Bank Zachodni WBK
Grupa Santander

BI-WEEKLY ECONOMIC UPDATE

28 April – 11 May 2014

Despite the agreement made at the start of the last week by heads of diplomacy of the USA, UE, Ukraine and Russia, tension in Ukraine has grown further. It seems likely that the uncertainty will not decrease significantly at least until the Ukrainian presidential election, scheduled at the end of May.

In the next two weeks the focus will be, apart from geopolitical situation, on the monetary policy of central banks, in particular of the ECB, which has suggested possible start of non-conventional measures. The key economic releases will be flash inflation in the euro area and US non-farm payrolls. Polish PMI may be still negatively affected by worries about Ukraine, while the MPC meeting will be probably completely ignored by the domestic financial market.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (29 April)					
14:00	HU	Central bank decision		%	2.50	-	2.60
16:00	US	Consumer confidence index	Apr	pts	82.3	-	82.3
		WEDNESDAY (30 April)					
11:00	EZ	Flash HICP	Apr	%YoY	0.8	-	0.5
14:15	US	ADP report	Apr	k	210	-	191
14:30	US	Advance GDP	Q1	%QoQ	1.1	-	2.6
20:00	US	Fed decision					
		THURSDAY (1 May)					
	PL, DE, FR	**Market holiday**					
14:30	US	Personal income/Consumer spending	Mar	%MoM	0.4/0.6	-	0.3/0.3
16:00	US	ISM – manufacturing	Apr	pts	54.2	-	53.7
		FRIDAY (2 May)					
9:00	**PL**	**PMI – manufacturing**	**Apr**	**pts**	**54.1**	**53.8**	**54.0**
9:55/10:00	DE/EZ	PMI – manufacturing	Apr	pts	54.2/53.3	-	53.7/53.0
14:30	US	Non-farm payrolls	Apr	k	210	-	192
		MONDAY (5 May)					
16:00	US	ISM – services	Apr	pts	54.1	-	53.1
		TUESDAY (6 May)					
9:55/10:00	DE/EZ	PMI – services	Apr	pts	55.0/53.1	-	53.0/52.2
		WEDNESDAY (7 May)					
	PL	**MPC decision**		**%**	**2.50**	**2.50**	**2.50**
13:00	CZ	Central bank decision		%	0.05	-	0.05
		THURSDAY (8 May)					
11:00	**PL**	**Bond auction**					
13:45	EZ	ECB decision		%	-	-	0.25

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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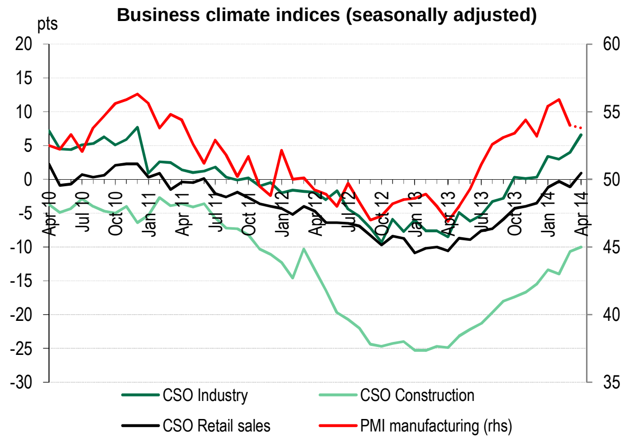
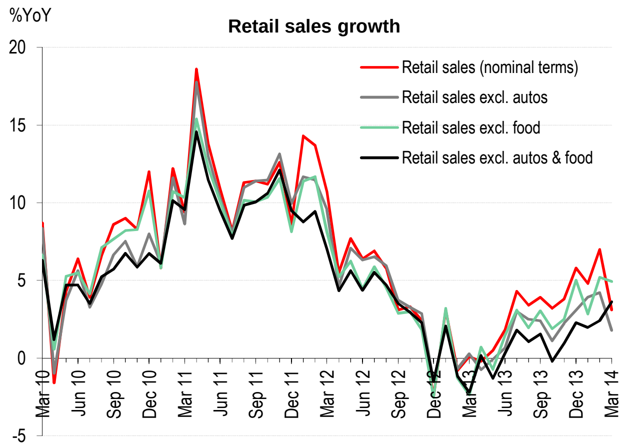
What's hot this week – Central banks in the focus of attention

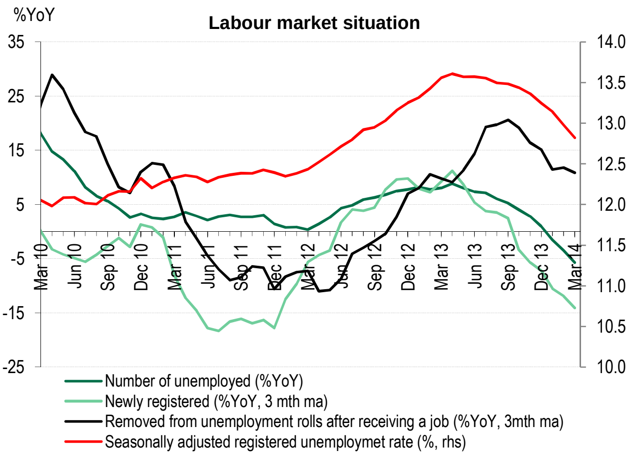


- In the upcoming two weeks market will focus not only on situation in Ukraine, but also on central banks' meetings, especially the one of the ECB. April's inflation reading for the euro zone may influence the bank's decision about implementation of non-standard measures. As regards the Polish MPC, no significant moves should be expected until July. The Hungarian MNB may cut rates again (by 10bp), while the Fed will continue with QE3 tapering.
- In our view, April's PMI for Polish manufacturing may remain under influence of worries about situation in Ukraine, so we are expecting a slight decrease of the index. CSO business climate indicator for manufacturing again climbed somewhat, showing an acceleration of activity in this sector (output diagnosis at the highest level since 2008). Other sectors also saw a further improvement of situation, suggesting a continuation of economic recovery.

Last week in the economy – Retail sales below expectations, unemployment as well



- March retail sales have fallen clearly below expectations – pace of growth decelerated to 3.1%YoY (the lowest since June 2013). In our opinion, there have been two sources of this disappointment – too optimistic forecasts of car sales in the final month of VAT deductions related to purchases of personal cars registered as trucks, and underestimation of high base effect impact due to Easter timing – pre-Easter shopping was conducted in April, not in March a one year ago. Growth in other categories was decent. According to our estimates, retail sales excluding autos and food accelerated in March to 3.6%YoY (the highest growth since August 2012). That is why we do not think that March data worsen the outlook for the consumption demand. Revival in the labour market is stronger than anticipated (see below) and has positive impact on households' financial situation and should support sales growth in the following months.



- In March the registered unemployment rate decreased to 13.5%, stronger than expected. The seasonally adjusted registered unemployment rate has started downward trend already in July 2013, but recently this figure began to surprise the downside. We would like to highlight that scale of the Labour Ministry's intervention, measured as sum of the unemployed sent to subsidised work and to training is more or less the same as in previous year. Therefore, this the downward unemployment trend stems from significant improvement in the firms' demand for jobs, and not from government's actions. We are expecting a further decrease in the registered unemployment rate in months ahead, which should support private consumption growth. According to the Labour Ministry, in April the unemployment rate may fall even to 13.0%. We expect the registered unemployment rate to decline below 12.5% at the end of the year.

Quote of the week – Hey Jude, don't make it bad…

Donald Tusk, Prime Minister, 21.04, YouTube

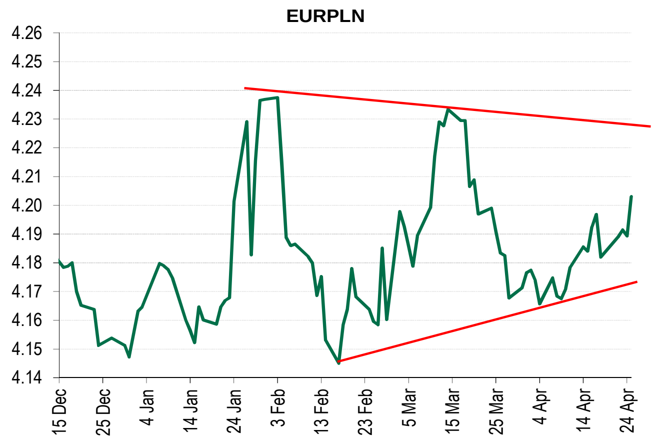
Hey Jude, don't make it bad. Take a sad song and make it better…

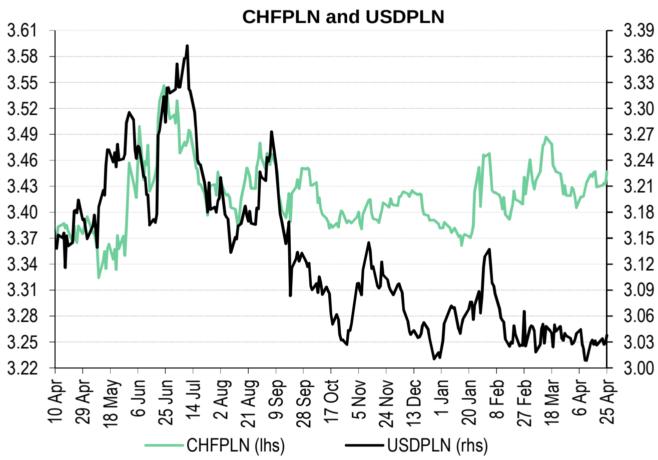
Mateusz Szczurek, Finance Minister, 23.04, Gazeta Wyborcza
We will lower the [general government] deficit below 3 per cent of GDP in 2015 and the excessive deficit procedure will be cancelled.

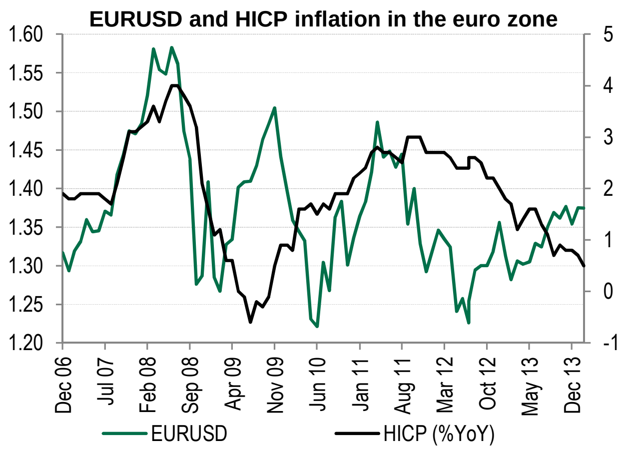
Today accession to the euro zone is connected to other duties than back in 2004, when we made an obligation we will adopt the single currency. I mean mostly additional financial liabilities we had to take. If we are not strong economically, there will be no benefit from the euro, even a political one.

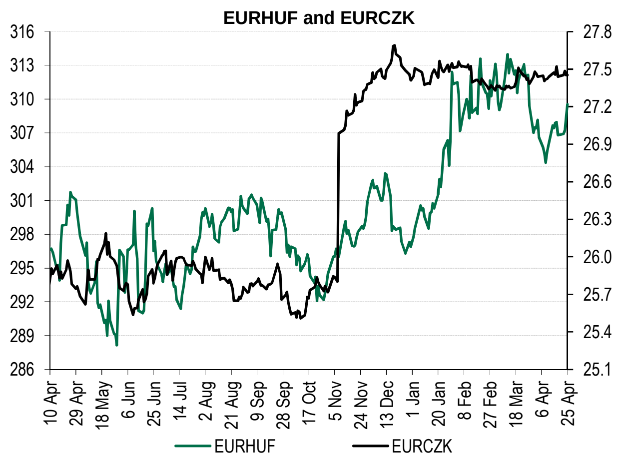
Prime Minister Donald Tusk began the campaign promoting 10 years of Poland's membership in the EU by singing "Hey Jude", which was used as a music theme for a movie clip showing the success of Poland over the last ten years. At the same time, the government accepted the Convergence Programme, where it presented optimistic (yet realistic) forecasts of economic growth in the upcoming years (3.3% in 2014, 3.8% in 2015 and 4.3% in 2016-2017). This should help Poland to lower the general government deficit below 3% of GDP and to leave the excessive deficit procedure. At the same time, according to the Finance Minister, this does not bring us closer to joining the euro zone (and we agree). It seems that we are as distant from the euro zone entry as we were 10 years ago (or even further).

Foreign exchange market – Bigger move of EURPLN likely









Ukraine and ECB will be key factors

- In late March we had suggested that situation in the Polish FX market is similar to changes recorded at the January/February turn. We indicated that after two weeks of zloty's appreciation vs. the euro the trend may reverse and last three weeks indeed saw a rebound of EURPLN (from 4.16 to nearly 4.21 – highest since mid-March). The domestic currency was under pressure of worries over more severe tensions in Ukraine. This negative factor has been partly neutralized by decent Polish macro data and hopes for more monetary policy easing by the ECB.
- Despite the agreement signed in Geneva, last week saw continued occupation of Ukrainian buildings by the pro-Russian separatists and actions taken by Kiev aimed at regaining control over these areas. Next US warnings on possible further sanctions do not seem to lead to a desired change of Russians attitude. Thus, one should assume that tensions in the east will persist in the nearest future and will still weigh on the CEE currencies, including the zloty.
- Also the ECB decision may be vital for the domestic currency. Flash April's HICP (due to be released on the last day of this month) may influence not only market expectations about next ECB actions, but also on the central bank decision itself. Last week Mario Draghi said that depending on what negative circumstances appear, the ECB may cut the deposit rate below zero or start ABS buying program. If the flash HICP does not show any visible rebound, expectations for more actions to be taken by the ECB as soon as on its May meeting are likely to strengthen. The outlook for more monetary policy easing could support the zloty.
- It is worth to notice, that the trading range of EURPLN is narrowing gradually and this suggests that some more visible move may occur in the coming weeks. Breaking 4.20 would open door towards this year's peak at 4.26 while falling below 4.15 may lead to zloty's appreciation to 4.12 per euro.

Flash HICP may determine direction for EURUSD

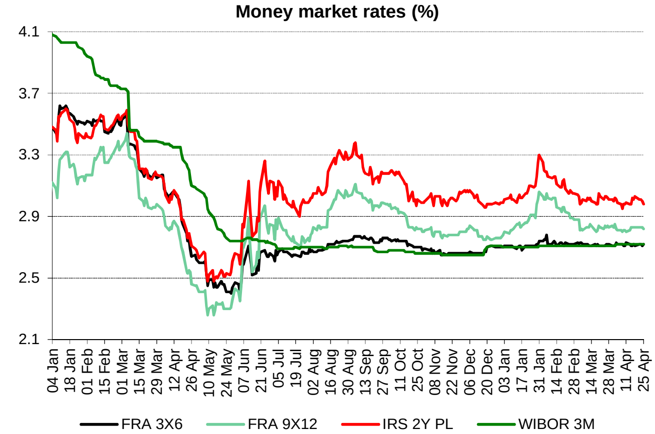
- The past week was a second in a row when EURUSD hovered in a very narrow 1.378-1.386 range.
- Data called important (or even key) by Mario Draghi at the last ECB press conference are due to be released in the coming days – flash April's HICP. The number may decide whether EURUSD will head towards this year's peak at nearly 1.40 reached in March or will start falling to 1.35-1.37.

Ukraine and central banks in the spotlight

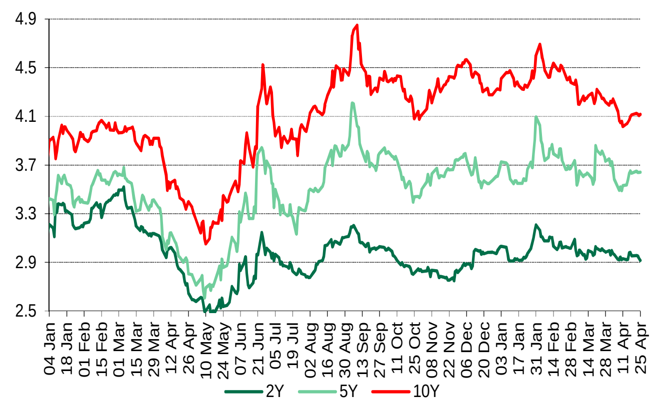
- Other CEE currencies also depreciated last week. Forint and ruble lost on value, just like the zloty. Russian currency was under an additional pressure from S&P decision to downgrade Russian rating to BBB, lowest investment grade, as the conflict with Ukraine may weigh on the economy.
- Central banks of Czech Rep. and Hungary will meet during the next two weeks. The head of the former said recently that the EURCZ floor at 27.0 may last longer than until early 2015 amid low inflation and the market will expect more comment on this issue. Investors expect a rate cut in Hungary, but the tone of the statement seems to be more important, as the market will try to assess whether the monetary policy easing cycle is coming to an end.

Interest rate market – ECB decision important for market perspectives

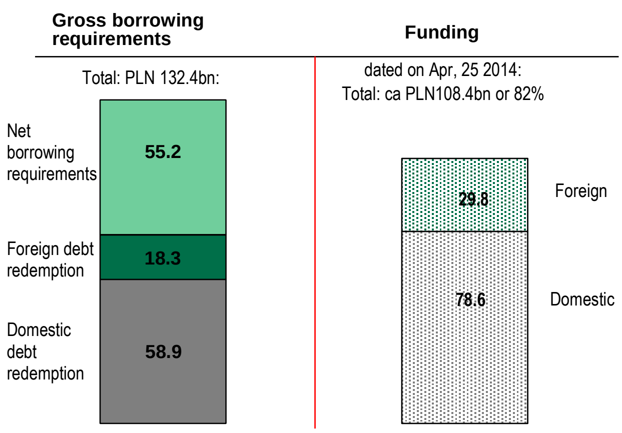
Money market rates (%)



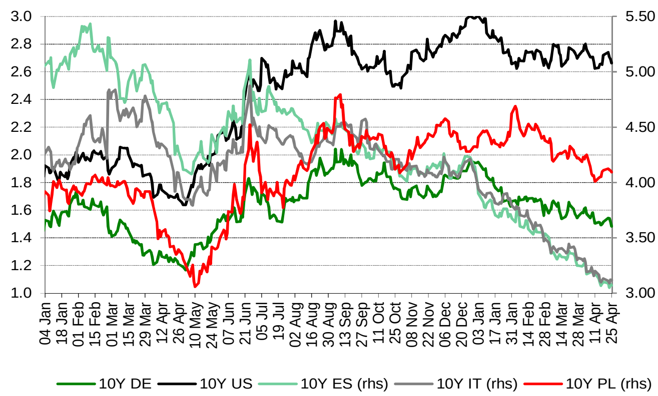
Yields of Polish benchmarks (%)



Gross borrowing requirements and its financing



10Y bonds yields (%)



Money market stable, Ukraine weights on T-bond market

- Money market has remained calm. Weaker than expected retail sales data or comments from the MPC's members were more or less neutral for the market. FRAs also did not change significantly. FRA rates up to 9 months were stable, while for longer tenors increased slightly. All in all, market expectations on monetary policy outlook remain unchanged – market is pricing-in a rate hike (by 25bp) in one year horizon.
- Post-Easter session was calm ahead of Wednesday's regular auction. At the same time supply side dominated on IRS market, and consequently 10Y IRS rate increased temporarily to 4%, the highest level since the beginning of April. Next days brought some strengthening on both markets, supported by favourable auction results and comment of the ECB's governor, who pointed out that in coming months the central bank may act to prevent deflation risk. In reaction to these factors yield of 10Y benchmark temporary fell to 4.06%, only slightly above important support level. Negative news flow from Ukraine trimmed some earlier gains and caused yields increase, in which yield of 10Y bond increased above 4.10%, while 10Y IRS stabilized slightly below 4%.
- Higher risk aversion regarding uncertain situation in Ukraine resulted in curves steepening, mainly on 2-5Y sectors. Potential further increase in risk-averse mood due to growing tension in Ukraine may result in further widening of 2-10Y spread.
- Poland's Ministry of Finance successfully launched T-bonds: OK0716, PS1016 and PS0718 worth PLN11.72bn in total. Higher than planned sale (above the maximum level of supply worth PLN10bn) came from high recorded demand (PLN16.6bn), but also high prices. One should notice that T-bonds were sold at higher prices than on the secondary market. We estimate that the 2014 borrowing requirements are secured in ca. 82% after this auction.

ECB's policy important for market's mood

- In two weeks ahead investors will focus on the central banks' meetings (FOMC, MPC, ECB). Meetings of the FOMC and domestic MPC will not bring any significant changes in rhetoric and action (we foresee Fed to maintain pace of tapering, and no change in Polish monetary policy), while ECB's decision and expectations linked with it can indeed influence the market sentiment. In this respect, the most important will be flash HICP release for the euro zone – lower than expected figure will increase hopes for implementation of non-conventional measures by the ECB in June or even in May (if it is significantly lower), strengthening Bunds and consequently domestic T-bonds. Lack of any surprise in inflation rate may be an impulse for correction in the short run on interest rates markets.
- Last sessions clearly confirm that investors' mood is under influence of three factors: situation in Ukraine, central banks' rhetoric and issuance plans. Expectations on ECB's action and low supply of domestic debt in months ahead may delay the process of normalisation on the domestic interest rate market. As a consequence we expect horizontal trend of yields, especially taking into account significant decrease in investors' activity due to long weekend at the beginning of May. We foresee yield of 10Y benchmark to stay in 4.05% - 4.20% range, oscillating close to middle of this channel. Situation on Ukraine will remain the main risk factor.
- Poland's Ministry of Finance will present May's issuance plan on domestic market at the end of April. We expect supply of Treasury Securities as compared with this month, to be limited. In our opinion, on two regular auctions the Ministry will offer T-bonds worth no more than PLN10bn (in total).

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.