Bank Zachodni WBK

Weekly economic update

11 – 17 February 2013

The biggest impact on the FX market during the past week was put by worries over euro zone's peripheries and the outcome of the ECB meeting. Over the weekend the Spanish governing party was accused of corruption and this fuelled worries that PM Rajoy may resign. Additionally, opinion polls before Italian parliamentary elections scheduled for late February show high support for Berlusconi. This inflated uncertainty whether Monti's reforms will be continued. The statement from the ECB meeting read that the outlook for economic growth (risk to the downside) and inflation (risks are balanced) did not change. Such an assessment clearly disappointed the market that expected rather more up-beat picture will be presented after recent much better than expected data. As regards the exchange rate, Draghi said the appreciation of the euro means higher confidence to single currency and stressed the importance of the exchange rate for price stability and economic growth. In March new GDP and inflation projections will be released and they will show the impact of euro's appreciation for mid-term outlook for GDP and HICP.

In line with expectations, the MPC cut interest rates by 25bps, with reference rate falling to 3.75%. Just like in January the Council mentioned inflow of next data (and additionally a new CPI and GDP projection) as factors that will determine next move on the interest rates. In our view the Council will decide to trim rates further in March. The upcoming data from the real economy, persistent downward trend of inflation and March projections of CPI and GDP will justify such a decision.

Worries over the euro zone's peripheries and the outlook for economic growth may play main role on the global market at the beginning of the week due to meetings of European minsters of finance. Additionally, investors may start to pay more attention to possible outcome of Italian elections. Swings of global market sentiment may have an impact on the zloty already since the beginning of the week, but for the interest rate market Friday seems to be crucial. We estimate that the annual CPI declined below 2% and this may strengthen expectations for a rate cut in March. Thus, the short end of the IRS and bond curve may recover slightly after the increase initiated after the MPC meeting.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 February)					
		Euro area finance ministers meeting					
		TUESDAY (12 February)					
		EU finance ministers meeting					
14:00	**PL**	**Exports**	**Dec**	**€m**	**10 884**	**10 678**	**13 023**
14:00	**PL**	**Imports**	**Dec**	**€m**	**11 469**	**11 307**	**13 417**
14:00	**PL**	**Current account**	**Dec**	**€m**	**-851**	**-543**	**-1490**
		WEDNESDAY (13 February)					
11:00	**PL**	**Bond auction**					
11:00	EZ	Industrial output	Dec	%MoM	0.2	-	-0.3
14:30	US	Retail sales ex autos	Jan	%MoM	0.3	-	0.3
		THURSDAY (14 February)					
8:00	DE	Flash GDP	Q4	%QoQ	-0.5	-	0.2
11:00	EZ	Flash GDP	Q4	%QoQ	-0.4	-	-0.1
14:00	**PL**	**Money supply**	**Jan**	**%YoY**	**4.3**	**5.4**	**4.6**
14:30	US	Initial jobless claims	week	k	360	-	366
		FRIDAY (15 February)					
14:00	**PL**	**CPI**	**Jan**	**%YoY**	**1.9**	**1.9**	**2.4**
15:15	US	Industrial output	Jan	%MoM	0.2	-	0.3
15:55	US	Flash Michigan	Feb	pts	74.2	-	73.8

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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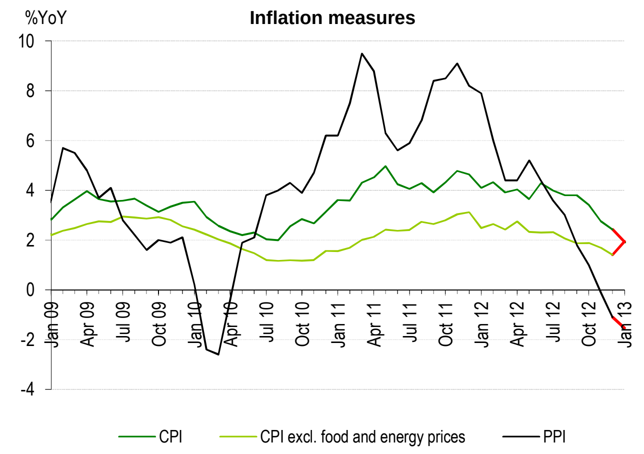
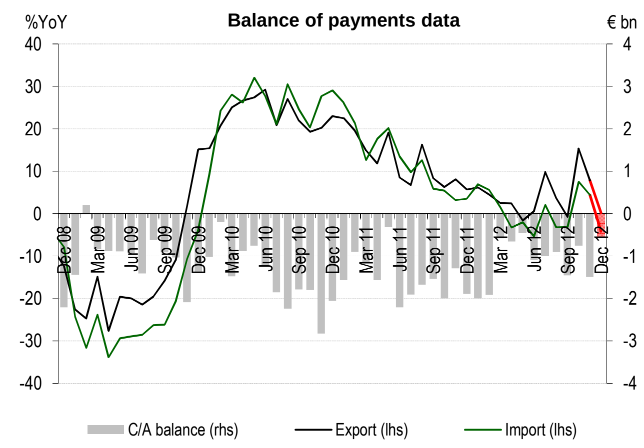
What's hot this week – Inflation below 2%, slowdown in foreign trade



▪ We are estimating that CPI inflation fell from 2.4%YoY in December to 1.9%YoY in January, i.e. to the lowest level since 2007. Such a reading will be supportive for market expectations about another rate cut in March – it should markedly enlarge room for cuts as perceived by these members, who are paying special attention to level of real interest rates.

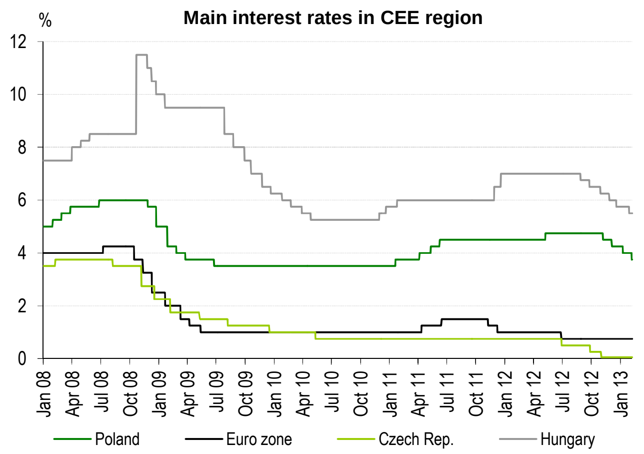
▪ It is worth noting that market forecasts are quite varying (1.6-2.3%). In our view this is due to the fact that there is a lot of risk factors in January's reading (cuts of gas and electricity prices, hikes of garbage, public transport, press prices). That is why any stronger surprise in the January's figure may substantially affect the whole-year inflation forecasts. We are expecting a continuation of downward inflation trend in upcoming months. CPI will reach its minimal level in mid-2013 and then rebound slightly.



▪ This week we will also see data on balance of payments in December. We are expecting a deceleration of growth of exports and imports after a strong rebound in November (working days effects) and a narrowing of current account deficit, mainly because of a high inflow of EU funds. In our view prospects for exports in the upcoming quarters are quite good (rebound in the euro zone economy, suggested by the PMI indices, should boost demand for Polish goods), while growth of imports will remain weak (due to sluggish domestic demand). Thus, current account deficit is expected to narrow further.

▪ We are expecting a slight acceleration of M3 money supply growth in January. Still, both growth rate of deposits and loans should remain at historically low levels.

Last week in the economy – Fourth rate cut in a row



▪ At February's meeting the Monetary Policy Council cut the main interest rates by 25bps, with reference rate falling to 3.75%. This was a fourth rate cut in a row – since the beginning of the cycle (which started in November 2012) the rates have fallen by 100bps.

▪ In our opinion a rate cut in March is quite likely. Weak data from real economy, continuation of downward trend of inflation (CPI below 2%YoY in January) together with new projection of CPI and GDP that will be presented to the Council next month will justify further easing of monetary policy. After a rate reduction in March (the main NBP rate will reach 3.50%, the level to which the MPC cut rates in response to crisis in 2009) we expect the Council may adopt "wait-and-see" mode in order to monitor the inflowing data.

Quote of the week – Monetary policy bias still dovish

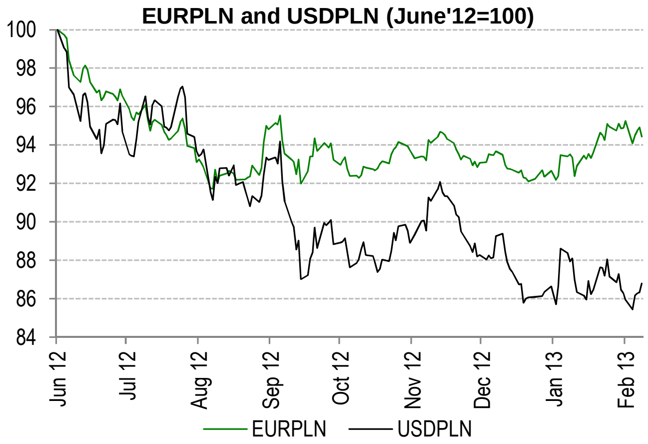
Marek Belka, NBP President, press conference, 06.02.

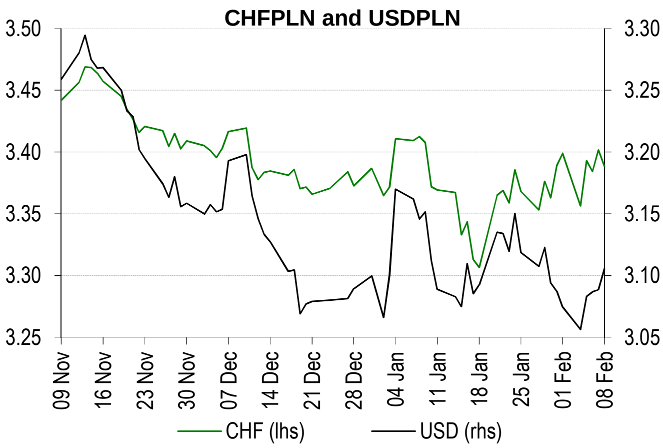
Of course they are worrying (data on GDP for 2012), decline of domestic consumption is deeper than ever, economic growth in recent quarters was due only to net exports. […] Surprisingly, even though the data look miserable, we did not observe any rapid deterioration of economic activity, but this is of course no reason for satisfaction.

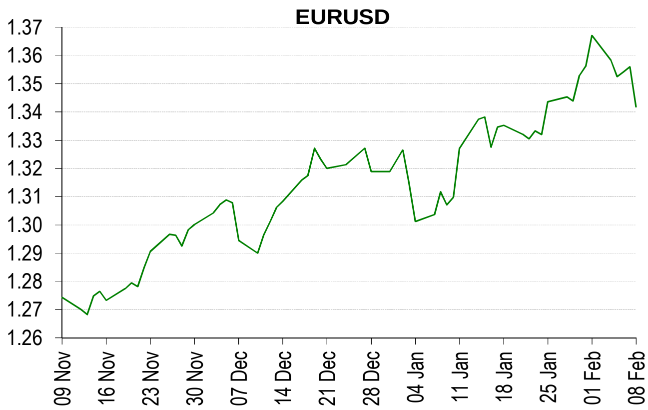
I don't think that the statement could suggest that we changed the bias from easing to neutral […] I don't think this move can be interpreted that way. […] When realising a strategy of a clear monetary easing, one has to make some resumption, consideration. […] in March all the options, apart from hike, are possible, but not necessary.

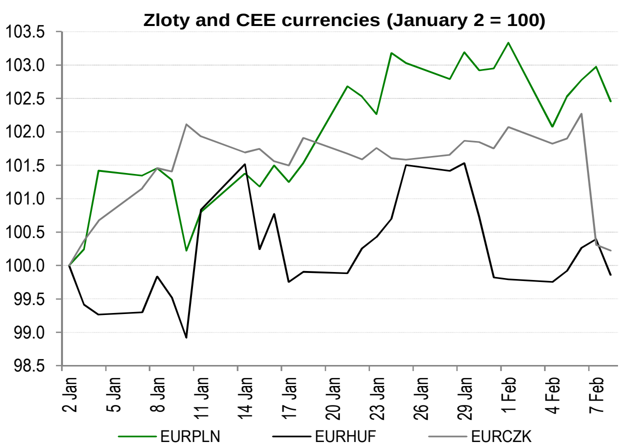
Statement of the MPC and comments of NBP President Marek Belka during the press conference suggest that the MPC's assessment of economic growth and CPI inflation outlook remains unchanged. Still, the Council decided to change its communication with markets and indicated that March projection (of CPI and GDP) will be crucial as regards further prospects of the monetary policy. Thus, the Council want to see the impact of rates reduction on medium-term inflation and GDP trends. In this context the words of Andrzej Sławiński, head of NBP Economic Institute may be crucial. Sławiński thinks that Poland is not threatened by a recession, but rather by a slowdown, longer than in 2009, but with no upward inflationary risks. Such a development may open door for further interest rate reductions (which were not ruled out by president Belka), supporting our baseline scenario expecting that the Council will cut rates at the upcoming March meeting.

Foreign exchange market – Dana on CPI may push the EURPLN up









Zloty only temporarily stronger after MPC meeting

▪ EURPLN was hovering in the range of 4.14-4.20 during the past week. The statement from the MPC meeting had only temporarily positive impact on the zloty. As the Council had left the door open for more rate cuts, the EURPLN rebounded from 4.15 to 4.18. The domestic currency clearly depreciated versus the dollar as the EURUSD plunged (USDPLN surged from 3.03 to 3.12).

▪ The MPC again left the market with uncertainty regarding its future decision on rates. Such rhetoric will in our opinion support the stabilization of the EURPLN at current, elevated level. On the one hand, next domestic data will justify more rate cuts (our forecast points the CPI declined in January below 2%) and this should put negative pressure on the zloty. On the other hand, latest data from the global economy have supported hopes that in the coming months the gradual improvement of economic activity will be continued and this should support demand for risky assets (including zloty).

▪ Second chart shows that since weaker-than-expected data on Polish 2Q GDP were released (in late August) and fuelled expectations for rate cuts, the EURPLN detached from the USDPLN and the zloty stopped gaining versus the euro. Since late August the S&P500 has increased by ca. 7% while the EURUSD by over 8%. Zloty's appreciation versus the dollar was only due to higher EURUSD.

▪ Vital levels for this week for the EURPLN are 4.14 (4.10)-4.21. Some appreciation of the zloty inside this range may be initiated by data on lower than expected data on current account data, but data on CPI may push the exchange rate up towards the upper band of the range. Additional pressure on the zloty may be put by worries over the euro zone's peripheries.

Euro zone's peripheries in the spotlight

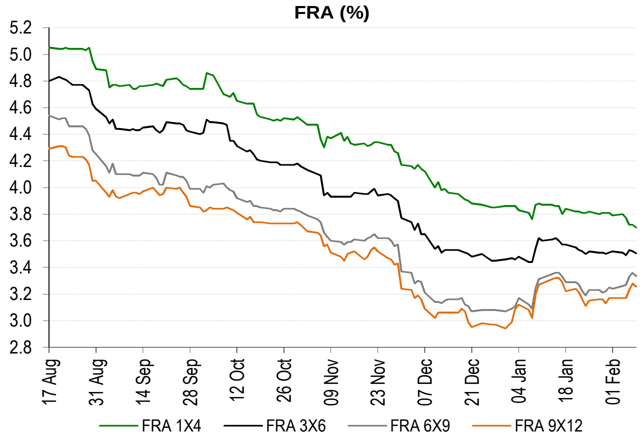
▪ The EURUSD plunged last week to the lowest level since the last week of January. Euro's depreciation was fuelled by the worries over possible changes on the euro zone's political scene (resignation of Spanish PM, Berlusconi's return as the new Italian PM) and disappointing outlook for economic growth presented by the ECB. Consequently, at the end of the week the EURUSD was close to 1.34. Still, in wider horizon, the exchange rate is still in the upward trend observed since July 2012 and developments from the past week did not change the general picture of the situation.

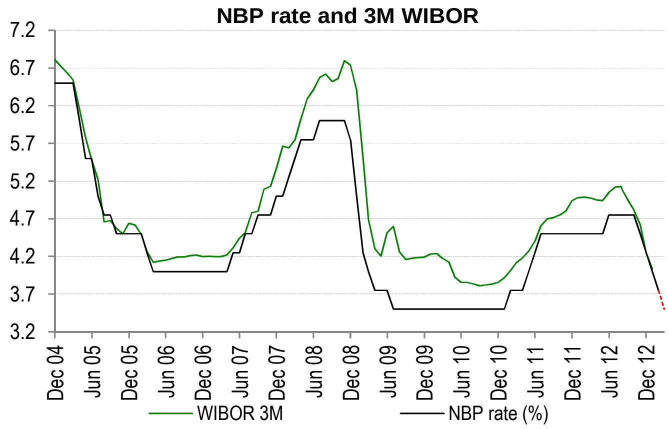
▪ Due to meetings of European finance ministers and approaching Italian elections the case of debt crisis may play main role on the EURUSD market. If the exchange rate declines below 1.34, then in the following weeks it may reach 1.33.

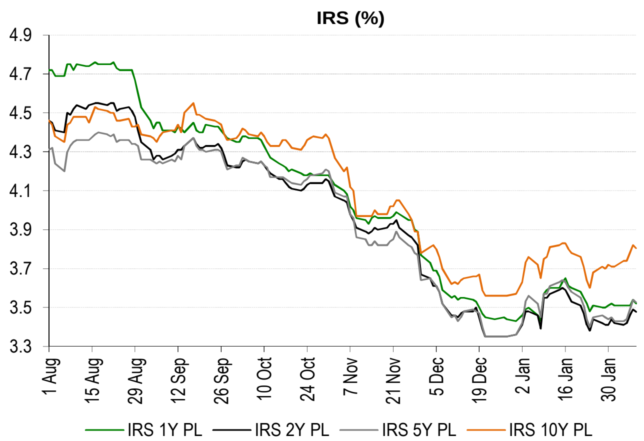
Meeting of Czech central banks supported koruna

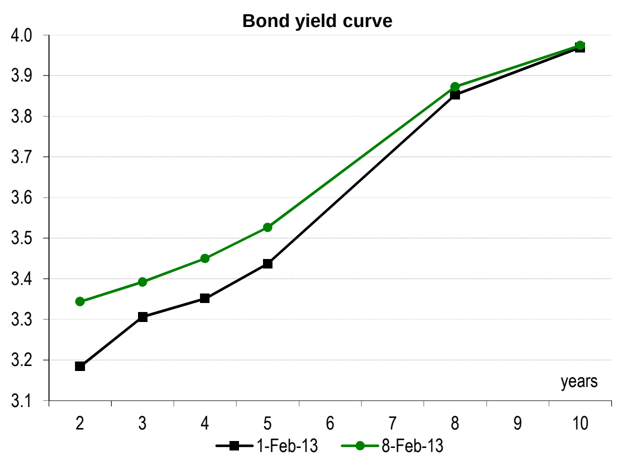
▪ The Czech koruna clearly gained versus the euro due to comment of Czech central bank governor. Miroslav Singer said that currently there is no need for more easing of monetary policy (interest rates are at record low level of 0.05%) as the currency is weak. The market interpreted this comment as there are lower changes for interventions aiming at weakening of koruna. The Czech currency was under clear pressure since the very beginning of the year, but after the comment of central bank governor, koruna pared almost all the losses. The EURCZK plunged from 25.7 to 25.1 versus just above 25.0 seen at the beginning of 2013.

Interest rate market – Upward move after the MPC, CPI inflation data in the spotlight









WIBOR rates move down, FRA for longer terms up

▪ Last week the MPC meeting was the key event on the money market. In the day of the Council's decision WIBOR rates fell by 2-6bps (with the deepest decline in 1M rate), anticipating rate cuts by the MPC. Next days brought further decline in rates. In weekly terms WIBORs fell by 10-13bps.

▪ FRA market was more choppy. Till the MPC's decision FRA rates were more or less stable, but after release of the statement and the press conference they increased more visibly. In contrast, FRA 1x4 has continued falling towards 3.70% at the end of week (decrease by 9bps in weekly terms), suggesting that investors are expecting a rate cut in March.

▪ After the February's MPC meeting investors again adjusted their expectations on the monetary easing path to new circumstances, suggested by the NBP's governor Marek Belka during the press conference. Nearly one rate reduction disappeared from FRA contracts quotations, showing more cautious approach to further rates reductions. We expect WIBOR rates to continue downward trend, but the scope of changes might be lower in case of rates with maturity 3M and longer.

Upward correction on bonds yields and IRS

▪ Ahead of the MPC decision, yields of bonds and IRS rates were relatively stable, with slight increase on the mid and long-end of the curves. Market players did not react to the MPC's decision to trim interest rates by 25bps. However, statement release and the NBP's governor comments on the press conference caused increase in yields and IRS rates. Additional factor, which negatively affected markets were Thursday's auction results.

▪ The front end of the yield curve lost significantly after deputy finance minister Wojciech Kowaczyk comments. He said that the Ministry considers return to 2Y zero-coupon bonds issue. In due course, yield of 2Y benchmark increased above 3.30% (by 8bps in intraday trade). Consequently, due to a bit lower increase in yields on mid and long end, yield curve flattened, with 2-10Y spread narrowing to 64bps, down from 67bps in previous week.

▪ Poland's Ministry of Finance sold 5Y benchmark PS0418 worth PLN2.4bn with yield at 3.521% (up from 3.437% in January) and floating rate T-bonds WZ0117 worth PLN3.4bn. Relatively weak bids on 5Y benchmark might have come from the fact that investors satiated their demand on January's auction. We would like to recall that the Ministry sold PS0418 worth PLN12.4bn with record high demand (PLN23.4bn in total) in January. We estimate that after Thursday's auction the Ministry has covered ca. 48% of the 2013 borrowing requirements.

T-bonds auction and CPI inflation in the spotlight

▪ This week the most crucial events are Wednesday's auction and Friday's release of CPI inflation for January. The Ministry will publish details about the tender on Monday, and we do not exclude that the ministry will offer a new 2Y bond OK0715. Planed offer is between PLN2.0bn and PLN6.0bn. To achieve the goal, i.e. to cover 50% of this year's borrowing needs, the Ministry needs to sell bonds worth PLN4bn.

▪ Further decline in CPI inflation (our forecast is at 1.9%YoY) should support the front end of the curve. We think that inflation release might cause some corrective move after significant weakening in the last days.

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