Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

21 – 27 April 2014

The most important factor influencing market moods last week was the conflict between Russia and Ukraine. Increased activity of the pro-Russian separatists and rumours that Russian troops entered the Ukrainian territory have scared investors, triggering a risky assets' sale-off, also on the Polish market. At the end of the week the situation calmed down after information about agreement between USA, UE, Russia and Ukraine following talks in Geneva.

Macro data releases abroad were mixed, although information about Chinese economic growth (which has been disappointing recently) surprised positively. Data released in Poland confirmed that inflationary pressure is low, situation in the labour market keeps improving quickly (real wage bill in corporate sector was fastest for two years), manufacturing is doing well and construction sector is leaving stagnation behind. It all confirms a scenario of non-inflationary economic recovery.

The most important data released this week are flash PMI indices for the euro zone and Germany. Both indicators declined in the last two months. Another disappointing reading could increase investors' worries about economic recovery in Europe, raising expectations for more monetary stimulus from the ECB. PMI index for China will be important as well. In Poland the last data for March will be released, which we think will be consistent with the trends observed recently. Important domestic event will be the bond auction. Its results will be supported by inflow of money from the redemption of PS0414 bonds and interest payments. After this auction this year's borrowing needs of the state should be financed at least in 80%.

Economic calendar

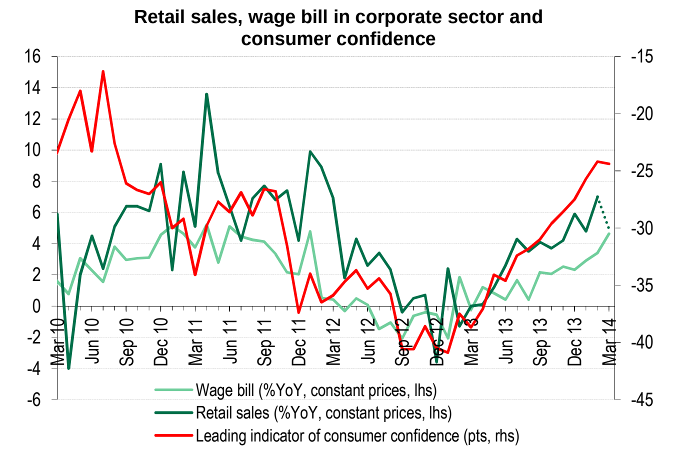
CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (21 April)					
		Second day of Easter					
		TUESDAY (22 April)					
16:00	US	Home sales	Mar	m	4.55	-	4.60
		WEDNESDAY (23 April)					
3:45	CN	Flash PMI – manufacturing	Apr	pts	48.3	-	48.0
9:28	DE	Flash PMI – manufacturing	Apr	pts	53.8	-	53.7
9:58	EZ	Flash PMI – manufacturing	Apr	pts	53.0	-	53.0
11:00	**PL**	**Bond auction of OK0716/PS1016/PS0718**					
16:00	US	New home sales	Mar	k	450	-	440
		THURSDAY (24 April)					
10:00	**PL**	**Retail sales**	**Mar**	**%YoY**	**5.7**	**4.7**	**7.0**
10:00	**PL**	**Unemployment rate**	**Mar**	**%YoY**	**13.6**	**13.6**	**13.9**
10:00	DE	Ifo index	Apr	pts	110.4	-	110.7
14:30	US	Durable goods orders	Mar	%MoM	2.0	-	2.2
14:30	US	Initial jobless claims	week	k	315	-	304
		FRIDAY (25 April)					
15:55	US	Michigan index	Apr	pts	83.0	-	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

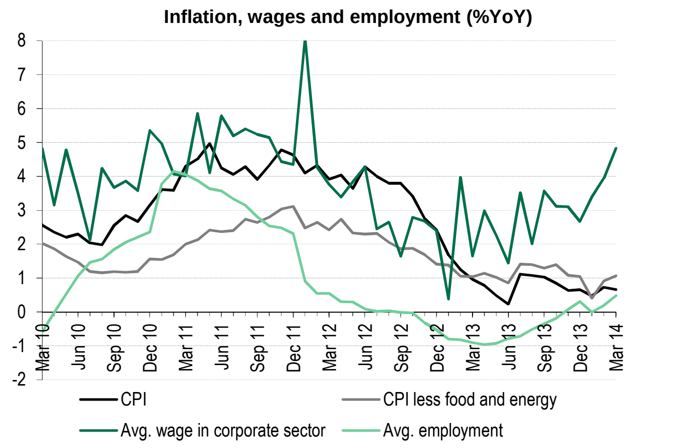
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

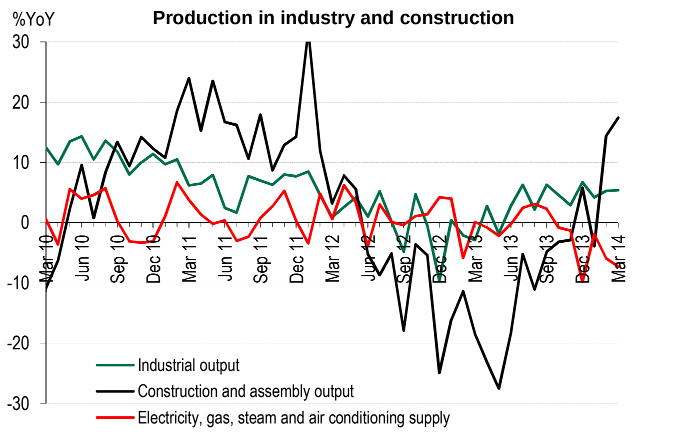
What's hot this week – Later Easter undermining March's sales



- We are expecting a slowdown of retail sales' growth in March, mostly due to statistical base effects (later timing of Easter holidays this year than in 2013), but not because of weakening consumer demand. Recent data from the labour market show a further considerable improvement of households' incomes, which allows for optimism about growth rate of consumption in the upcoming months. Results of retail sales in March were still positively affected by effect of ending tax deductions on cars registered as trucks.
- Estimates of the Labour Ministry show that registered unemployment rate fell in March quite considerably, actually stronger than a seasonal pattern would suggest. Number of jobseekers is diminishing at a speed similar to that seen in 2008, when the Polish economy was still in pre-crisis boom phase.

Last week in the economy – Non-inflationary economic recovery in progress





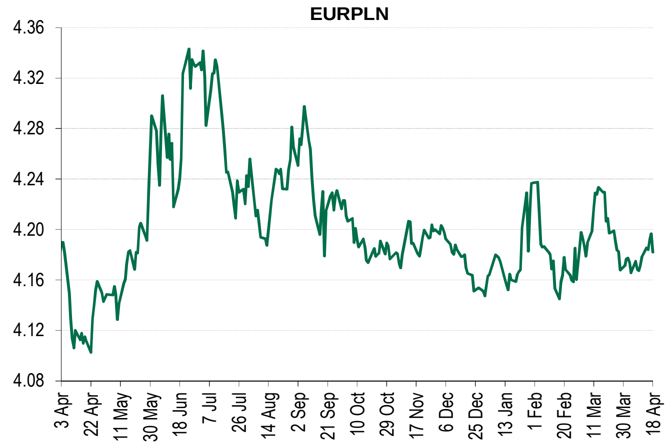
- In March CPI inflation stabilized at 0.7%YoY, in line with expectations. As regards monthly growth in prices, the most considerable increase was posted by "clothing and footwear" (+0.8% due to spring collections), "alcoholic beverages, tobacco" (by 0.7%) and "communication" (by 0.6%). "Food and non-alcoholic beverages" prices declined (by 0.3%, which is untypical for this month) as well as housing costs (by 0.1%).
- Core inflation excluding food and energy prices climbed in March to 1.1%YoY, the highest level since December. Producer prices fell in March by 0.2%MoM and by 1.3%YoY, confirming the non-inflationary economic growth.
- Growth of average wages and employment in March beat expectations, accelerating to 4.8%YoY and 0.5%YoY, respectively. Further visible improvement in the labour market reflects positive sentiment among Polish companies and is probably the effect of ongoing investment rebound. Meanwhile, a gradual rise of households' labour income supports the consumption demand. We think that this may influence pace of CPI growth in the medium run and thus inflation may not stay subdued longer than a couple of months.
- Growth of industrial output reached 5.4%YoY in March, slightly below expectations, while construction output accelerated to 17.4%YoY, beating consensus. Both numbers have been influenced by weather conditions, which were much better than a year ago (it was cold and we had a heavy snowfall in March 2013). Consequently, the output in the energy supply sector plunged substantially for a second month in a row (-7.3%YoY) and weighed on the overall performance of industry. Still, manufacturing output recorded a strong growth (7.7%YoY) confirming that the economy is expanding due to rising domestic and foreign orders.

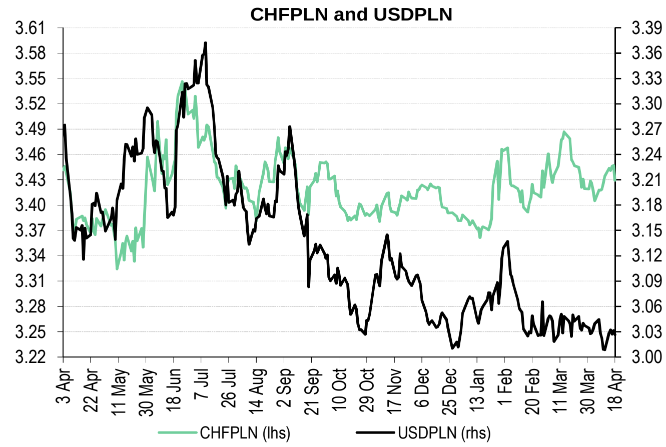
Quote of the week – Rate hike possible should growth exceed 3.5%?

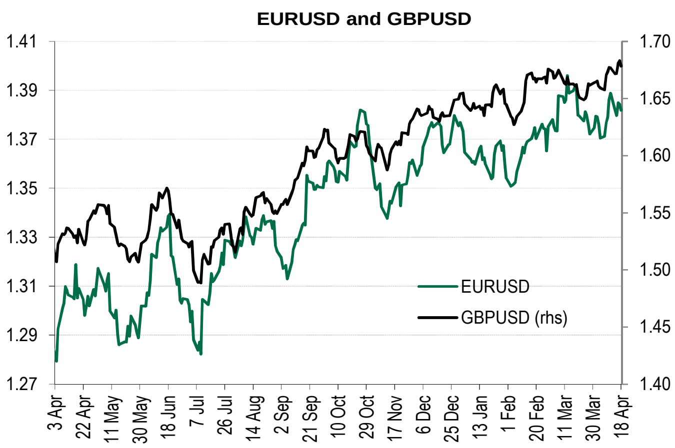
Andrzej Rzońca, MPC member, 17.04, Bloomberg
I am not saying that rates should be raised immediately in the fourth quarter, I mean I cannot rule out a possibility they will be hiked prior to the year-end.
Andrzej Bratkowski, MPC member, 17.04, Reuters
I do not rule out that at the end of Q4 we may begin the hiking cycle, a gradual one with changes not every month. The cycle may begin in Q4, provided that GDP expands faster, e.g. we will see 3.5% in Q2 and wage growth accelerates visibly.
Elżbieta Chojna-Duch, MPC member, 14.04, PAP
In my opinion, chances for an extension of stable rate period until the year-end at the July's meeting are high. (…) Data showing a significant acceleration of investment, to 9.0% in Q4 (…) can encourage us to consider further possible reaction in form of interest rate hike in 2015, after Q1.

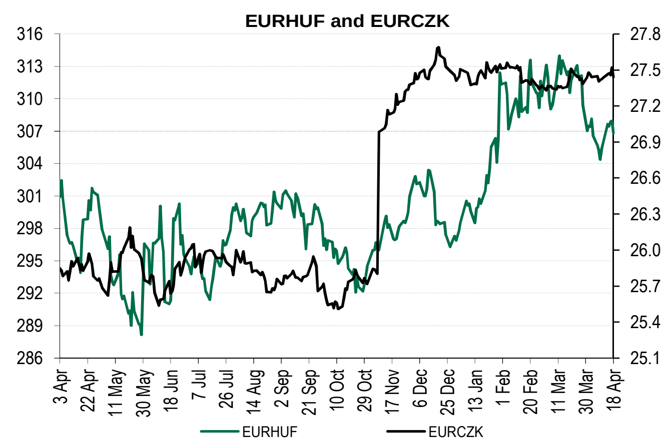
After a series of dovish signals from the MPC, which caused a postponement of market expectations about possible interest rate hikes, we saw a few hawkish comments. A. Rzońca and A. Bratkowski did not rule a rate hike already in 2014, and both pointed that GDP growth above 3.5% is one of conditions for such a decision (Bratkowski additionally mentioned faster wage growth). However, these voices seem to be alone in the MPC – most members (including J. Hausner, who was not ruling out hike in Q4 until recently) are strongly suggesting that chances for stable rates until the year-end are high. There is still a lot of time until 2015, but we find it probable that the MPC will prolong its *forward guidance* by one quarter in July. However, the rate hikes may start in early 2015, when CPI will start trending upwards and GDP growth will be gaining steam.

Foreign exchange market – Lower concerns about Ukraine supportive for currencies in the region









Zloty under pressure of situation in Ukraine

▪ Last week zloty as other currencies from the emerging markets was under pressure of situation in Ukraine. Renewed escalation of Ukraine-Russia conflict (rumours that Russian army invaded Ukraine) increased risk aversion and consequently caused zloty weakening. It is worth noting that zloty's sell-off was not sharp and EURPLN only approached to 4.20. Please recall that during the March sell-off the rate grew above 4.23, while at the beginning of February it reached 4.26. It clearly shows that zloty has become more resistant to news about Ukraine-Russia conflict, supported by expectations that ECB will act in upcoming months and by better data from domestic economy.

▪ In weekly terms zloty lost the most against the British pound (by 0.7%) due to quite visible strengthening of GBP (details below) and versus the US dollar (by 0.6%). On the other hand zloty was more or less stable in relation to the euro and the Swiss franc.

▪ Last week brought some narrowing of fluctuation channel to 4.16-4.20 for EURPLN and to 3.0-3.04 for USDPLN. This week will be shorter due to Easter, but we will know the last part of domestic macro data (retail sales and unemployment rate). However, these data may be in the shadow of events abroad (mainly macro data releases, including flash PMI for euro zone, Ifo for Germany). We believe that lower worries about further escalation of Ukraine-Russia conflict after achieving agreement between Ukraine, EU, Russia and the US in Geneva should be supportive for the zloty. Domestic currency should gain against the main currencies, shifting towards the bottom of fluctuation band.

Euro slightly weaker, pound stronger

▪ Last week EURUSD was under influence of comments from the central banks representatives. While ECB's bankers keep their dovish rhetoric, Fed's governor Janet Yellen slightly softened her previous stance. Her comments boosted expectations that accommodative monetary policy in the USA will continue longer than currently expected. Consequently, in weekly terms EURUSD stayed in fluctuation channel 1.379-1.389, remaining slightly above 1.38.

▪ In previous week we observed quite significant strengthening of British currency. It came from much stronger than expected data about unemployment rate. Britain's unemployment dropped to a five-year low in February, reaching 6.9% (down from 7.2% in previous month). These data strengthened expectations that BoE will start monetary tightening this year. As a result the pound jumped to 1.684 against the US dollar, from 1.672 (before the release).

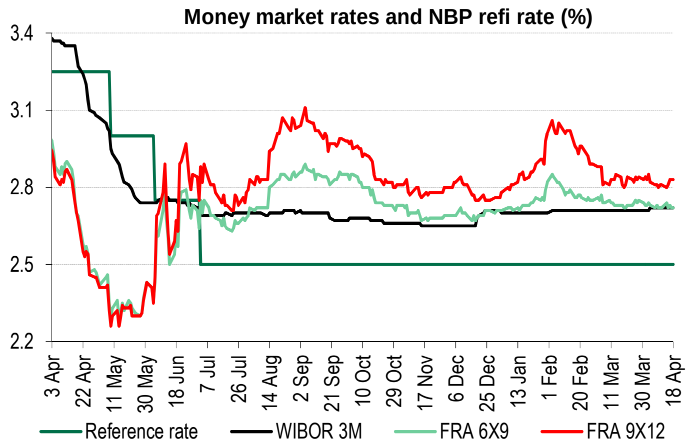
▪ This week investors will focus on macroeconomic data releases, including flash PMI for the euro zone, Ifo for Germany and data from the US real estate market. Better than expected reading of PMIs may cool expectations on quick action by the ECB and as a consequence EURUSD may test the top of fluctuation channel.

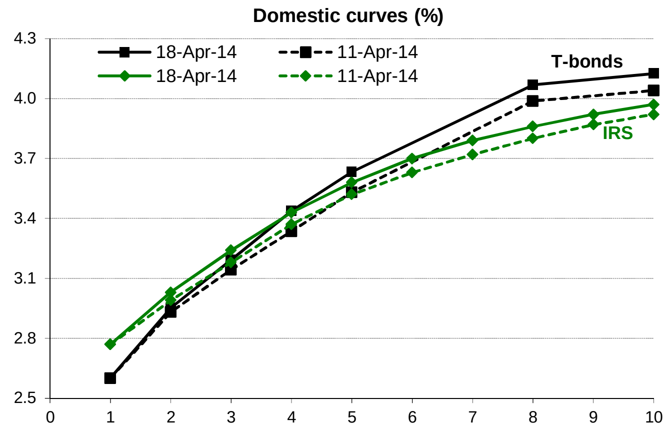
Investors' mood under influence of external factors

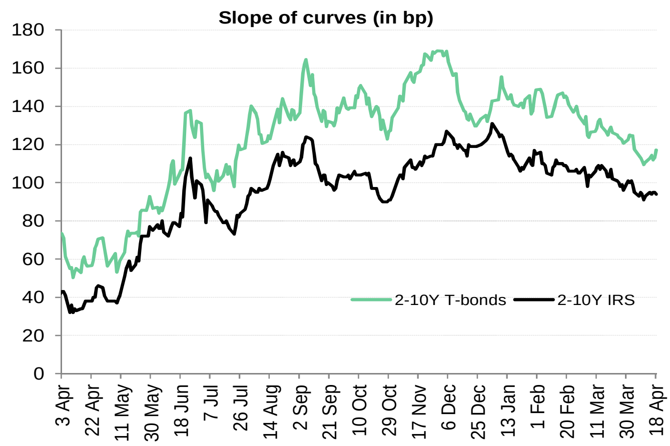
▪ Currencies from the region, similarly as the zloty, weakened at the beginning of last week due to negative news flow from Ukraine. Next days brought some improvement in market sentiment, which helped the market to recover slightly. Consequently, in weekly terms the Russian ruble gained the most, while the Hungarian forint was on the second place.

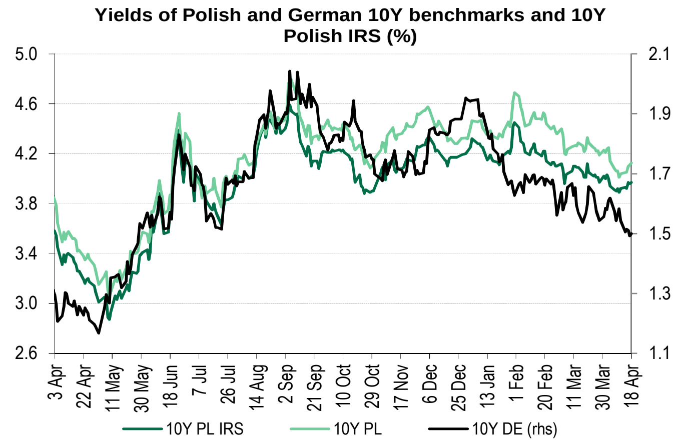
▪ This week there are no important events in the region. Therefore, the CEE currencies will be under influence of global factors. We think that after reaching agreement about de-escalation of conflict in the East, emerging market currencies, including forint and the Czech koruna should rebound further.

Interest rate market – Bond auction will be an important event









Money market well anchored

- WIBOR rates between 1M and 12M have not changed last week, while longer FRAs increased slightly, following rising IRS rates. Current MPC's rhetoric – interest rates stable at least until the end of Q3 and possible change of the communique in July at the earliest – plus comments of MPC members suggesting no change in monetary policy until the end of 2014, are effectively stabilising money market rates.
- Situation in the money market should not change in the nearest week. The release of domestic data (retail sales, unemployment), similarly as last week, should be neutral for the market, stabilising WIBOR and FRA rates near current levels.

Correctional rise of bond yields and IRS

- Last week saw a correction of strengthening of bonds and IRS observed since February. An impulse for a rebound was rumour from Ukraine, suggesting activity of Russian army at the Ukrainian territory. Sharp rise of worries about possible military conflict near to our border triggered a retreat of investors from the domestic debt market. The bonds' sell-off was additionally supported by domestic data from the labour market and US industrial production. What is important, the weakening of bond market was accompanied by rising market turnover. Eventually, during the week the 10Y IRS increased towards 4% versus 3.9% on the previous Friday (thus, the lowest level since October has not been broken). A move up of ca. 10bp was also recorded in case of 5Y IRS (from 3.5% to 3.6%). Yields of analogous bond benchmarks rebounded to 3.8% and 4.1% correspondingly (weekly high at 4.14%). Similarly as in previous weeks, the short end of the curves was more stable, which remains close to 3% for both bonds and IRS rates.
- Higher risk aversion triggered widening of spreads 2-10Y for bonds and IRS, mainly due to steepening of 2-5Y segment. For 5Y and 10Y there was also a widening of asset swap spreads, while for 2Y this spread has narrowed slightly.

Bond auction in focus

- The key events this week for the debt market will be Wednesday's bond auction and flash data about activity in manufacturing for China, Germany and the euro area.
- The Ministry of Finance announced that at the second auction this month it will offer bonds OK0716 / PS1016 / PS0718 worth PLN6-10bn in total. The last FinMin's data showed that at the end of February the biggest share of OK0716 was held by domestic investment funds (PLN1.6bn) and banks (PLN1.5bn), while two other series were predominantly owned by foreign investors (respectively 40% and 44% of total outstanding amount), and Polish banks were second with share above 30%. We expect that demand at the auction will be decent, supported by the inflow of liquid money worth ca. PLN16bn from redemption of PS0414 and PLN5.6bn from interest payments on PS and WS bond series. In our view, the realisation of this year's budget borrowing needs may reach 80% after April.
- During the last days the market was hoping that slowdown in China will encourage its authorities to support the economy. However, Chinese policymakers are cautious about necessity of such actions. Data for Germany and for the euro zone can affect expectations about further ECB actions, but April's flash inflation will be more important and we will not see it until the end of month.

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.