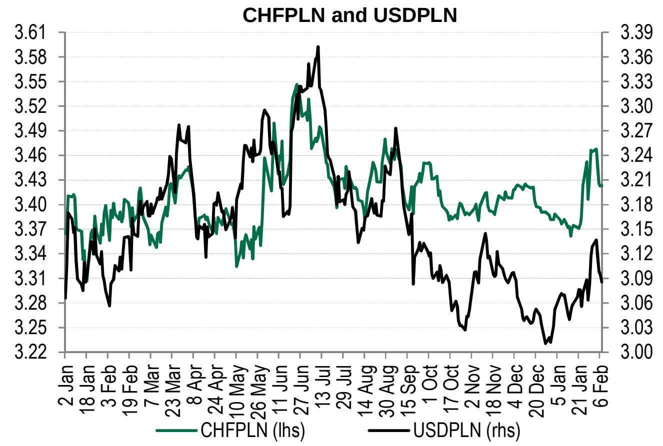
We have a situation any central banker can dream of (…) the economy is accelerating and inflation is not only kept at bay, but also seems to be running at low level in the future (…) Economic acceleration is start at a very low level. Output gap is still considerable and it will be closed slowly (…). Text of the statement you received is a replica of last months' sentences. We would like to send a strong signal for the market, as we will that situation is under control and there are no reasons to change our stance (…) as for the time being, we still have a lot of time (for decisions). I would like to avoid a situation, when we will be getting markets used to something, like betting for hikes or cuts.

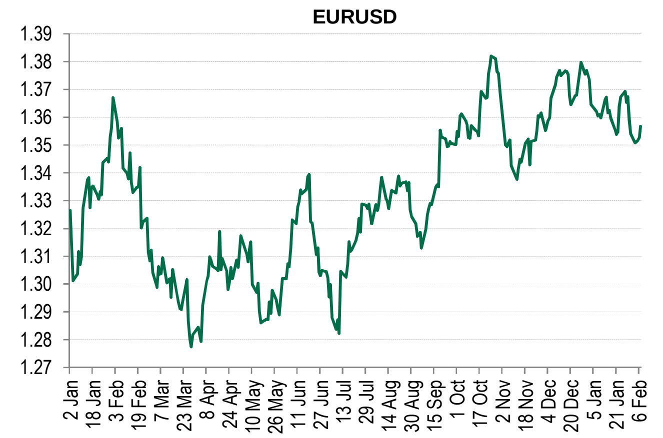
President Marek Belka was rather clear during the MPC press conference that the Council feels comfortable amid current conditions (accelerating economic growth and low inflation) and is not willing to rush with decisions concerning changes in the monetary policy.

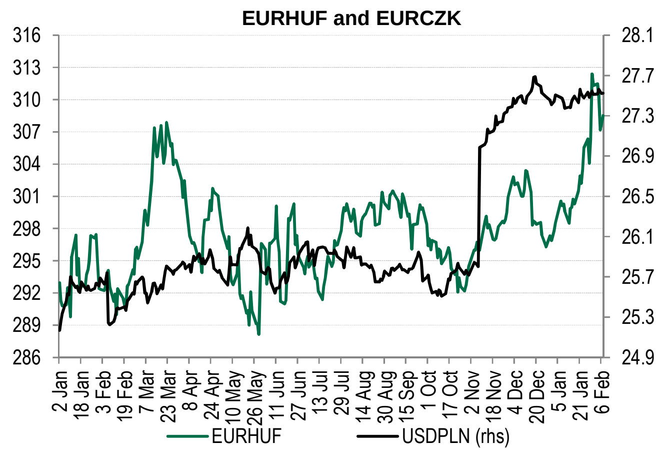
March's MPC meeting will be the most interesting in 1Q 2014 due to release of the new GDP and CPI inflation projection. However, most probably the Council will not suggest a change in its stance during this meeting and will wait until next inflation projection in July. At that time, the relatively long (as for Poland) *forward guidance* might be abandoned to the benefit of "meeting to meeting" analysis of situation. We do not change our forecast that the first hike will be implemented in the autumn.

Foreign exchange market – Zloty recorded sharpest recovery last week









Domestic and foreign data supported the zloty

- The three-week-long streak of zloty depreciation versus main currencies has been broken last week. The stabilisation of moods in global markets, much better than forecast PMI index for Polish manufacturing and the start of the week and poor US labour market data at the end of the week, all triggered a drop of EURPLN from 4.26 to 4.17. Meanwhile, CHFPLN fell from 3.49 to 3.40, GBPPLN from 5.20 to 5.10, and USDPLN from 3.16 to 3.07. As a result, the zloty was the fastest gaining currency last week among emerging markets' currencies, versus euro, dollar, Swiss franc and British pound.
- This week we will see important domestic data releases. Especially important for the zloty may be current account data for January and GDP for 4Q 2013. Both releases have the potential to support Polish currency. We expect to see below-consensus deficit in current account. The significant improvement in this area in recent months was among the factors supporting the zloty during elevated risk aversion. GDP data are not likely to be very surprising, however confirmation of acceleration of GDP growth from 1.9% to 2.8% may be positively perceived by the market.

Euro gaining thanks to ECB and NFP

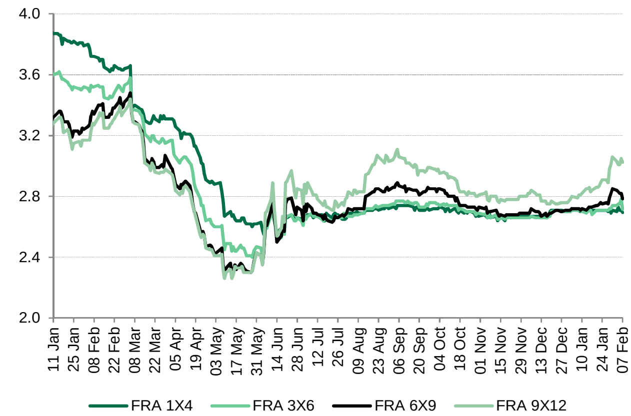
- Last week the biggest impact on the EURUSD exchange rate came from the decision and rhetoric of the ECB and the monthly data from the US labour market. Data on flash inflation in the euro zone, released in the previous week, proved weaker and this fuelled expectations that the central bank may be willing to ease the monetary policy. Meanwhile, the ECB kept interest rates unchanged and only mentioned its readiness to implement further actions. This positively affected the single currency – EURUSD climbed dynamically from 1.35 to 1.362. Another impulse, yet not so strong, was delivered by the US data. January added less jobs than expected so the weekly peak of EURUSD was at ca. 1.363.
- The upcoming week's macro calendar will not be as rich in important releases as the last one. However, we will see speeches of numerous FOMC members, whose comments may considerably affect expectations about pace of QE3 reduction further in the year. Important levels for this week are 1.35 and 1.37.

Forint gained thanks to PMI; more data due this week

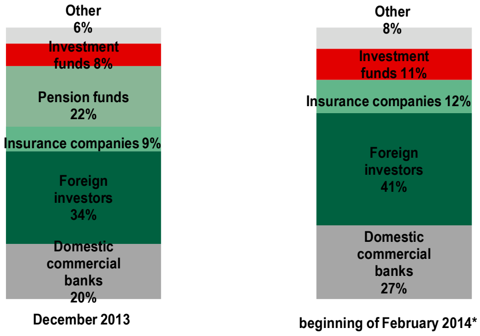
- Forint, just like the zloty, benefited from the improvement of the global market sentiment and strong Hungarian PMI – index for manufacturing reached highest level since March 2007. Consequently, EURHUF plunged from 314 (last time it went that high two years ago) to 306.
- The Czech central bank kept interest rates on hold. Its president said that the decision to intervene on the FX market in November 2013 was right and helped to avoid deflation. He added that a floor for EURCZK at 27.0 was chosen thoughtfully and will be kept at least until early 2015 (in line with earlier communication). The outcome of the meeting did not have much impact on the koruna, EURCZK stayed in the horizontal trend last week.
- Flash 4Q GDP growth and January's inflation are due to be released this week and may have visible impact on koruna and forint. When during the recent emerging market turmoil some central banks tightened monetary policy, head of Hungarian bank said that low inflation gives room for further monetary policy easing (in December inflation was at 0.4%YoY vs. inflation target at 3%YoY) and this weighted on forint. In case of Czech data, inflation reading will help to assess the impact of FX intervention on pace of price growth. Any positive surprises in GDP data shall have positive impact on both currencies; but potential for bigger move if for forint.

Interest rate market – Large demand for Polish bonds even without OFE

FRA (%)



Changes of bond holders' shares without OFE sector



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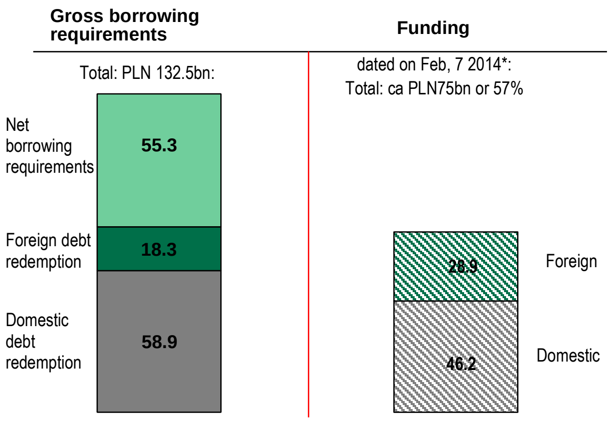

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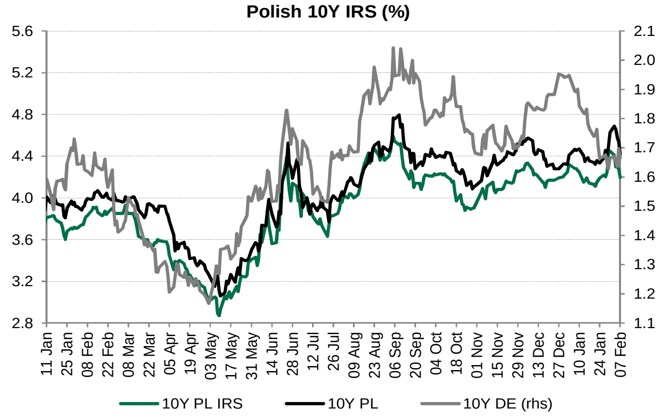
Yields of Polish and German 10Y Bonds and Polish 10Y IRS (%)



Market is pricing-in interest rate hike in the autumn

- Improvement of global moods, but also the domestic debt strengthening, brought a slight decline of FRA rate amid relatively stable WIBOR rates (increase by 1bp for 9M and 12M). February's MPC decision to keep rates unchanged and to maintain declaration that rates will be stable until mid-2014 was neutral for the market. Despite rebound after strong rises at the end of January, FRA9x12 rate maintained above 3%. This means that the market is pricing-in a full 25bp hike in 9 months' time, which is close to our expectations.
- Inflation data may be important for the money market situation in the upcoming days. CPI in line with our forecast (and below market consensus) may again scale back expectations for hikes, especially if the zloty keeps on gaining.

Rebound after a strong sell-off

- A very interesting week for the bond market is behind. First, OFE transferred to ZUS assets worth ca. PLN153.2bn, which means that investor breakdown changed considerably. OFE disappeared as an active player and the share of foreign investors climbed to ca. 41% (up from 34% at the end of December 2013) – see chart beside.
- Calmer moods on the global markets triggered a rebound on bond and IRS markets. Good results of domestic debt auction (see details below) also supported the positive market moods. In due course, bond yields and IRS rates declined by 14-31bp and by 11-19bp, respectively, with the most considerable declines in 5Y sector. Due to these changes, both curves flattened – 2-10Y spread fell to 139bp for bonds (from 149bp at the end of December) and to 109bp for IRS (from 115bp).
- Finance Ministry informed that at two regular auctions in February it will offer bonds worth PLN4-9bn in total. The first auction (without OFE) included bonds neutral for the market, i.e. OK0716 and WZ0119 worth PLN2-4bn. Investors' demand was twice as high as bond supply, and this encouraged the ministry to offer these papers also at top-up auction. In general, the ministry placed bonds OK0716 worth PLN1.4bn in total with yields at 3.181% (below secondary market level) and WZ0119 worth PLN3.4bn. After this auction this year's gross borrowing needs are covered in ca. 57%. Such a realisation of borrowing needs allows for high elasticity in adjusting the offer to investors' expectations and market situation.

This week another auction and inflation data

- On Tuesday the Ministry of Finance will announce details about Thursday's auction. The Ministry plans to offer bonds worth PLN2-5bn, and the structure of supply will depend "on the degree of strengthening on bond market in its particular segments". Bearing in mind that the middle of the yield curve has strengthened the most, we think that 5Y benchmark PS0718 may be offered, which liquidity dropped substantially after redeeming OFE assets. Taking into account the liquidity effect, we also think that the Ministry may offer the following bonds: OK0715, PS0417, DS1021, or WZ0124. Offering bonds from the long end of the curve may slightly weigh on the market. However, we believe the auction will meet large investors' demand, similarly as the previous one.
- Economic data to be released this week (including CPI) should be supportive for debt market (our inflation forecast is below market consensus). However, in the first part of the week the global market moods will be crucial.

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