Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

24 – 30 March 2014

Global market sentiments improved considerably last week, among other factors, thanks to expectations that situation in Ukraine will not turn into an open military conflict. This provided an impulse for strengthening of risky assets, including the zloty and domestic bonds. The FOMC meeting affected financial markets, especially debt markets, in the middle of the week. The Fed surprisingly altered its rhetoric, suggesting that rate hikes may be implemented earlier than expected. This gave an impulse for a short-lived correction on all markets. Releases of domestic macro data, confirming a continuation of economic recovery amid no inflationary pressure were overshadowed by global events.

New macro data from main economies (China, euro zone, USA) are due for release this week. We will also see the last set of data from Poland (retail sales, unemployment rate). Setniment can be significantly affected by numbers from China, which recently showed a slowdown of economic activity, putting a negative pressure on global moods. The CEE currencies, including the zloty, may be affected by results of meetings of central bank in Hungary and the Czech Republic. Situation in Ukraine remains in focus.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (24 March)					
2:45	CN	Flash PMI-manufacturing	Mar	pts	-	-	48.5
9:28	DE	Flash PMI- manufacturing	Mar	pts	-	-	54.8
9:58	EZ	Flash PMI- manufacturing	Mar	pts	53.3	-	53.2
		TUESDAY (25 March)					
10:00	**PL**	**Retail sales**	**Feb**	**%YoY**	**6.0**	**6.2**	**4.8**
10:00	**PL**	**Unemployment rate**	**Feb**	**%YoY**	**14.1**	**14.0**	**14.0**
10:00	DE	Ifo index	Mar	pts	110.9	-	111.3
14:00	HU	Central bank decision		%	2.60	-	2.70
15:00	US	Consumer confidence index	Mar	pts	78.6	-	78.1
15:00	US	New home sales	Feb	k	445	-	468
		WEDNESDAY (26 March)					
13:30	US	Durable goods orders	Feb	%MoM	1.0	-	-1.0
		THURSDAY (27 March)					
13:00	CZ	Central bank decision		%	0.05	-	0.05
13:30	US	Final GDP	Q4	%QoQ	2.7	-	4.1
13:30	US	Initial jobless claims	week	k	325	-	320
15:00	US	Pending home sales	Fed	%MoM	0.0	-	0.1
		FRIDAY (28 March)					
13:30	US	Personal income	Feb	%MoM	0.3	-	0.3
13:30	US	Consumer spending	Feb	%MoM	0.3	-	0.4
14:55	US	Michigan index	Mar	pts	80.5	-	79.9

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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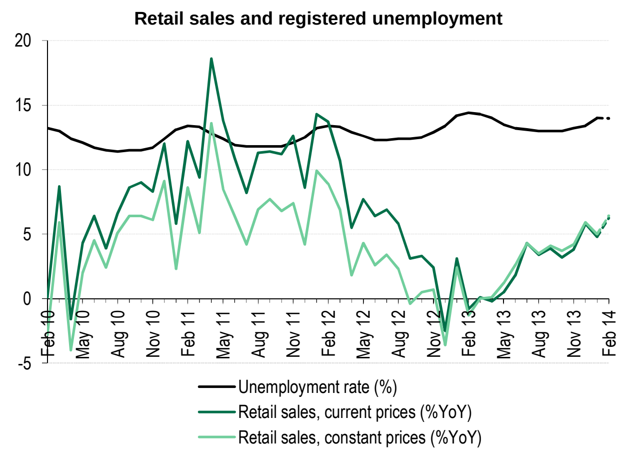
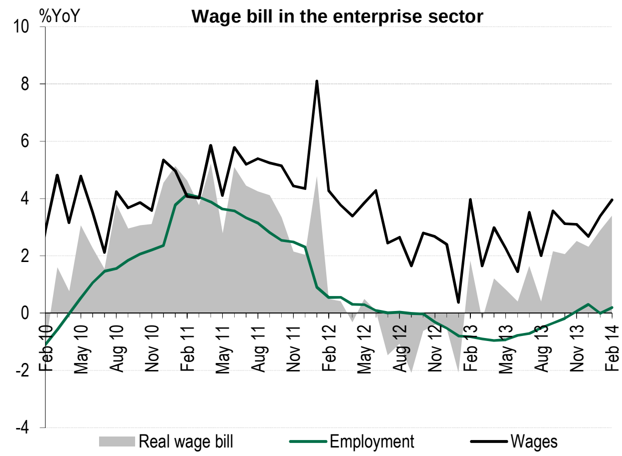
What's hot this week – New signals of recovery in consumption

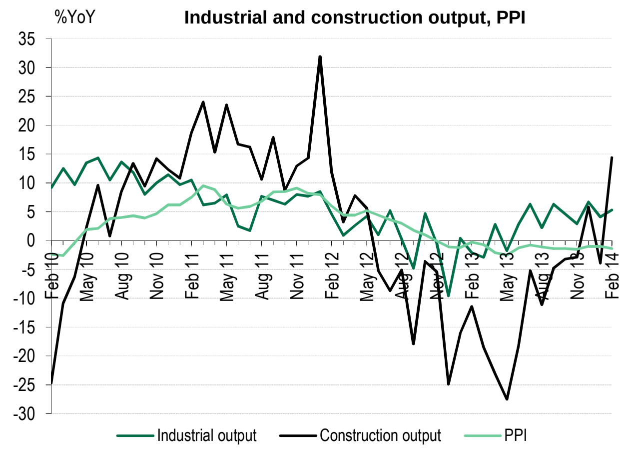


- We are expecting that February's registered unemployment rate stayed at January's level, i.e. 14.0%, which is in line with estimate of the Labour Ministry (thus, unemployment rate fell by 0.4pp in annual terms). What is interesting, the ministry's estimate suggested that the number unemployed fell in monthly terms, which is untypical for this month and is suggesting that recovery on the Polish labour market is gaining steam.
- In our view, growth rate of retail sales accelerated in February, among other factors thanks to higher sales of personal cars registered as trucks due to changes in tax regulations. However, acceleration will be also visible in other categories, supported by rising disposable incomes.
- The data should confirm the economic recovery and rebound in private consumption.

Last week in the economy – Good domestic data



- Employment in corporate sector increased in February by 0.2%YoY. 2.1k of workplaces were added on monthly terms – the first increase of employment in February since 2011.
- Data on wages surprised to the upside showing a growth by 4.0%YoY. This is the fastest pace of wage growth in twelve months. Total wage bill in corporate sector increased in February by 4.2%YoY in nominal terms and by 3.4%YoY in real terms, highest growth rates since January 2012
- Current account deficit in January amounted to -€1.1bn. However, tendencies in foreign trade are still positive – growth rate of exports exceeded 10%YoY for the second month in a row, while import growth accelerated to 6.6%YoY and trade balance recorded a considerable surplus (€419m). Data confirmed the economic recovery fuelled with rising external demand but also with growing role of domestic demand.



- Industrial output expanded in February by 5.3%YoY. Production growth proved slightly lower than expected, which may have been due to a deeper decline of output in electricity, gas, steam and air conditioning supply (-5.9%YoY) due to mild winter. Meanwhile, output growth in manufacturing accelerated to 7.3%YoY from 5.9%YoY one month earlier, with the most considerable increases in export-oriented branches.
- Construction and assembly output surprised to the upside, showing a leap by 14.4%YoY. This was the highest growth rate in this sector for two years, but we should not neglect the weather effect (which, contrary to industrial output, was exerting a positive impact).
- PPI inflation was at -1.4%YoY. Inflationary pressure is still low

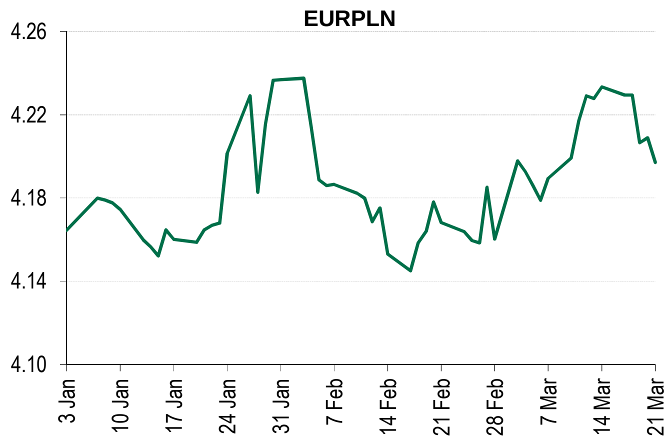
Quote of the week – Moment for a policy change moved later in time

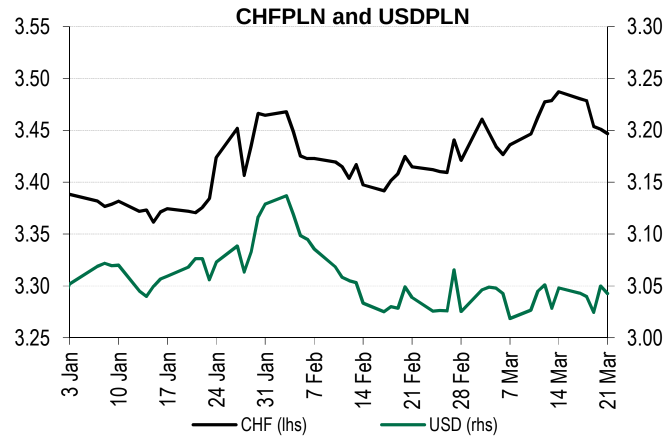
Jerzy Hausner, MPC member, 17 March, Reuters
Two months ago I thought we are approaching a moment when we should begin monetary policy tightening, but situation changed and I am ready to say that the moment for policy change moved later in time. It is possible that neutral bias in monetary policy will be maintained until end of 2014.
Andrzej Bratkowski, MPC member, 20 March, Reuters
I would like the hiking cycle to begin early and proceed at a slow pace, by 0,25 percentage points every two, three months. Hike of rates in Q4 is still possible, but probability than hikes will begin in 1Q2015 is higher than earlier.
Jerzy Osiatyński, MPC member, 21 March, Reuters
It seems that the Council will be able to keep interest rates at current level at least until the year-end. I think that in 2015 as well.

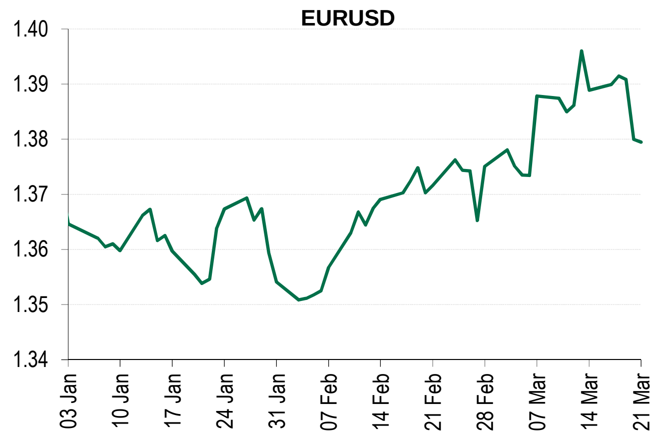
Comment of Andrzej Bratkowski, who did not rule out a hike of interest rates in 4Q2014, affected the interest rate market during last days. However, it seems that a majority of MPC members support the idea that interest rates should remain stable until end of 2014. Jerzy Osiatyński is even ready to keep rates at all-time low for a longer period of time, but his view is probably as isolated as the one of Bratkowski. In our view, the MPC may extend its *forward guidance* until the year-end at meeting in July (after seeing the new NBP projection) and the first hike will be implemented in 1Q2015.

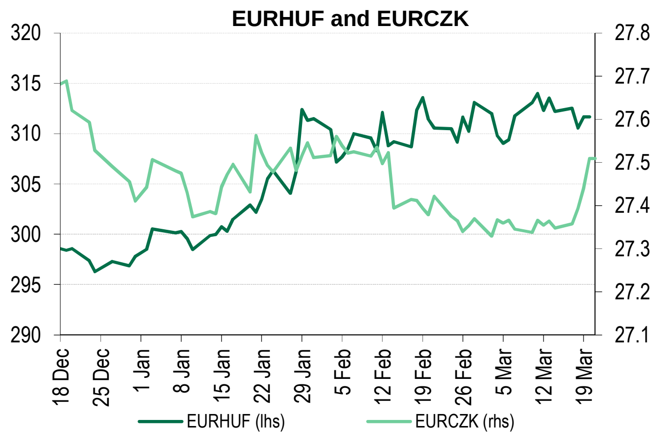
Foreign exchange market

Foreign exchange market – Global mood improvement supports zloty strengthening









Zloty strengthened due to global mood improvement

- After relatively calm opening of the week, next days brought gradual strengthening of the zloty against the main currencies. It came from global mood improvement, in particular after Tuesday's Russian president's statement, which market players interpreted as a chance to curb escalation of Russia-Ukraine conflict. As result of higher risk appetite EURPLN tested support at 4.19, but without permanently breaking it. Investors decided to take profit after more hawkish than expected Fed's rhetoric. But zloty's weakening was only short-lived and EURPLN returned quickly below 4.20 after reaching nearly 4.22. Among others, domestic currency might have been supported by comment of the MPC's Bratkowski who did not exclude rate hike later this year.
- Global mood improvement caused zloty strengthening against the main currencies. In weekly terms zloty strengthened the most vs CHF (by 1%) and vs EUR (by 0.9%), and the less vs US dollar. Strengthening against USD was limited by EURUSD decline.
- Situation on EURPLN did not change significantly. The exchange rate remains in the wide horizontal channel between 4.18 and 4.24. What is more, EURPLN is closer to the lower limit of boundary due to last week strengthening. Currently, the level of 4.19 effectively limits further EURPLN decline. We think that this week will not bring significant changes in EURPLN behaviour and the rate will stay between 4.19 and 4.22.

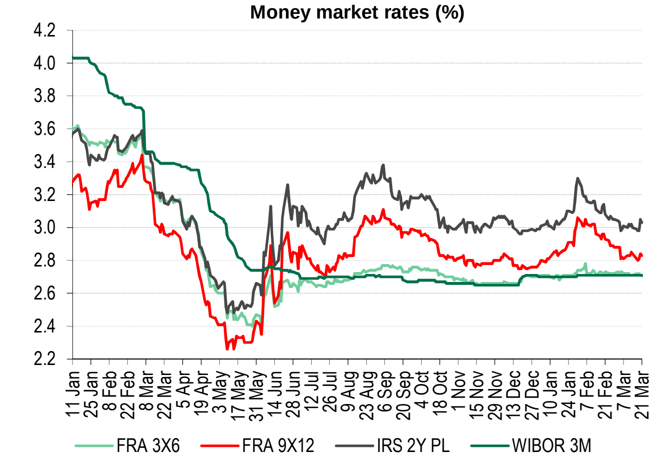
EURUSD under influence of FOMC's rhetoric

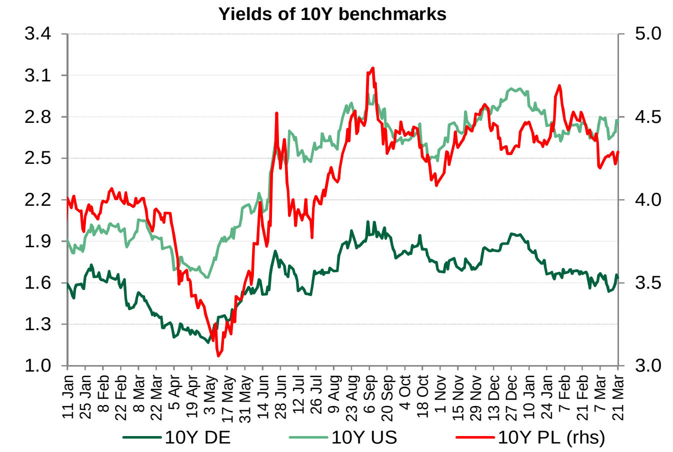
- EURUSD had stabilized near 1.39 ahead of FOMC's decision on Wednesday. Unexpectedly, Fed changed its rhetoric, suggesting earlier than expected the start of monetary tightening. It caused relatively strong impulse of EURUSD decline, below 1.38. The US dollar was also supported by better than expected the US macro data, which exceeded forecasts. Due to lack of further supportive factors EURUSD stabilised near 1.38 on Friday's session.
- Euro weakening after Fed's decision, in our opinion, is only correction move in upward trend. In medium term we expect euro to strengthen and EURUSD to return of upward path towards 1.40. In short run EURUSD will be under influence of upcoming macro data from both the European (flash PMI, Ifo) and the US economy (consumer confidence indices, data from labour market or final reading of 4Q GDP). Further increase in PMI's should support the euro.

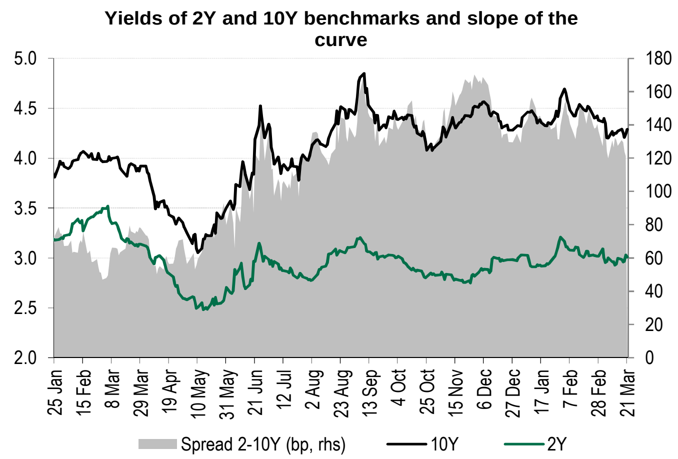
Central banks' meetings in the spotlight

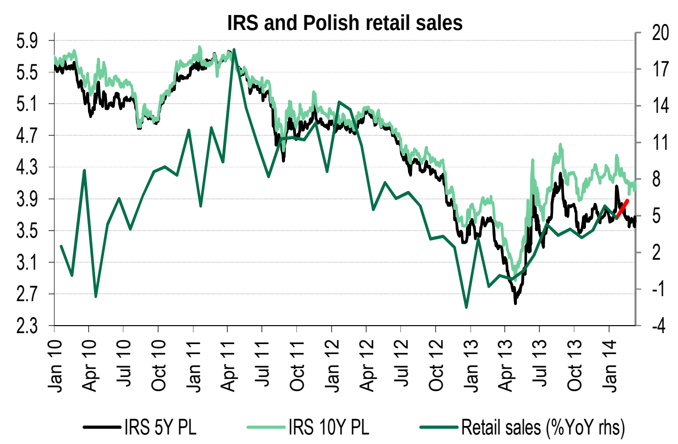
- The Hungarian forint strengthened, similarly as Polish zloty, due to global mood improvement. Consequently, EURHUF exchange rate reached tow-weeks low at 310.5. However, FOMC's decision and mainly expectations on March's NBH meeting caused EURHUF increase towards 312.
- In contrary to other CEE currencies, the Czech koruna gradually weakened, increasing towards four-weeks high of 27.5 against the euro. One should notice that during tension on Ukraine, which resulted in higher risk aversion EURCZK remained relatively stable (around 27.35).
- This week the key events for CEE currencies will be central banks meetings in Hungary (25.03) and the Czech Republic (27.03). We foresee the Czech central bank to keep monetary policy unchanged. As regards the Hungarian central bank we do not exclude further loosening of monetary policy (it is widely expected that NBH will cut rates by 10bp). We think that only decision about keeping rates stable might support forint strengthening.

Interest rate market – A lot of US data, but trend seen unchanged









WIBOR rates still stable…

- MPC rhetoric is stabilizing 1-12M WIBOR rates. Shortest rate is currently at 2.61%, that is unchanged when compared to September 2013. 3-9M rates are 1bp higher than in September while 12M one increased by 3bp since then. During this period of time, FRA9x12 plunged by 25bp while 6x9 by 15bp.
- Currently, the FRA market – that has been quite volatile last week due to comment of MPC's Bratkowski and FOMC rhetoric – is pricing-in an increase of 3M WIBOR by slightly more than 10bp in 9-months' time and ca. 30bp during next 12 months. Our path of 3M rates is close to market expectations and thus we expect short FRA to remain stable on in the next two quarters.

… while IRS and bond yields highly volatile

- Polish interest rate market proved very volatile during the past week. As the tensions in Ukraine have not strengthened in reaction to result of Crimean referendum, global market sentiment improved and this dragged IRS and bond yields down by 10bp during the next few days. However, the downward move did not last long – hawkish tone of the FOMC statement and press conference triggered sudden correction. Additional upward pressure on IRS and bond yields was provided by comment of Bratkowski from the MPC. During the past week, the market has also shown some reaction to domestic data, that initially constrained the room for a decline of IRS and bond yields (higher than expected pace of wages growth) and then stabilized market amid deterioration of global market sentiment (slightly below-consensus industrial output growth). Consequently, IRS and bonds did not change much on weekly basis, the market stayed in the horizontal trend observed for already few months.
- The Finance Ministry sold bonds worth PLN4.8bn. Sale of PS0718 raised PLN2.7bn and sale of DS1023 brought PLN2.1bn. Yields recorded at the auction were close to secondary market levels (weaker than Wednesday's close due to investors' reaction to FOMC rhetoric). Our estimates show that the ministry has already covered almost 70% of this year's borrowing needs. Market perceived the demand for debt as rather low and this also contributed to a yields increase seen in the second half of the week.

A lot of US data, but trend seen unchanged

- FOMC rhetoric – even if this was not intended – has become more hawkish after the March meeting (Yellen's suggestion of a rate hike in spring 2015 and higher support for a rate hike next year among Committee's members). Dropping the 6.5% unemployment rate threshold determining the stance of the monetary policy and adopting kind of expert analysis may make the market more sensitive to the US macro data releases (and much of them is due this week).
- At the same time, it is worth to remember, that recent data may be still under the negative impact of severe weather conditions. Market reaction to disappointing releases may be weaker than for positive surprises.
- The passing week showed that the domestic interest rate market is sensitive also to Polish data. We think that February's retail sales reading may beat marginally the consensus. However, we do not expect this data – and the US publications – to end the stabilization observed on the market since around July 2013.

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.