Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

17 – 23 February 2014

Last week the moods in the global financial markets were quite good. Janet Yellen's declaration to continue the Fed's policy – including further tapering of QE3 – has not stopped gains in equity markets or appreciation of the zloty. Domestic events had biggest impact on the local interest rate market than external factors – weakening of the market triggered by offer at bond auction has been partly offset after weaker than forecast GDP data for Q4.
We expect to see relatively dovish data for January, only in case of employment our forecast is above market consensus. Industrial output reading may reinforce the effect of weaker than expected data about Q4 GDP growth, adding impulse for drop of IRS rates and bond yields. Apart from Polish data, also economic releases abroad may have important impact on the market, especially those about flash PMI indices. It is noteworthy that it was the weak reading of PMI index for China that triggered a sharp deterioration of moods in emerging markets last month, which resulted in significant zloty depreciation, and rise in Polish bond yields and IRS rates.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 February)					
		No important data releases					
		TUESDAY (18 February)					
11:00	DE	ZEW index	Feb	pts	44.0	-	41.2
14:00	**PL**	**Wages in corporate sector**	**Jan**	**%YoY**	**3.2**	**3.1**	**2.7**
14:00	**PL**	**Employment in corporate sector**	**Jan**	**%YoY**	**0.6**	**1.2**	**0.3**
14:00	HU	Central bank decision		%	2.75	-	2.85
		WEDNESDAY (19 February)					
14:00	**PL**	**Industrial output**	**Jan**	**%YoY**	**3.6**	**3.1**	**6.6**
14:00	**PL**	**Construction and assembly output**	**Jan**	**%YoY**	**1.3**	**0.0**	**5.8**
14:00	**PL**	**PPI**	**Jan**	**%YoY**	**-0.8**	**-0.9**	**-0.9**
14:30	US	House starts	Jan	k	950	-	999
14:30	US	Building permits	Jan	k	975	-	968
20:00	US	FOMC minutes					
		THURSDAY (20 February)					
2:45	CN	Flash PMI – manufacturing	Feb	pts	49.4	-	49.5
9:28	DE	Flash PMI – manufacturing	Feb	pts	56.3	-	56.5
9:58	EZ	Flash PMI – manufacturing	Feb	pts	54.0	-	54.0
14:00	**PL**	**MPC minutes**					
14:30	US	CPI	Jan	%MoM	0.1	-	0.3
14:30	US	Initial jobless claims	week	k	330	-	339
16:00	US	Philly Fed index	Feb	pts	10.0	-	9.4
		FRIDAY (21 February)					
16:00	US	Home sales	Jan	m		-	4.87

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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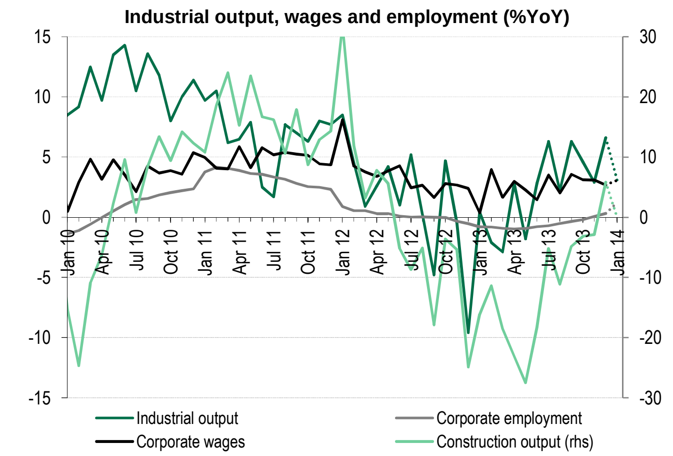
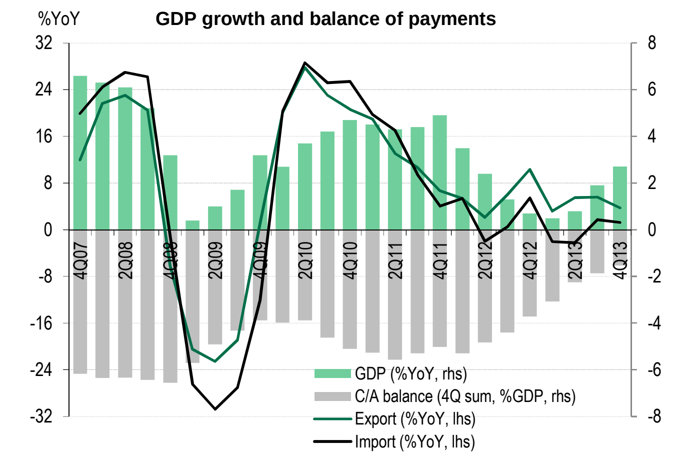
What's hot this week – Data on employment under impact of sample revision, slowdown of output

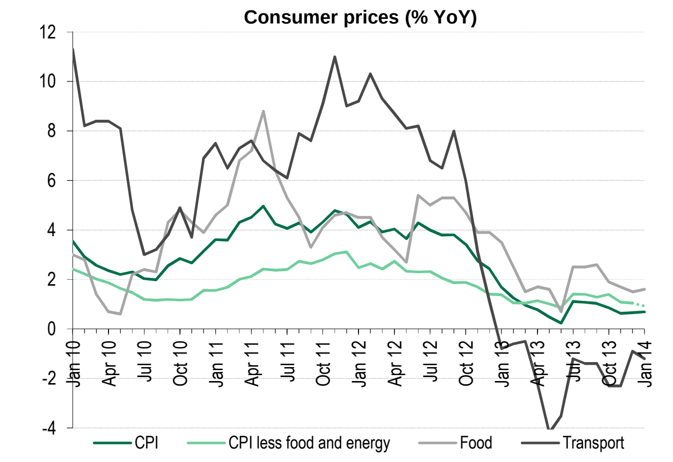


- Employment in corporate sector is the most interesting release of the week. In January the CSO is always revising its sample of companies and we are expecting that this effect may cause a leap in growth rate of employment. Our forecast is visibly above market consensus. We are also expecting a moderate wage growth, similar to the one observed last year.
- We are expecting some deceleration of growth rates of industrial and construction-assembly output in January. A negative impact on output was exerted by negative working day effect. However, the impact of low temperatures in January is not straightforward, as they could have negatively affected the construction output, but at the same time supported the energy output. Still, in our view the message behind the data will be positive and will suggest further improvement of economic activity

Last week in the economy – Economy accelerating and inflation still low



- Current account deficit in December 2013 was lower than expected and amounted to €843m. The good result is primarily due to acceleration of exports (10.6%YoY). In entire year the current account deficit amounted to 1.5% of GDP, the lowest level since 1995. The economic recovery in the euro zone and the sluggish appreciation of the domestic currency should help maintaining a two-digit growth rate of exports growth this year, so the trade balance will remain in surplus and current account deficit will drop further.
- GDP growth in 4Q2013 amounted to 2.7%YoY and 0.5%QoQ after seasonal adjustment. The results were slightly weaker than we expected, but they confirm that recovery of the domestic economy is continued. More detailed data on GDP in Q4 will be released at the end of February.



- Inflation rate remained in January at 0.7%YoY, in line with our forecast and below market consensus. When compared to December, prices rose mainly in case of food (1.4%MoM) and alcohol and tobacco (0.8%MoM). Not all details of CPI components have been released as – just like each year – publication of January's data is preliminary and will be revised next month after reweighing of the CPI basket. Based on these data, we estimate that core inflation excluding food and energy prices amounted to 1.0%YoY in January, just like in December.
- Pace of money supply growth decelerated in January to 5.5%YoY but the data suggests continuation of a gradual revival of loans, both as regards loans for companies and for household, which should be underpinning further economic growth.

Quote of the week – We still have a few months

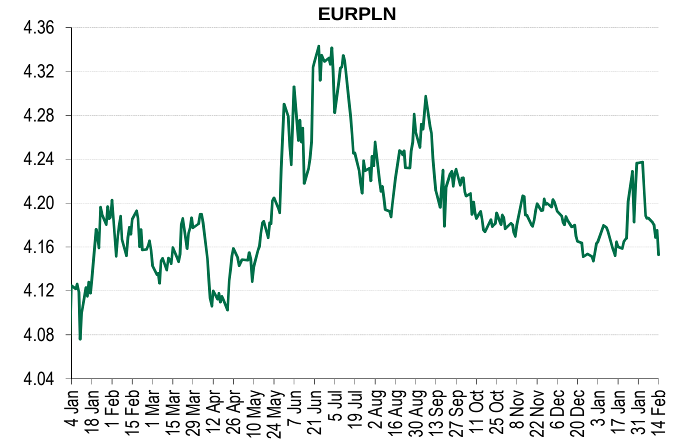
Elżbieta Chojna-Duch, MPC member, 10.02, PAP
It cannot be ruled out that period of flat rates, declared by the MPC to last at least until mid-2014 will be extended. I can imagine a situation, when rates remain stable throughout the year. Stable interest rates are a positive factor for the economy.

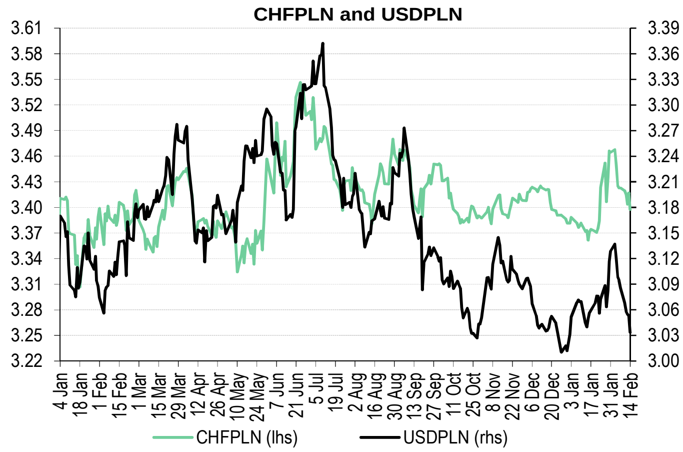
Andrzej Rzońca, MPC member, 11.02, Reuters
There were no data, which have supported a shortening of flat-rate period. But I also agree with views that there are no reasons to extend this *forward guidance*.

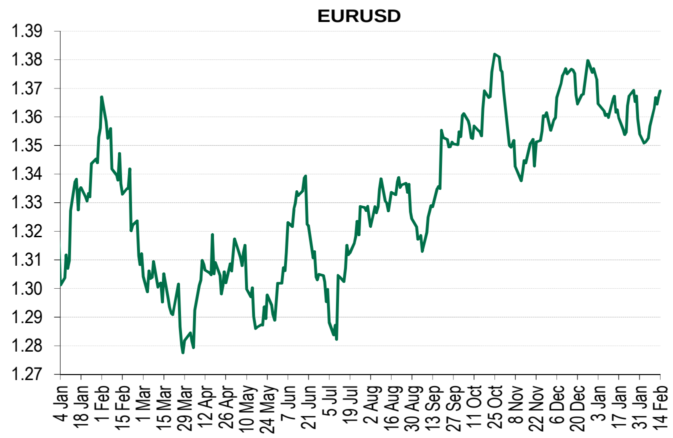
Marek Belka, NBP president, 14.02, DGP
We still have a few months to see how will the economic situation look like in the second half of the year.

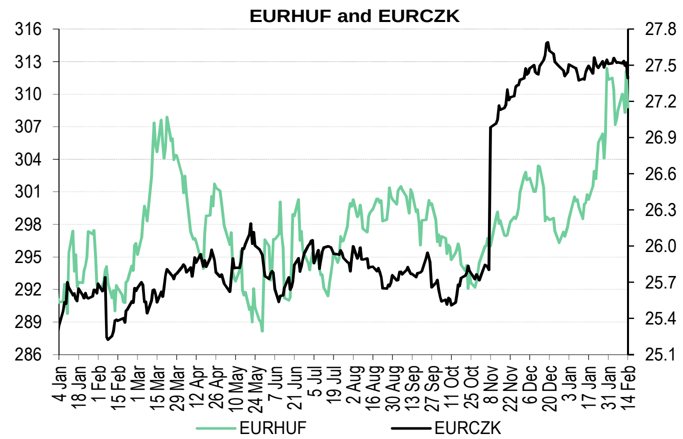
Different views among MPC members about possible extensions of *forward guidance* are surely related to their expectations about economic growth – Hausner, Bratkowski and Rzońca, who recently suggested they do not support an extension of flat-rate period, are expecting a relatively quick and strong acceleration of GDP growth (to ca. 4%YoY already in Q3) and thus a relatively quick closing of output gap. In this context, new data on economic activity and new NBP projections can actually substantially affect views of the Monetary Policy Council about their future actions. We maintain our opinion that the MPC will not prolong the current *forward guidance* and only in July it can suggest a direction for further changes in monetary policy more visibly and implement the first rate hike in the autumn.

Foreign exchange market – Zloty strengthened due to better macro data









Zloty's appreciation supported by better macro data

▪ Last week the zloty appreciated against the most main currencies. It came not only from calmer global moods, but also better than expected domestic macro data (December's current account deficit lower than predicted). What is more, the better-than-expected preliminary 4Q GDP data for the Czech Republic and Hungary increased hopes that the same situation took place also in Poland. Slightly weaker than forecasted domestic GDP growth only has temporary limited zloty appreciation; the domestic currency continued strengthening Friday in the afternoon.

▪ The zloty was more vulnerable against the US dollar and the British pound. While USDPLN increased more substantially (due to decline of EURUSD) at the beginning of the week, next days the zloty erased all earlier losses, ending the week higher by 1.7% against the US dollar. As regards GBPPLN, the exchange rate increased above the level of 5.08 due to sharp strengthening of the British pound on the international market. In weekly terms, zloty lost 0.8% against GBP, but in the same time it gained 0.2% against CHF.

▪ During the first two weeks of February zloty gained significantly and as a consequence erased almost all losses incurred in the second half of January. This week the macro calendar is rather heavy in terms of data releases. We think that the zloty will stay under the influence of domestic data, in particular industrial output. Our forecast is below market consensus, and it may negatively affect the zloty. We do not exclude that data released abroad will be also important, especially flash PMI for China or euro zone countries. Weaker than expected figures might result in weakening of emerging markets' currencies, including the zloty. Until publishing these data, EURPLN will stay slightly above support level at 4.14-4.15. The resistance level at 4.18 is still valid.

Better economic outlook supports EUR and GBP

▪ Last week EURUSD increased towards 1.37 due to weaker than expected the US macro data. Consequently, euro rally has cut nearly all losses incurred in the first part of the week. However, better than expected preliminary GDP data for the euro zone countries resulted in EURUSD increase above 1.37.

▪ The British pound strengthened considerably against the main currencies last week (GBPUSD increased to 1.6672, while EURGBP fell to 0.8176). It was a consequence of the release of the *Inflation Report*, in which the Bank of England (BoE) quite significantly increased its GDP forecasts. What is more, BoE altered its forward guidance, pointing out that not only unemployment rate, but also other macroeconomic indicators will be crucial for further decision about interest rate. Market interpretations were mixed – for some investors it means that the first hike will be postponed, for other that it will come earlier.

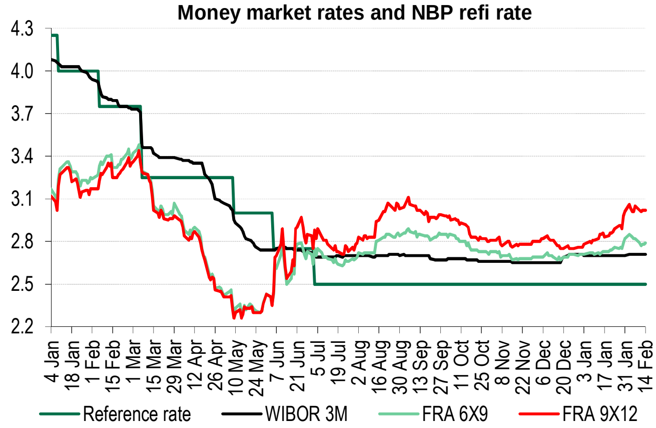
▪ Upcoming macro data from the US economy and the euro zone investors will translate into future central banks decisions. The resistance channel for EURUSD is between 1.37 and 1.374, which breaking will open the way towards 1.38.

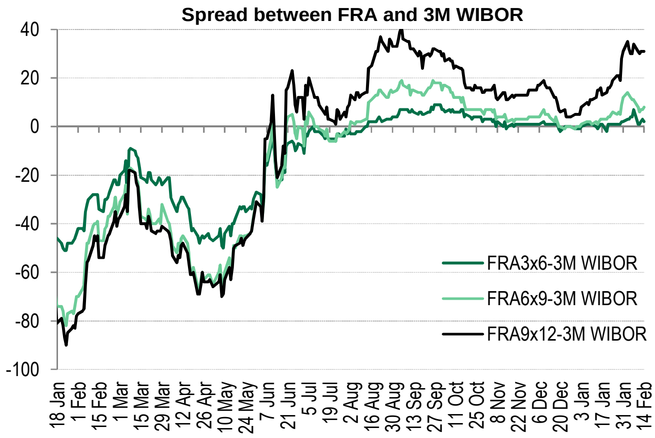
Data on GDP in Q4 supported moods in the region

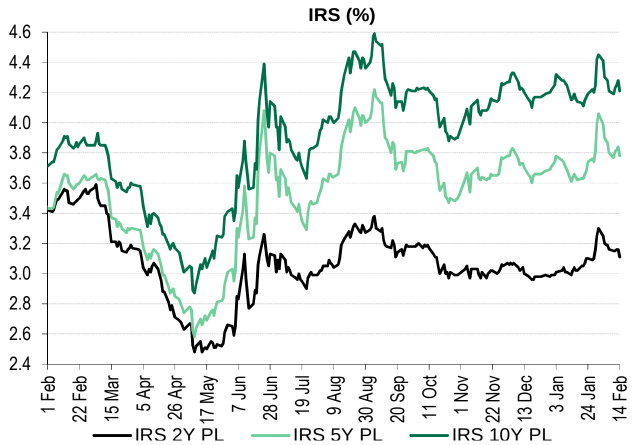
▪ Flash readings of GDP in Q4 proved the most important event for CEE3 currencies. The better-than-expected data from Hungary and the Czech Republic gave an impulse for strengthening of these currencies. After these releases, EURHUF fell below 308 from 311, while EURCZK slid to ca. 27.3 from 27.5.

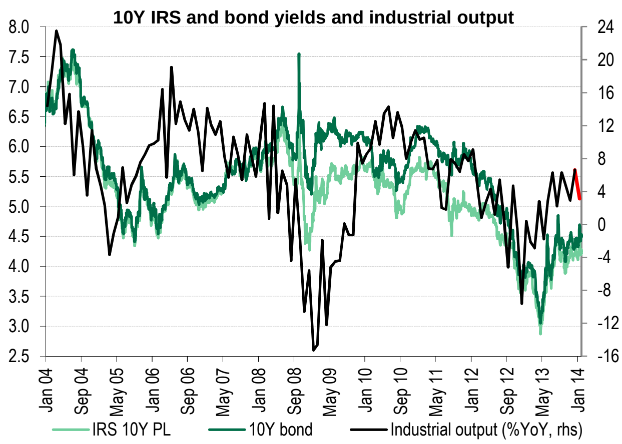
▪ This week investors will focus on meeting of the Hungarian central bank. Another interest rate cut may again generate an upward impulse for EURHUF above 310. As regards EURCZK, we are expecting a stabilisation close to 27.5.

Interest rate market – Industrial output data should support market, watch for flash PMIs









WIBOR rates slightly up, FRA still high

- During the week following the MPC meeting, after which the NBP Governor was reassuring that March does not have to be critical regarding the Council's communication with the market on the future decision on the interest rates, 6-12M WIBOR rates moved up by 1bp. Remaining rates in the 1-12M segment stayed unchanged.
- Interestingly, despite some recovery in the bond and IRS market (rates from middle and long end of the curves plunged by 25-28pb from peak from the turn of January and February) FRA 6x9 and 9x12 pulled back only by ca. 10bp, including the move after Friday's domestic data. However, we see a room for more decline of FRA in the short-term. This week data on the Polish industrial output may provide an impulse.

High volatility of IRS and bonds, domestic factors crucial

- Mid- and long-term IRS and bond yields stayed in the upward trend since the beginning of the week. This tendency was fuelled by the decision of the Ministry of Finance to offer 5Y and 10Y benchmarks at the auction. Additionally, the market was under pressure of comments of new Fed Governor, who said she will continue the style of monetary policy, including QE3 tapering started last year. Only Polish data released at the very end of the week – slightly lower than expected Q4 GDP and January's inflation – halted the upward move and helped bonds pare nearly half of losses suffered earlier in the week. IRS managed to end the week flat vs. previous week closing. The IRS curve moved down by 20-28bp from local peak.
- The Finance Ministry sold DS1023 bond worth PLN1.8bn with yield at 4.54% (close to secondary market levels) and PS0718 bond worth PLN2. with yield at 3.882% (also close to secondary market levels). Total demand amounted to PLN8bn. Our estimates show that after this auction the borrowing needs are covered in almost 60%. While the announcement of the offer had a negative impact on the market, auction results can be described as moderately positive – upper limit of sales (PLN5bn) was not reached, as the Ministry can afford it, given high coverage of borrowing needs.

Output data should support the market, watch for flash PMI

- The upward trend of IRS and bond yields, which started in May after the first Bernanke's remark on plans to taper QE3 – halted in recent months. As the chart shows, the annual pace of industrial output growth also stabilised in recent months after an impressive rebound seen in the first half of the past year. We expect, that January's data will fit the horizontal trend. Our forecast is slightly below market consensus and together with GDP and CPI data it may be the next impulse that will drag IRS and bond yields down. In the following months, however, we expect a continuation of visible acceleration of pace of industrial output growth (to just below 10%YoY) and this should lead to a restart of upward trend of IRS and bond yields.
- Next to the Polish data, the domestic interest rate market may be under the impact of foreign publications, particularly flash Chinese, German and euro zone PMIs for manufacturing in February. It is worth to remind, that it was the poor estimate for Chinese index that was one of triggers of sudden deterioration of market sentiment on the emerging markets which lead to visible depreciation of the zloty and surge of IRS and bond yields in late January.

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.