

# WEEKLY ECONOMIC UPDATE

## 24 February – 2 March 2014

Last week was rich in important macro releases and in events, which strongly affected assets on the financial markets. Weaker readings of flash PMI for China and the euro zone, minutes of the January's Fed meeting (FOMC confirmed its willingness to continue QE3 tapering at current pace) and escalation of conflict in Ukraine fuelled the risk aversion, which was reflected in prices of emerging markets' currencies. This weakening was temporary and considerably less significant than at the end of January. End of the week brought a rebound on financial markets.

One week ahead of the ECB meeting we will see the euro zone's inflation data. These can prove important, as deeper-than-expected decline of inflation can encourage the ECB to act (we already saw this pattern in November). On the other hand, even weak data readings in the USA should be neutral for the market as they are justified by severe weather conditions in the eyes of investors. Data from the domestic economy will probably confirm a continuation of economic recovery but they will be neutral, supporting consolidation of the zloty and of bond yields. Situation in Ukraine still remains the main risk factor.

### Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (24 February)</b>							
10:00	PL	Retail sales	Jan	%YoY	4.6	3.1	5.8
10:00	PL	Unemployment rate	Jan	%YoY	14.0	14.0	13.4
10:00	DE	Ifo index	Feb	pts	110.7	-	110.6
11:00	EZ	HICP	Jan	%YoY	0.7	-	0.8
<b>TUESDAY (25 February)</b>							
8:00	DE	GDP	Q4	%YoY	1.3	-	1.1
15:00	US	S&P/Case-Shiller home price index	Dec	%MoM	0.6	-	0.88
16:00	US	Consumer confidence index	Feb	pts	80.0	-	80.7
<b>WEDNESDAY (26 February)</b>							
16:00	US	New home sales	Jan	k	405	-	414
<b>THURSDAY (27 February)</b>							
14:30	US	Durable goods orders	Jan	%MoM	-1.0	-	-4.2
14:30	US	Initial jobless claims	week	k	333	-	336
<b>FRIDAY (28 February)</b>							
10:00	PL	GDP	Q4	%YoY	2.7	2.7	1.9
10:00	PL	Private consumption	Q4	%YoY	2.0	1.9	1.0
10:00	PL	Gross capital formation	Q4	%YoY	1.2	1.3	0.6
11:00	EZ	Flash HICP	Feb	%YoY	0.7	-	-
14:00	PL	Inflation expectations	Feb	%YoY	-	-	0.5
14:30	US	Preliminary GDP	Q4	%QoQ	2.5	-	4.1
15:55	US	Michigan index	Feb	pts	81.2	-	81.2
16:00	US	Pending home sales	Jan	%MoM	2.7	-	-8.7

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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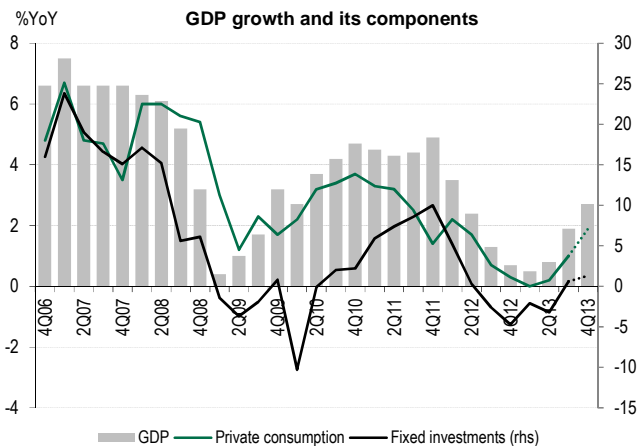
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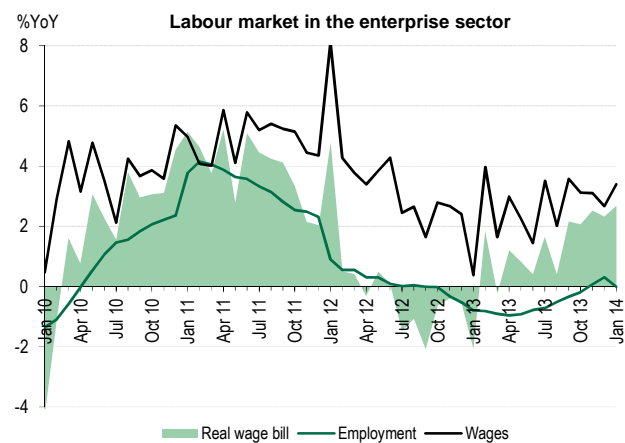
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**What's hot this week – Retail sales and unemployment rate, GDP breakdown in 4Q2013**

■ We are expecting a deceleration of retail sales' growth versus December, mainly under impact of statistical base effect (shift of payments for farmers from December 2012 to January 2013). Our forecast sits considerably below market consensus.

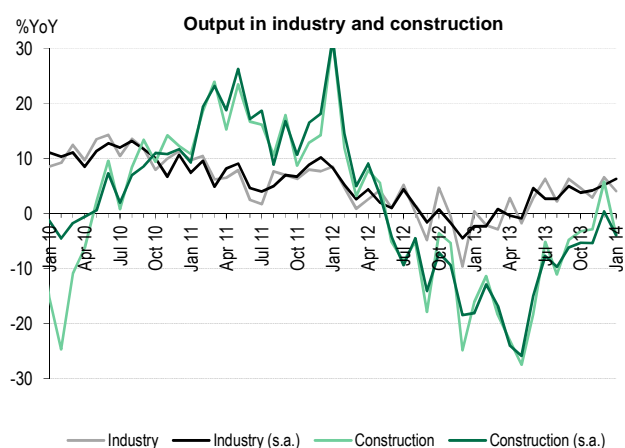
■ In our view, registered unemployment rate amounted to 14.0% in January and recorded a decline in YoY terms for the first time since February 2009. These numbers will confirm that labour market situation has been improving, despite disappointing reading from the corporate sector (details below).

■ Flash GDP estimate for 4Q2013 showed an increase by 2.7%YoY, a considerable acceleration versus previous quarters of the year. The final reading will probably be close to this number, so detailed breakdown of growth will be surely more important. We are expecting a confirmation of growing role of domestic demand – rising consumption and investments.

**Last week in the economy – Employment disappointed but output was better than expected**

■ Employment in corporate sector disappointed with 0.0%YoY growth in January. Only 15.1k of workplaces were added, and this was the lowest increase in January in 10 years. In our opinion this deceleration was mainly due to the annual change of sample examined by the CSO. Corporate sector covers only units employing 10 or more persons and every January Poland's Statistical Office updates its sample, excluding units, where employment decreased below 10 and adding these in which it increased above this level in the course of the last year. Thus, the reading in January may be an echo of weak situation on the labour market in 1H2013. Thus, we view this disappointment as a one-off and expect better data in coming months.

■ Wage growth reached 3.4%YoY in January. Wage bill in corporate sector advanced by 2.7%YoY in real terms (vs. 2.3%YoY in December), so real growth rate of consumers' income is accelerating, which should support private consumption in Q1.



■ Pace of growth of industrial output decelerated in January to 4.1%YoY from 6.6%YoY seen in December. This result proved better than expected and confirmed positive signals given by leading indicators (PMI, gauges calculated by the CSO).

■ On the other hand, data on construction and assembly output disappointed, contracting by 3.9%YoY, well below market consensus.

■ PPI inflation amounted to -0.9%YoY in January, i.e. was slightly higher than in December (-1.0%YoY).

■ The general picture drawn by January's data released so far show a continuation of disinflationary economic revival. These data confirm positive tendencies in the economy and this should be reflected in higher pace of economic growth presented by the MPC in March.

**Quote of the week – Will the MPC be preparing markets for possible changes?**

**Anna Zielińska-Głębocka, MPC member, 19.02, Reuters**

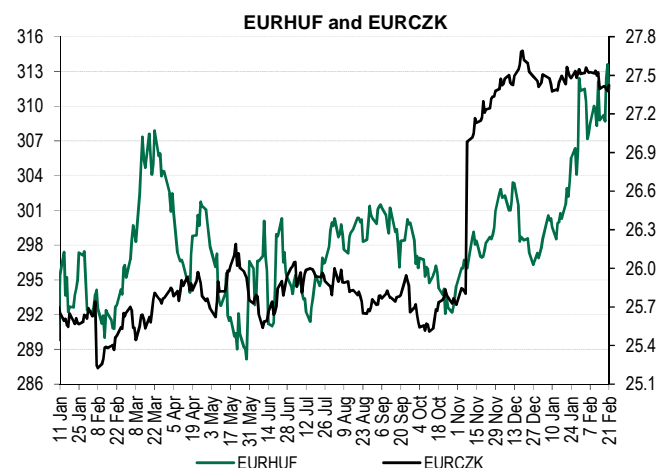
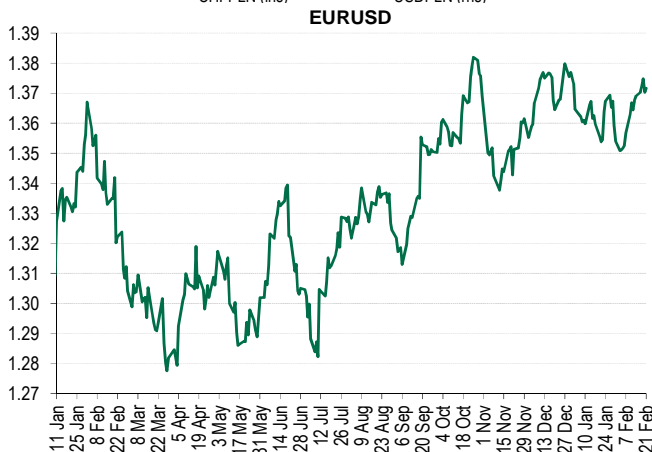
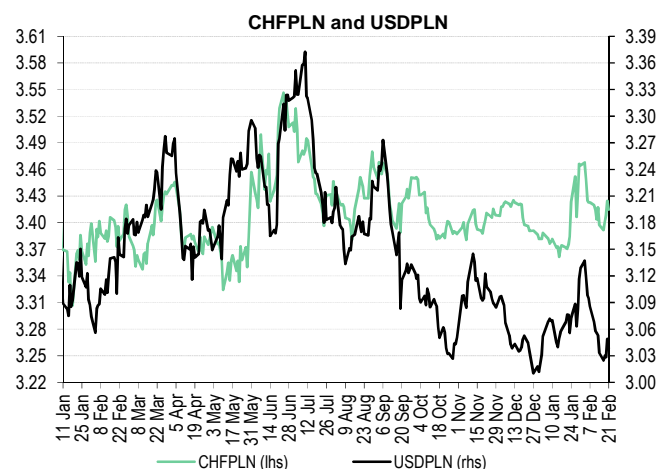
We will surely be preparing markets for possible changes in the *forward guidance*. I think that April will be a month when the Council will be deciding what to do later and will gradually be informing investors about its plans. Shortening of *forward guidance* can be favourable as regards monetary policy. But it will not necessarily be favourable as regards stability of situation for investors.

**Jerzy Hausner, MPC member, 21.02, Bloomberg**

Monetary tightening is somewhere out there on the horizon, most probably in the second half, although I'm not at all certain it will happen then. The later we raise rates, the better, because that would help keep the economy on a relatively strong growth path.

Last week two MPC members suggested when the Council may signal what is going to happen with monetary policy after *forward guidance* ends. According to Anna Zielińska-Głębocka this will happen in April, i.e. after the Council will digest the March's projection. On the other hand, Jerzy Hausner suggested May. We doubt both these dates – if the Council want to wait until May, then it can also wait until June to see GDP data for Q1 (due for release on 30 May), quite important for the monetary policy prospects. And a bit later, in July, new GDP and CPI projection will be available and it can provide the MPC with important new information. During the last meeting president Belka said that the Council has a plenty of time and it does not want financial markets to bet on hikes or cuts, so we are not expecting the Council to risk strong statements prior to data, which can potentially change the picture.

## Foreign exchange market – EM currencies under pressure again



### Poor EM sentiment weighs on the zloty

■ In the second half of February, just like in the first month of the year, market sentiment in emerging markets deteriorated quite significantly. Similarly as in January, negative pressure originated from worries over further QE3 tapering (after FOMC minutes released last week) and situation in the Chinese economy (this month flash PMI for Germany and the euro zone disappointed as well). Additional factor that contributed to depreciation of the EM currencies last week was the crisis in Ukraine. Thus, the zloty and other currencies from EM markets have been under visible pressure. The domestic currency – just like during the previous wave of weakening – performed quite well, somewhere in the middle among EM currencies versus the dollar and the euro. EURPLN established weekly peak at 4.185 while USDPLN at nearly 3.06. Despite weak data from Europe, currencies managed to recover slightly at the end of the week.

■ Hopes for stabilization in Ukraine emerged at the end of the week and impact of this factor was visible on the Polish FX market. We see room for further appreciation of the zloty if upcoming days show that improvement behind our eastern border may be maintained. If euro zone's inflation data show further decline, then this factor may also support the zloty versus the euro, but the decline of EURUSD (that may be triggered by this release) may put an upward pressure on the USDPLN exchange rate.

### No big changes of EURUSD, watch for important data

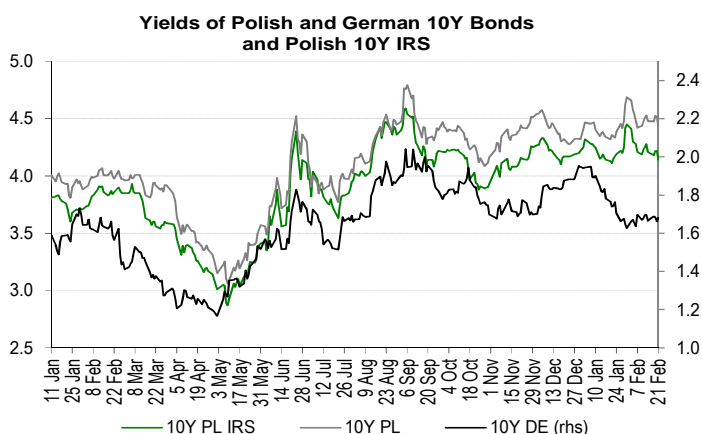
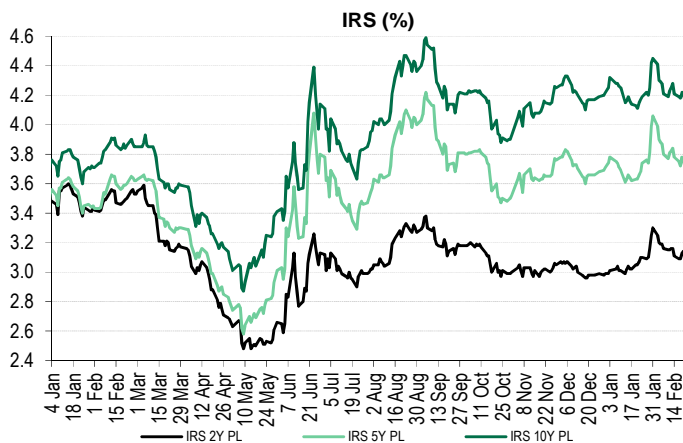
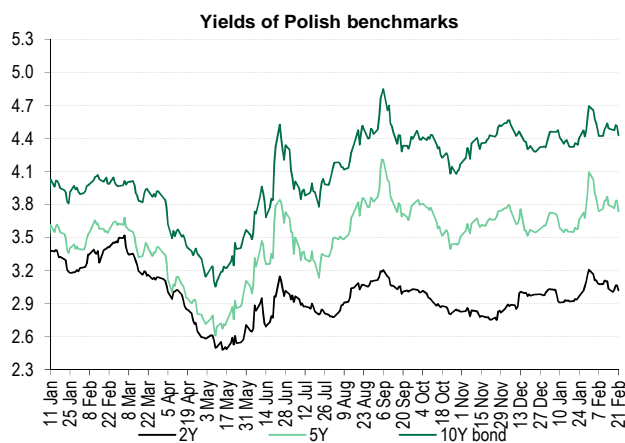
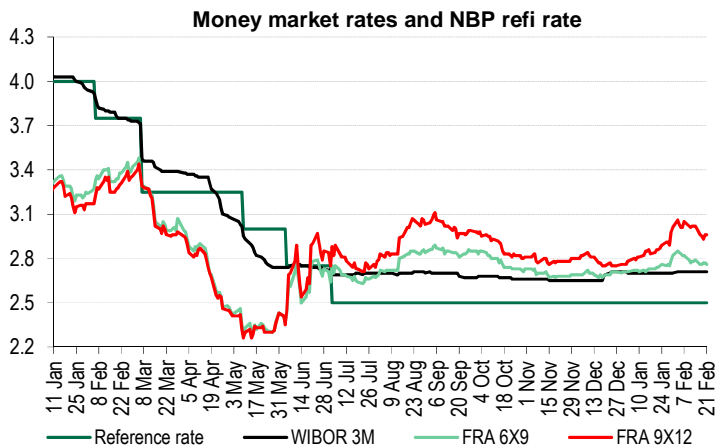
■ EURUSD stayed in a relatively narrow range last week (1.368-1.377). Just like during the January's wave of risk aversion, main FX rate remained surprisingly stable also this time. Flash PMI for manufacturing and release of FOMC minutes provided much volatility last week. Indexes have clearly disappointed and the FOMC minutes stated that QE3 will be reduced further. Those factors weighed on the euro, EURUSD established a weekly low in reaction to these publications.

■ One week before the ECB decision, vital inflationary data are due for release – final January's HICP and flash estimate of February's index. HICP at 0.7%YoY pushed the ECB to the unexpected 25bp rate cut in November and that is why these data may influence market expectations regarding the March ECB decision. As regards the US data, any negative numbers are likely to be justified with severe weather conditions so only positive surprises may have an impact on the market. Borders of the last week's trading range are vital levels for coming days.

### MNB decision adds pressure on the forint

■ No big changes were recorded in case of the Czech koruna while the forint was under the impact of global and domestic factors. In the first days of the week, additional negative pressure on the Hungarian currency was provided by the decision of the central bank, which surprised again. In February the MNB cut rates by 15bp versus 10bp cut expected by the market. Main interest rate is now at 2.70%, the lowest level in history. Statement read that decision on the continuation of the monetary policy easing cycle will be taken in March after fresh economic forecasts for Hungary will be available for the central bank. EURHUF surged temporarily even above 315, but managed to pare half of losses suffered earlier in the week due to successful Hungarian bond auction.

## Interest rate market – Domestic debt market relatively resistant to external factors



### Money market remains stable

▪ WIBOR 1M-12M rates were stable last week despite better than expected industrial output data. Like in previous weeks, FRA rates were more sensitive to macro data releases. At the beginning of the week rates declined further, following positive sentiment initiated by lower CPI and lower 4Q GDP readings. Downward move was strengthened after weak data from labour market. But the higher-than-expected industrial output reading caused an increase of rates (mainly in longer tenors). All in all, FRA9x12 slightly declined in weekly terms, while FRA for shorter tenors remained stable.

▪ Investors' expectations about rate hikes did not change significantly. Market is pricing-in the first rate hike in 9 months' time. We think that weaker reading of retail sales might add some volatility on the FRA market in the short-run.

### Domestic market rebound at the end of week

▪ After stable start of the week (due to absence of the US investors), in the following days the market volatility stayed at an elevated level. The better-than-expected data from domestic industrial sector together with deterioration in global moods (due to, among other factors, situation in Ukraine) caused an increase of 10Y benchmark yield to ca. 4.56% and of 10Y IRS rate to 4.22%. One should notice that the front end of curve underperformed (with 2Y yield climbing to 3.07% and 2Y IRS rate jumping to 3.14%), which resulted in flattening of curves. However, some improvement in global mood at the end of the week supported the domestic debt market – T-bonds' yields and IRS rates declined along the curves, with yield of 10Y benchmark falling to 4.46%, and 10Y IRS rate sliding to 4.14%.

▪ Changes in yields due to deterioration of investors' mood were not as significant as compared with the end of January (intraday changes reached only 5 bp vs over 10 bp in January). What is more, some investors took advantage of elevated yields to purchase sovereign papers. It may suggest that domestic debt is relatively resistant to external factors. What is more, influence of increasing German yields on domestic bonds was only short-lived. Notwithstanding, spread over 10Y Bunds remained at the level observed at the end of previous week, i.e. 281 bps. This is 20 bp lower than at the end of January, but 45 bp higher than at the end of 2013.

### Moderate supply of bonds in March

▪ Market sentiment will be still driven by macro data this week. If our forecasts of January's retail sales prove correct, then yields may decline along the curve.

▪ At the end of the week, investor's sentiment may be influenced by information about bond supply at March auctions. Deputy finance minister, Wojciech Kowalczyk, has already said that two auctions will be held next month – standard and switch auction. We expect rather moderate supply on the standard auction (PLN3-5bn). We expect a diversified basket of bonds offered as the Ministry of Finance has covered already slightly more than 60% of 2014 borrowing needs and has the comfort of being flexible when adjusting the supply to market conditions and investors' expectations.

▪ Kowalczyk expects that after April borrowing needs will be covered in 80% assuming "conservative" sale of bonds in March and rolling bonds maturing in April.

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