WEEKLY ECONOMIC UPDATE

7 – 13 April 2014

As expected, the ECB meeting was the key event of the last week. Although the central bank, as we had suggested, did not decide to change monetary policy yet, Mario Draghi's press conference revealed a softening of the overall tone and boosted expectations that at one of the next meetings the ECB will finally have to use one of the non-standard measures (QE, negative rates). This triggered a clear depreciation of euro versus the dollar. March PMI indices confirmed slower expansion of activity in European economies, however their impact on the markets was limited.

At the start of the week the investors' sentiments in CEE region may be considerably affected by the results of parliamentary election in Hungary. According to opinion polls, the ruling Fidesz party should secure an easy win for a second time in a row; moods may be however calmed somehow by high support for the nationalist Jobbik party. Calendar of macro releases and events for the upcoming week is rather thin. Meeting of the domestic MPC should not bring much new – one month after extension of forward guidance until end of Q3 no crucial changes in monetary policy or MPC's rhetoric should be expected. Data on balance of payments for February should confirm the quite good health of Polish exports, showing trade surplus and low current account deficit, which can potentially support the zloty at the end of the week. As regards events abroad, release of Fed minutes may be important. We will also see quite numerous public speeches of FOMC members.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (7 April)					
8:00	DE	Industrial output	Feb	%MoM	0.3	-	0.8
9:00	CZ	Industrial output	Feb	%YoY	6.5	-	5.5
		TUESDAY (8 April)					
		No important data releases					
		WEDNESDAY (9 April)					
	PL	**MPC decision**		**%**	**2.50**	**2.50**	**2.50**
8:00	DE	Exports	Feb	%MoM	-0.5	-	2.2
9:00	CZ	CPI	Mar	%YoY	0.2	-	0.2
20:00	US	FOMC minutes	Mar				
		THURSDAY (10 April)					
14:30	US	Initial jobless claims	week	k	-	-	326
		FRIDAY (11 April)					
9:00	HU	CPI	Mar	%YoY	0.2	-	0.1
14:00	**PL**	**Current account**	**Feb**	**€m**	**-533**	**-398**	**-1135**
14:00	**PL**	**Exports**	**Feb**	**€m**	**13 462**	**13 352**	**13 503**
14:00	**PL**	**Imports**	**Feb**	**€m**	**13 025**	**12 942**	**13 084**
15:55	US	Flash Michigan	Apr	pts	81.0	-	80.0

Source: BZ WBK, Reuters, Bloomberg, Parkiet

ECONOMIC ANALYSIS DEPARTMENT:

ul. Marszałkowska 142. 00-061 Warszawa fax +48 22 586 83 40

email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl

Maciej Reluga (Chief Economist) +48 22 534 18 88

Piotr Bielski +48 22 534 18 87

Agnieszka Decewicz +48 22 534 18 86

Marcin Luziński +48 22 534 18 85

Marcin Sulewski +48 22 534 18 84

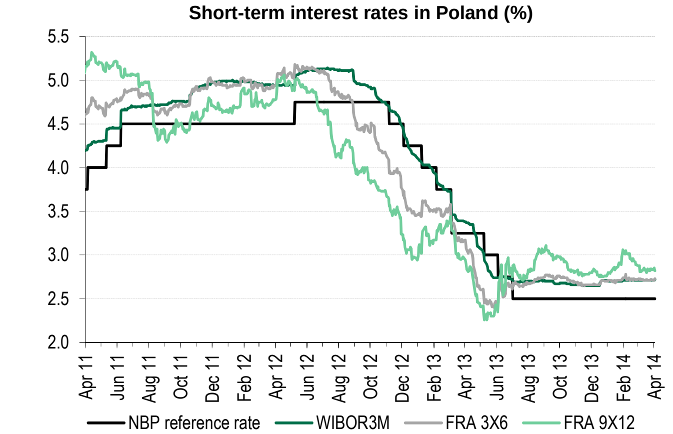
TREASURY SERVICES:

Poznań +48 61 856 5814/30

Warszawa +48 22 586 8320/38

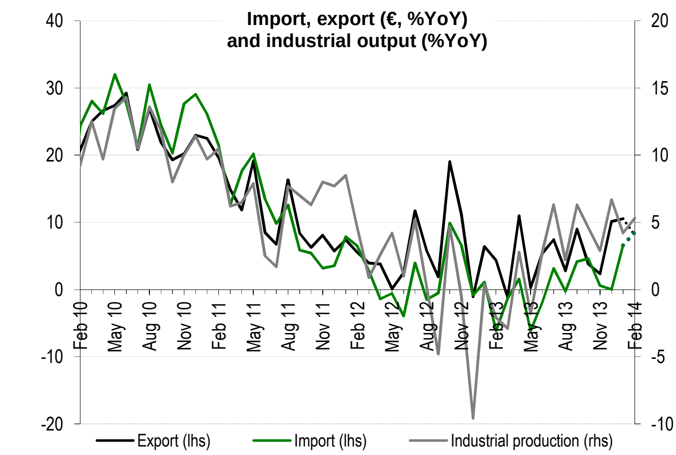
Wrocław +48 71 369 9400

What's hot this week – No change in monetary policy, export still strong



▪ The upcoming MPC meeting should not bring any surprises. Even though recent comments of MPC members suggest that some of them do not rule out a stabilization of interest rates until the year-end (A. Zielińska-Głębocka) or even until end of 2015 (J. Osiatyński), we think that important changes in the MPC statement only one month after extension of *forward guidance* until end of Q3 are quite unlikely. In our view, since the last MPC meeting no important information appeared, which could have changed the economic or inflationary outlook substantially.

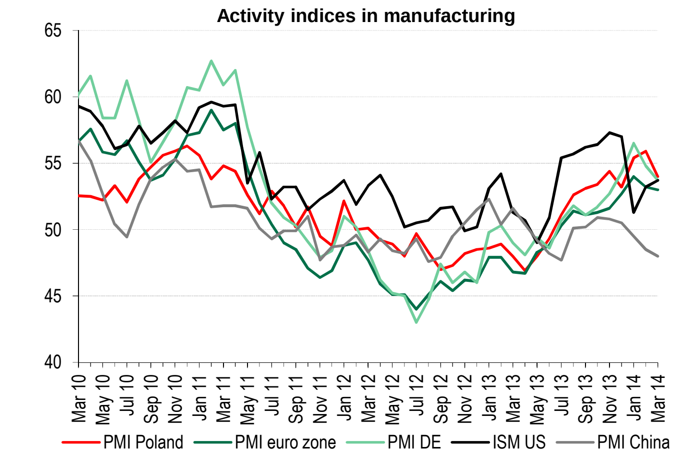
▪ One of the MPC members (A. Kaźmierczak) suggested recently that reserve requirement ratio may be reduced for commercial banks and suspended for cooperative banks in order to boost loans for companies. We doubt whether such actions would be effective and we do not think that this idea will find support in the MPC.



▪ We are expecting the data on balance of payments in February to show another decent rise of Polish exports, which is suggested by quite good results of industrial output for that month. We are also likely to see another surplus on trade balance. Data will be covering period before annexation of Crimea by Russia, so we are not expecting them to show impact of recent events in the East on Polish foreign trade. On the other hand however, already in previous months exports to Russia and Ukraine were weakening under impact of deteriorating business climate in these countries and considerable sell-off of the ruble and the hryvnia visible since the start of the year may have intensified this effect.

▪ Quarterly data on balance of payments showed an upward revision of exports for the previous months. Current account deficit shrank to 1.3% of GDP at the end of 2013 and we expect this relation to slide further in the upcoming quarters (to ca. 0.7% of GDP at the end of 2014).

Last week in the economy – Situation in Ukraine weighed on moods in manufacturing



▪ PMI for Polish manufacturing plunged in March much deeper than expected – to 54.0pts from 55.9pts in February. However, PMI remained above the neutral mark of 50pts and continues to show that the activity in domestic manufacturing sector is expanding. Additionally, the March's decline was only the second one in the last 11 months. The biggest impact on the move down was provided by slower growth of export orders as they expanded at the slowest pace since mid-2013 due to uncertainty related to the situation in Ukraine. Slower growth of this subindex had a negative impact on output, but only marginally influenced the pace of employment growth (which recorded even a slight improvement). Data confirmed that inflation pressure remains subdued, producer prices continued to decline in March.

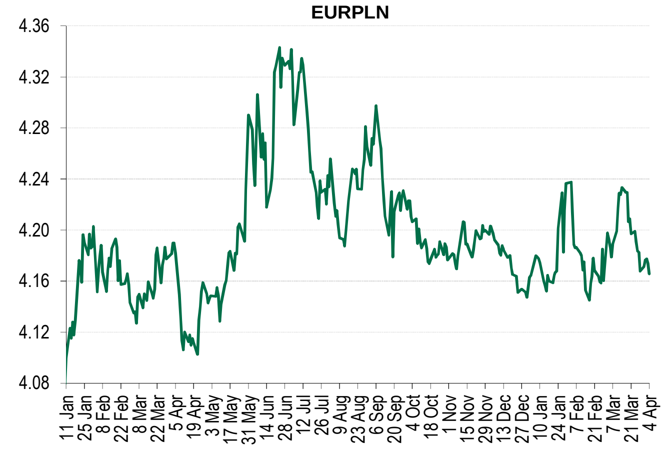
▪ In general the PMI data do not change our forecast of March industrial output (5.9%YoY), as it seems quite conservative (market average 6.5%YoY, max 7.8%).

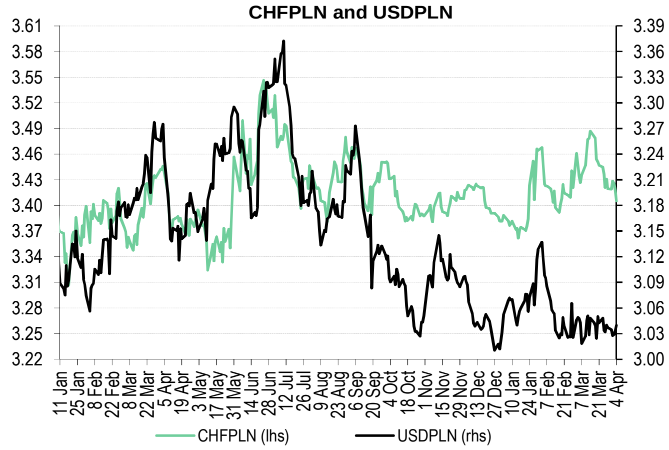
Quote of the week – Higher number of MPC members in 2015?

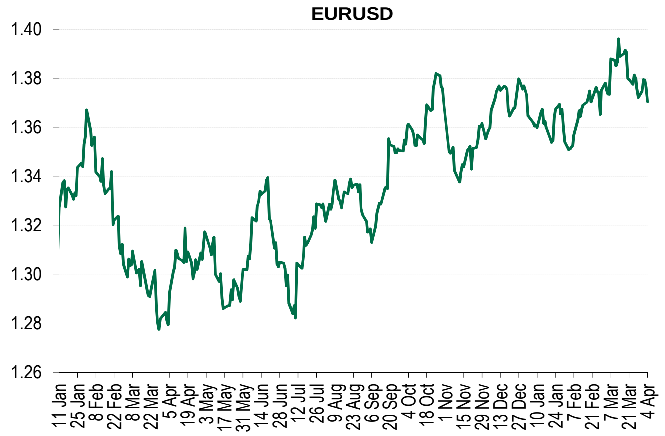
Wojciech Kowalczyk, deputy finance minister, 2 April, Reuters
We already have resolved doubts about draft of assumptions for the new NBP bill. This draft of assumptions should be discussed by the Council of Ministers in the upcoming months. Thus, I think that draft of bill amendment will go to the parliament in September. Realistically speaking, extension of the MPC by three additional seats will be possible not earlier than in 2015.

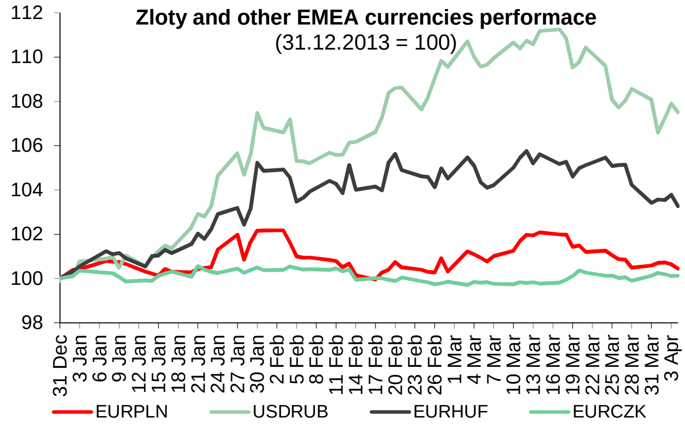
In December 2013 the Finance Ministry presented its draft of NBP amendment, aiming at changing the MPC so that its members' terms do not finish at the same time, but will be overlapping (replacement of 3 members after each 2 years). We welcomed this idea and in our view it may enhance the stability of monetary policy. However, due to these changes the MPC will swell to 12 members temporarily. If 3 new members are of similar opinions to Jerzy Osiatyński, nominated recently, the balance within the MPC will be likely to shift towards more dovish. However, in our view postponement of MPC extension lowers the risk that the Council will wait too long with the start of monetary policy tightening – we are assuming that the first hike will take place at the start of 2015.

Foreign exchange market – Zloty has remained strong, election in Hungary in the spotlight









The ECB's rhetoric supports the zloty

- Last week the key event on the financial market was the ECB meeting. Before that, lower than expected PMI manufacturing index caused temporary EURPLN increase towards 4.18 and then the rate stabilized around 4.17 ahead of the ECB's decision. While decision was in line with expectations, the press conference confirmed the central bank's readiness to act. Mr Draghi highlighted possibility of monetary easing and as a consequence EURPLN temporary decreased to 4.1585. But waiting for the US labour market data, the exchange rate quickly increased above 4.16. The US data were mixed (unemployment rate slightly increased, non-farm payroll in March was below consensus, while February's data was sharply revised upward). After these data release, EURPLN fell to 4.1585 and then again returned above 4.16.
- In weekly terms zloty gained the most against the Swiss franc (by 0.4% due to EURCHF increase). In relation to euro and British pound it strengthened by only 0.05%. In the same time zloty lost 0.1% against the US dollar due to significant decline of EURUSD during the ECB's press conference.
- Situation on EURPLN chart did not change significantly last week. The exchange rate has remained in the wide consolidation channel between 4.14 and 4.25, oscillating closer to the lower boundary. The most important release for this week will be FOMC's minutes, but also domestic data about February's balance of payments (on Friday). Still the crucial support is at 4.14, while the first resistance level is 4.183.

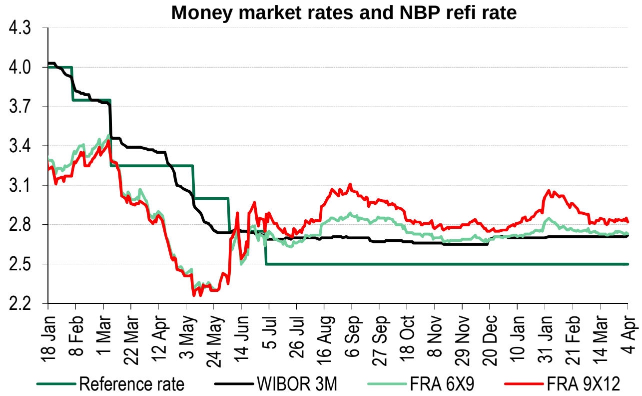
Euro significantly weakened after ECB's press conference

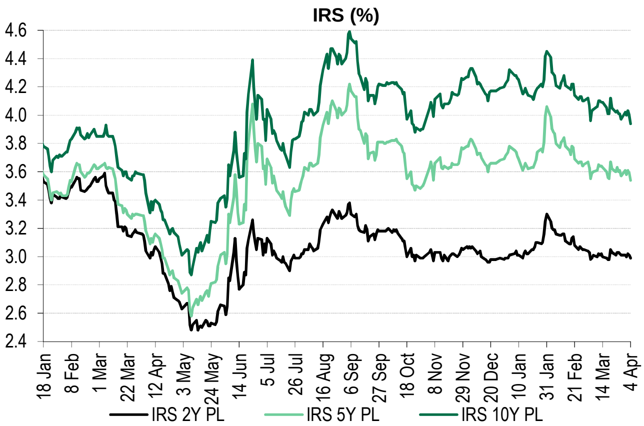
- Turn of March and April brought strengthening of euro ahead of the ECB meeting. Market consensus clearly suggested that official interest rates would remain on hold, but some of investors were expecting the ECB to cut rates or to implement non-conventional steps to limit risk of deflation. ECB decided to keep monetary policy measures unchanged, which gave an impulse to EURUSD increase above 1.38. But it was only short-lived as the exchange rate fell sharply to 1.37 after Draghi's suggestion that the ECB might act in coming months. This level was tested after the US labour market data release. But EURUSD after reaching 1.368 quickly returned above 1.37.
- Dovish rhetoric of Mr Draghi triggered strengthening of Swiss franc against the euro, especially that the SNB's governor said the bank stands ready to act if the ECB decides to ease monetary conditions. All in all EURCHF increased towards 1.224, up from 1.218 at the beginning of the last week.

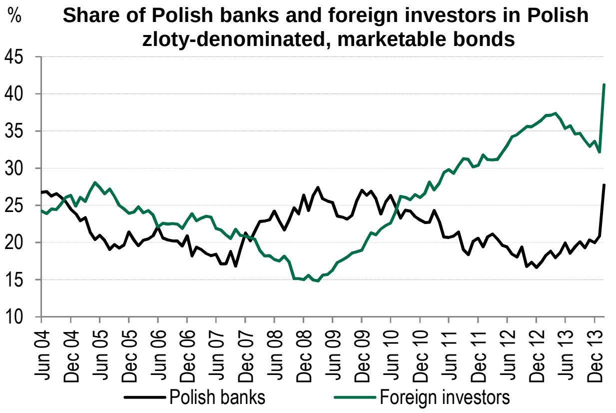
Focus on election in Hungary and CPI in the Czech

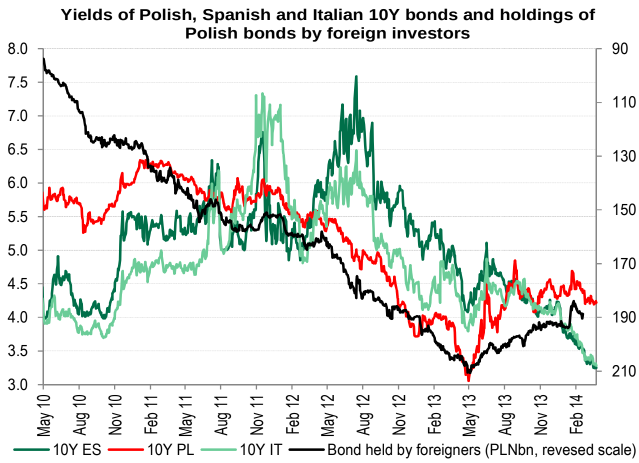
- Sentiments in the CEE region were mixed. In the course of the week, the ruble and the forint gained (by almost 1%), while the Czech koruna weakened by 0.2% versus the euro. Strengthening of the forint was caused by the ECB rhetoric and stronger non-residents' demand for Hungarian debt. The Czech koruna stays under impact of central bank's rhetoric, as it declared its readiness to intervene, should necessary, and to keep EURCZK at 27 at least until start of 2015.
- Result of the parliamentary election will be the key driver for the forint in the upcoming week. It seems that the ruling Fidesz party should win a majority of votes. Such a scenario should be supportive for the forint (or at least stabilizing). The Czech koruna will stay under influence of macro data (output and CPI inflation). CPI close to zero may deliver an impulse for a short-term increase towards 27.45.

Interest rate market – ECB and Fed policy crucial









WIBOR and FRA rates stable

▪ Among 1-12M WIBOR rates only the 3M rate has inched up last week by 1bp. FRA remained stable and the market expectations regarding future decisions of the MPC have not changed (first hike by 25bp in one year time). We do not anticipate any change in MPC rhetoric and the April's meeting should not have a visible impact on the WIBOR and FRA.

IRS still close to local lows

▪ Middle and long end of the IRS curve hovered around lowest levels since November 2013 (4% for 10Y and 3.60% for 5Y). Short end remained anchored close to 3% and did not change much in recent days. Also in case of bonds biggest changes were recorded in 5Y and 10Y sectors, those tenors gained visibly amid dovish rhetoric of the ECB and US nonfarm payrolls data.

▪ Data on holders of Polish zloty-denominated, marketable bonds at the end of February released by the Ministry of Finance showed the impact of pension reform for the first time. OFE transferred nearly PLN130bn of bonds to state pension fund (ZUS). Consequently, at the end of February, foreigners held over 40% of Polish zloty-denominated, marketable bonds outstanding vs. 32% in January. The increase was also partly fuelled by monthly buying of bonds (nearly PLN2.5bn). After the bond transfer, there are 17 bond series in which foreign investors hold at least 40% of debt outstanding, and this represents 87% of foreign-owned bond portfolio. Within this group there are 11 series where foreigners hold over 50% of bonds outstanding and this makes 62% of their total portfolio. This shows that after the OFE reform, Polish debt market relies strongly on the foreign investors' moods.

▪ The Ministry of Finance issued debt of total value of PLN5.8bn amid demand at PLN8.4bn. Investors purchased DS1023 worth nearly PLN3.5bn at yield of 4.261%, marginally above secondary market level, demand amounted to nearly PLN5bn. We estimate that after this auction the Ministry has covered nearly 74% of this year's borrowing needs.

ECB and Fed policy crucial

▪ Comments of Mario Draghi during the ECB press conference strengthened market expectations for central bank monetary policy easing. Although this was again only verbal declaration, the fact that multiple measures have been discussed during the meeting (quantitative easing or cutting deposit rate below zero) has clearly fuelled market hopes that such actions are still possible. It is worth to notice, that expectations for more ECB actions have provided visible support for Spanish and Italian bonds while the Polish debt was under pressure of the outlook of the end of the QE3 in the USA. This was even despite the fact, that domestic debt offers higher yield than Spanish and Italian one.

▪ US March monthly nonfarm payrolls were close to market consensus, but February's release was revised clearly to the upside. Some decent US macro data was also released earlier in the week and this may fuel hopes that the negative impact of severe winter is gradually losing strength. The likely continuation of QE3 tapering by the FOMC (and nearing rate hike) and higher demand for risky assets is expected to pressure core markets and this shall have an impact on the domestic interest rate market.

Bank Zachodni WBK
Grupa Santander

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.