Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

3 – 9 March 2014

Situation in Ukraine has drawn investors' attention last week. Despite violent riots have ended and the new government has been established, there are still significant worries about the country's possible default, maintenance of territorial integrity and potential Russia's engagement. Those issues may continue fuelling market worries in the nearest weeks.
This week the key events will be meetings of central banks in Poland and the euro zone, as well as the release of US payrolls data. Polish PMI index, similarly as German, may see a (temporary) correction in February. We expect no changes in monetary policy parameters of the ECB and the Polish MPC. The results of new projections, and the lack of extension of current MPC's forward guidance, may slightly strengthen analysts' belief that interest rate hike in Poland in the autumn is a viable option (currently only 3 of 24 analysts surveyed in Parkiet's poll expect such scenario).

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (3 March)					
2:45	CN	PMI – manufacturing	Feb	pts	48.5	-	49.5
9:00	**PL**	**PMI – manufacturing**	**Feb**	**pts**	**54.8**	**54.4**	**55.4**
9:53	DE	PMI – manufacturing	Feb	pts	54.7	-	56.5
9:58	EZ	PMI – manufacturing	Feb	pts	53.0	-	54.0
14:30	US	Personal income	Jan	%MoM	0.2	-	0.0
14:30	US	Consumer spending	Jan	%MoM	0.1	-	0.4
16:00	US	ISM – manufacturing	Feb	pts	52.0	-	51.3
		WEDNESDAY (5 March)					
	PL	**MPC decision**		**%**	**2.50**	**2.50**	**2.50**
9:00	HU	GDP	Q4	%YoY	2.7	-	1.7
9:53	DE	PMI – services	Feb	pts	55.4	-	53.1
9:58	EZ	PMI – services	Feb	pts	51.7	-	51.6
11:00	EZ	GDP	Q4	%YoY	0.5	-	-0.3
14:15	US	ADP report	Feb	k	158	-	175
16:00	US	ISM – services	Feb	pts	53.6	-	54.0
20:00	US	Fed Beige Book					
		THURSDAY (6 March)					
9:00	CZ	GDP	Q4	%YoY	0.8	-	-1.2
11:00	**PL**	**Auction of OK0716/WZ0119 bonds worth PLN2-6bn**					
13:45	EZ	ECB decision		%	0.25	-	0.25
14:30	US	Initial jobless claims	week	k	335	-	348
		FRIDAY (7 March)					
14:30	US	Non-farm payrolls	Feb	k	150	-	113
14:30	US	Unemployment rate	Feb	%	6.6	-	6.6

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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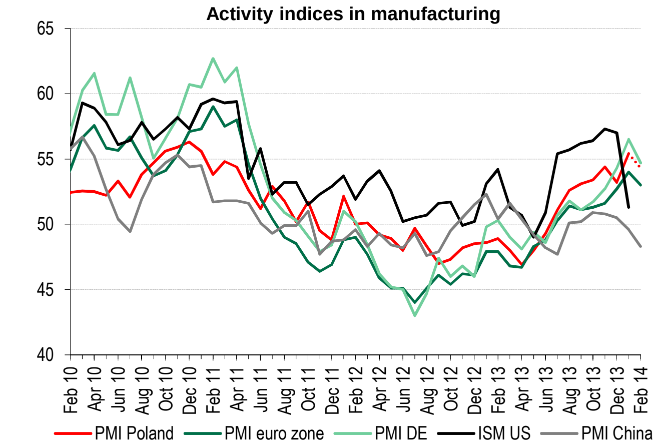
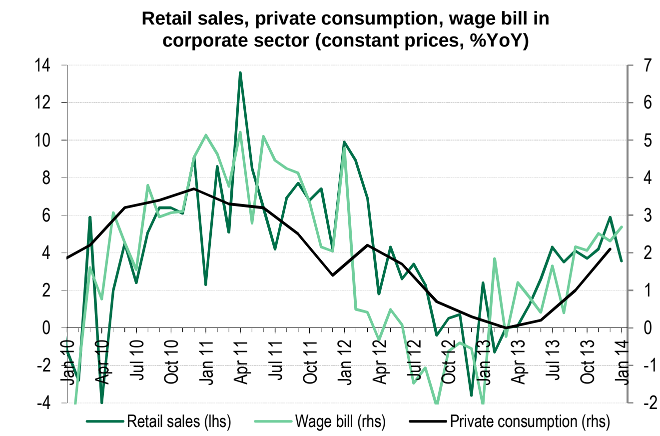
What's hot this week – Correction of PMI, monetary policy unchanged

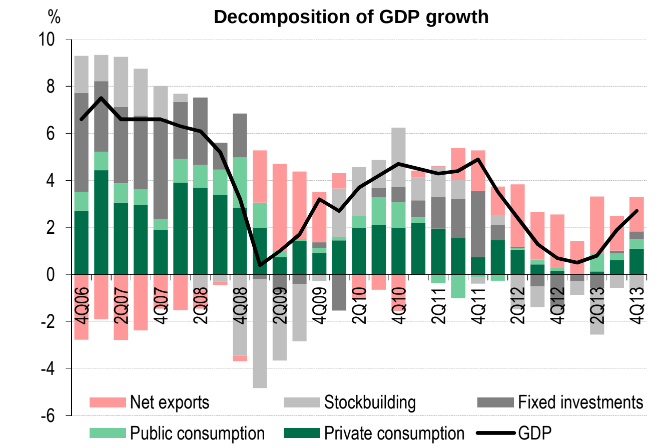


- Flash PMI indices for the euro zone declined in February, correction was recorded also by the CSO indicator of business climate in domestic industry (seasonally adjusted). Additionally, entrepreneurs' moods may have been undermined by events in Ukraine, as some firms may potentially lose access to eastern markets. That is why we are expecting the PMI for Poland will post a slight (temporary) decline.
- MPC meeting will be more interesting than in past few months, as the Council will see the new CPI and GDP projections. In our view, these can show a considerably higher economic growth path in 2014 and inflation, which may stay below the previously predicted path in the short run, but above it in longer horizon. We also think that the MPC will neither extend its current *forward guidance*, nor it will suggest that interest rate hikes are approaching.

Last week in the economy – Rising domestic demand is supporting the GDP growth



- Pace of growth of retail sales decelerated in January to 4.8%YoY from 5.8%YoY in December 2013. The data show a continuation of positive tendencies in retail trade and rising consumption demand. Turnover in retail trade (which includes sales in small shops but excludes autos) slowed down more than retail sales (to 2.4%YoY from 5.6%YoY in December). However, it is worth to notice that during the last half of the year, the former was clearly above the latter.
- Registered unemployment rate climbed in January to 14.0% from 13.4% in December. Thus, unemployment has fallen in annual terms for the first time since February 2009 (down from 14.2% in January 2013). We are expecting a continuation of these positive tendencies in the upcoming months. Improvement of the labour market situation will be underpinning private consumption growth.



- GDP growth amounted to 2.7%YoY in 4Q2013 (as compared to 1.9%YoY in Q3) and to 0.6%QoQ after seasonal adjustment, in line with flash estimate shown by the CSO.
- Private consumption advanced by 2.1%YoY – at the fastest pace since 1Q2012. Recovery was also continued in investment activity – gross capital formation increased by 1.3%YoY. Contribution of domestic demand to GDP growth amounted to 1.2pp while net exports added 1.5pp, so we can say that the Polish economy is no longer flying on one engine only. Domestic demand is still based mostly on private consumption, but we are expecting investment to join in a couple of quarters.
- We are expecting a further acceleration of growth in the upcoming quarters, to nearly 4%YoY at the year-end (and to 3.5% on average in the entire year).

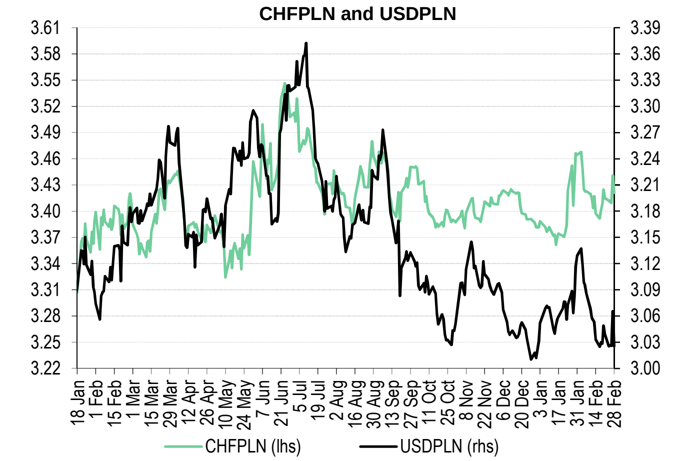
Quote of the week – Constant monitoring of situation in Ukraine is needed

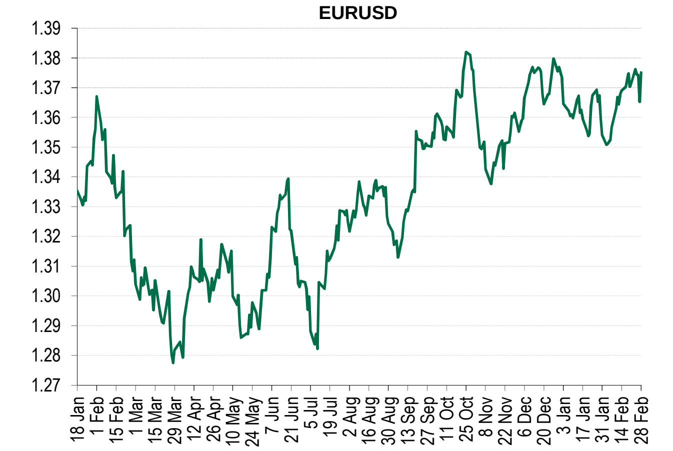
Bronisław Komorowski, President of Poland, 26.02, PAP
We need a constant monitoring of economic situation in Ukraine and its impact on Polish economy. We will try to observe the situation and to react.

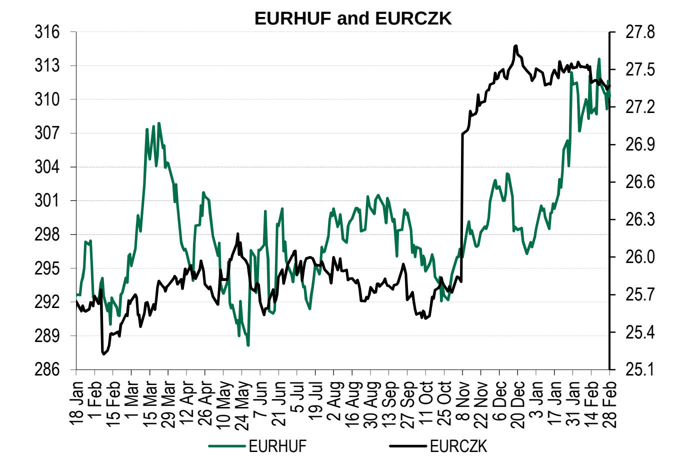
Janusz Piechociński, minister of economic affairs, 21.02, PAP
Today, when FX reserves evaporate and Ukraine needs money to prevent its economy from falling apart, and this is an actual threat, some dozens of billions of dollar, we know that this will affect Polish entrepreneurs (…) This is an economic space, where Polish firm were investing most, almost $1bn over the last 25 years.

Development of the situation in Ukraine can be important for the Polish economy, as it may affect not only our relations with this country, but also with Russia. Ukraine is our eighth biggest export market with ca. 3% share in total exports. Russia is our fifth biggest partner with over 5% share in exports (exposition of Poland to both markets is surely most considerable among CEE countries). Polish exports to Russia and Ukraine were boosting in 2012. This growth rate faded somewhat in 2013 and it may even collapse this year due to deteriorating economic conditions in both countries and political destabilization. Let us also remind about Poland's dependence on gas imports from Russia, which is mostly conducted via Ukraine.

Foreign exchange market – Ukraine still threatening







Worries about emerging markets stay present

- Last week brought a strengthening of worries about further development of situation in Ukraine and this temporarily undermined the CEE currencies. The zloty weakened to 4.19 per euro and 3.07 per dollar, EURHUF surpassed 310 again. Apart from the Ukrainian hryvnia, worst performance among CEE currencies (and other emerging markets) was delivered by the Russian ruble. USDRUB reached almost 36.27 and approached the all-time high (36.56), set in February 2009. At the end of the week the domestic FX market recovered with EURPLN ending the day close to Monday's level, the zloty gained slightly versus the dollar thanks to a strong rise of EURUSD in reaction to the euro zone data.
- Positive PMI readings for manufacturing in January helped the CEE currencies trim losses caused by the first wave of worries about emerging markets. We are expecting, similarly as the market, that given considerable declines of PMI for Germany and the euro zone, we can also see weaker readings in our region in February. Moreover, situation in Ukraine becomes increasingly more complicated, which can limit appreciative potential of the zloty and of other CEE currencies.
- Worries about emerging markets are present since the beginning of the year, new sources of uncertainty are still rising (like protests in Venezuela, Thailand, new threads of corruption scandal in Turkey). Let us remind that according to the IMF, this year the spread between economic growth in emerging markets and core markets will sit at the lowest level since 2001. All these can cause that pace of PLN appreciation, expected by us, will be weaker than we were hoping so far.

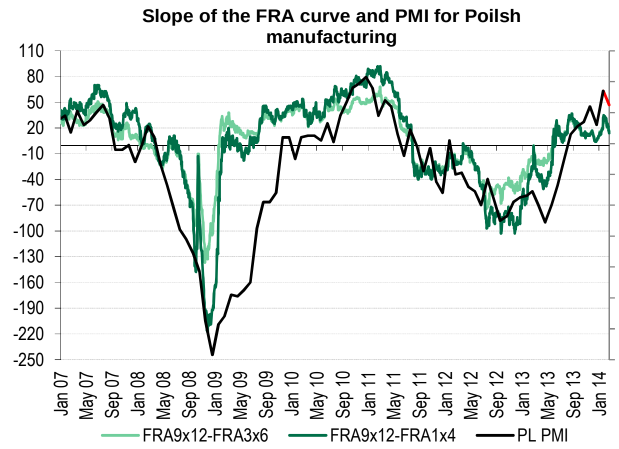
- **Inflation data support the euro prior to ECB decision**

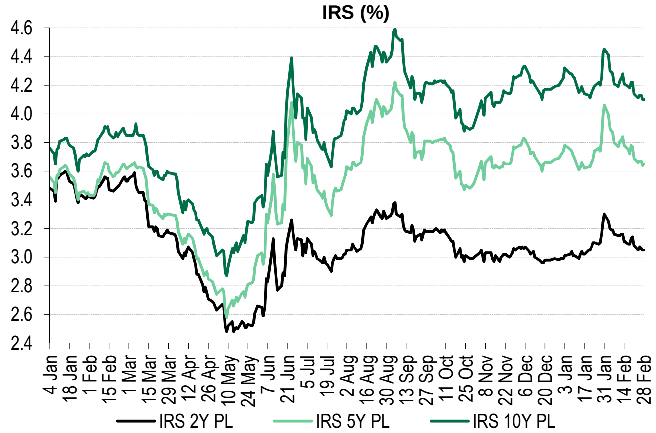
- Worries about Ukraine and inflation data from the euro zone were the main drivers of EURUSD last week. Growing uncertainty about further development of situation in Ukraine (mobilization of Russian army and a threat of Ukraine's default) pushed the rate downwards to 1.364. At the end of the week the rate rebounded to 1.38 quite quickly, when it turned out that flash February's inflation in the euro zone was higher than expected.
- Friday's HICP reading scaled back expectations that the ECB will cut rates this week. At the upcoming meeting the central bank will see new GDP and inflation forecasts and their message may affect the ECB rhetoric. European Commission forecasts, released this week showed inflation staying below 2% until 2016 and a similar picture can be drawn by the newest ECB forecasts, which should be enough to keep a dovish tone in the statement. Moreover, since February's meeting EURUSD climbed from 1.355 to 1.38 and this should also encourage the ECB to maintain its rhetoric, which should not be supportive for the euro. Last week's testimony of the new Fed president indicates that QE3 will be limited further but the central bank will try to assess the impact of severe weather on economic indicators. A possible weak reading from the labour market in July may not be so favourable for the dollar, like before Yellen's testimony.

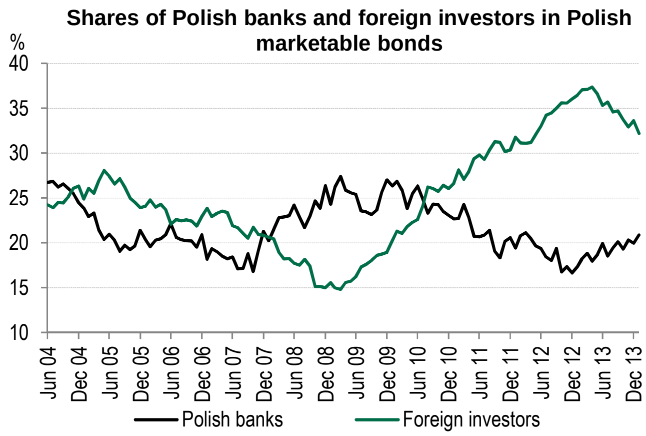
Koruna and forint are waiting for important information

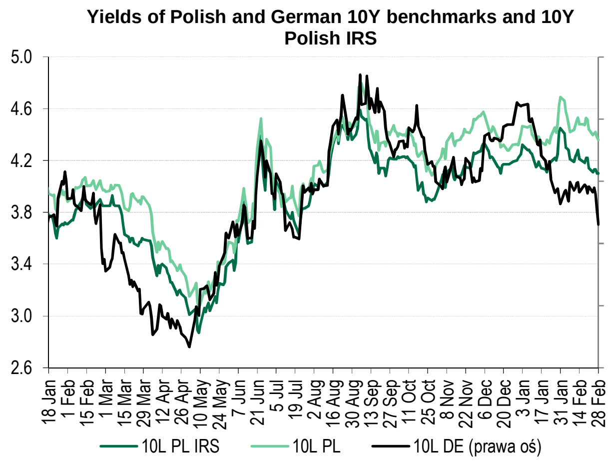
- Apart from global moods, the forint and the koruna may be affected by final data on GDP in Q4. Flash estimates released in mid-February surprised to the upside, so investors are hoping that these positive tendencies will be confirmed. Earlier, i.e. on Monday, some important information can come from Hungary. Hungarian constitutional court will assess the legality of currency loans and ways to change current loan contracts in order to help citizens holding FX-denominated loans. Tribunal's comment will be a response to motion of the justice ministry.

Interest rate market – Little impact of the MPC, core markets crucial









FRA9x12 close to equilibrium?

- Money market rates did not change last week, FRA rates also did not record considerable changes, only longer rates saw a slight downward move following strengthening bonds and falling IRS.
- Currently, 3-12M WIBOR rates are 20-30bp above the NBP reference rate. FRAs are pricing-in roughly stable 3M rate during the next 6 months and its rise by ca. 20bp from current levels at the end of the year. We anticipate 3M WIBOR to be 25bp higher in December 2014 vs. current levels with the spread between the main NBP rate within the 20-30pb range. Thus, in our opinion FRA9x12 should remain stable. Also when we look at the slope of the FRA curve at the current stage of an economic revival in Poland (as measured by the PMI index), we reach a conclusion that that FRA9x12 might have found an area of balance. We expect some correction of PMI in February, and this should stabilize the slope. We do not expect the MPC to give any hints to investors on the future path of NBP rates in March. On the other hand, lack of forward guidance extension may be interpreted as a signal that the MPC is not sure that rates should remain stable in H2.

IRS down thanks to strengthening core markets

- Even though situation in Ukraine becomes more complicated and the zloty (as well as other CEE currencies) depreciated, IRS rates and bond yields declined, especially on the middle and longer end of curves. These negative factors were offset by strengthening of 10Y Bunds on the wave of investors' retreat from risky assets (long-term German bond yields fell temporarily below support at 1.60%). Thus, IRS fell by 3-5bp in 2-10Y sector. Rates for 2, 5 and 10Y came close to the lowest level since end of January.
- Data released by the Ministry of Finance showed that nominal value of PLN, marketable bonds held by foreign investors plunged by PLN6.9bn, most since October 2013. This contraction was mainly due to maturity of OK0114, of which foreigners held over PLN8bn at the end of the 2013. Apparently, foreigners did not decide to roll their position in Polish debt, they did not show also much interest in new 2Y bond, OK0716 (they purchased only PLN200m of this new bonds). After January, share of foreigners' holdings in Polish debt market was lowest since May 2012 and in nominal terms the value was lowest since September 2012. In January Polish banks purchased significant amount of bonds (+PLN6.2bn vs. end of December 2013), their activity concentrated in the middle and long end of the curve (PS and DS series).

Conservative supply at auction, Bunds still important

- At the auction planed for Thursday the ministry will offer bonds OK0716 and WZ0119 worth PLN2-6bn. In line with earlier suggestions of deputy finance minister Wojciech Kowalczyk, it is a "conservative" supply. The long-term bond in offer is probably a response to demand from domestic investors; the short end should enjoy interest in the period of uncertainty.
- We believe the MPC will not extend the current forward guidance and will not make any suggestions regarding timing of potential interest rate hike. In the face of uncertain situation in Ukraine, domestic debt will be influenced by German Bunds and zloty behaviour. While in period of moderately high risk aversion the IRS rates and bond yields may follow the core markets, in the event of serious escalation of situation the market may focus on close links between Poland and Ukraine, which may negatively affect the domestic debt. After recent decline, yields of Polish 5Y and 10Y bonds are now close to upward trend line.

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