Bank Zachodni WBK

Weekly economic update

22 – 28 April 2013

During the past week volatility on the global market clearly increased. Investors' sentiment was on the one hand supported by better than expected data from the US real estate market and dovish signals from the Fed. On the other hand, data from China on Q1 GDP growth and quarterly earnings of US companies disappointed. Particularly strong decline was recorded in case of commodities prices (gold, silver, copper – temporarily by over 10%) and stock prices. Temporary surge was recorded on the EURUSD market. In such circumstances, Polish FX and FI market looked like an oasis of stability. The EURPLN stayed in the range of 4.093-4.12 (the upper band was broken only temporarily) while yields of IRS and bonds continued to decline. Data from Poland brought nothing new to the overall picture of the Polish economy (slight contraction in manufacturing in 1Q, lower and lower CPI, deterioration of situation on the labour market). Surely there will some MPC members willing to cut rates in May, but we do not expect such a motion to be accepted. March data only confirmed the well-known situation in the economy in 1Q and the MPC will need to see data for next month(s) to make a judgment on the medium-term outlook for inflation. Minutes from April's meeting due this week may confirm that MPC members think that way.

This week we will see Ifo index and flash PMI indexes for manufacturing in the euro zone and in Germany. In March these gauges surprised to the downside after a couple of months of increases, but it cannot be ruled out that this was a one-off effect, caused e.g. by prolonged unfavourable weather conditions. Thus, April's reading will help to assess if outlook for economic recovery is really evaporating. Moreover, data from the USA will affect market's expectations about future of the quantitative easing programme (QE3). On Wednesday the Hungarian central bank is taking decision on rates, the market will probably take its actions under scrutiny, as the bank is suspected to implement excessively loose monetary policy. As regards Poland, we will see last bunch of data for March and information about general government deficit in 2012. The latter numbers will be crucial for expectations about abrogation of excessive deficit procedure and may affect prices of domestic bonds (and consequently, on the zloty).

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 April)					
11:00	**PL**	**Public finance deficit**	**2012**	**% GDP**	**-**	**-**	**-5.0**
16:00	US	Home sales	Mar	m	5.0	-	4.98
		TUESDAY (23 April)					
3:45	CN	Flash PMI – manufacturing	Apr	pts	51.4	-	51.6
9:28	DE	Flash PMI – manufacturing	Apr	pts	49.3	-	49.0
9:58	EZ	Flash PMI – manufacturing	Apr	pts	46.7	-	46.8
10:00	**PL**	**Retail sales**	**Mar**	**%YoY**	**0.4**	**0.1**	**-0.8**
10:00	**PL**	**Unemployment rate**	**Mar**	**%**	**14.4**	**14.3**	**14.4**
11:00	**PL**	**Bond auction**					
14:00	HU	Decision of central bank on interest rates		%	4.75	-	5.0
16:00	US	New home sales	Mar	k	419	-	411
		WEDNESDAY (24 April)					
10:00	DE	Ifo index	Apr	pts	106.5	-	106.7
14:30	US	Durable goods orders	Mar	%MoM	-2.9	-	5.6
		THURSDAY (25 April)					
10:30	GB	Flash GDP	Q1	%QoQ	0.1	-	-0.3
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	350	-	352
		FRIDAY (26 April)					
14:30	US	Advance GDP	Q1	%QoQ	3.0	-	0.4
15:55	US	Flash Michigan	Apr	pts	73.5	-	72.3

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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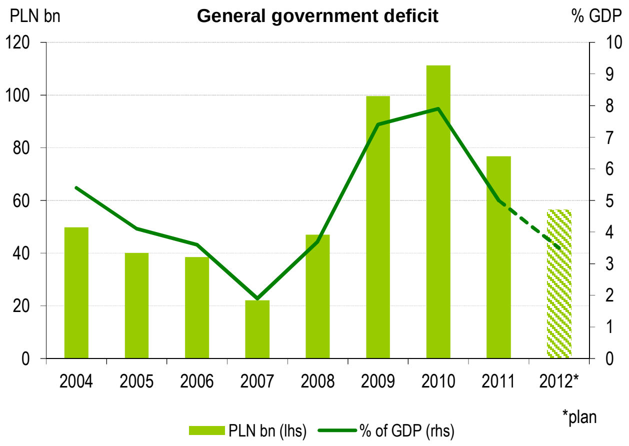
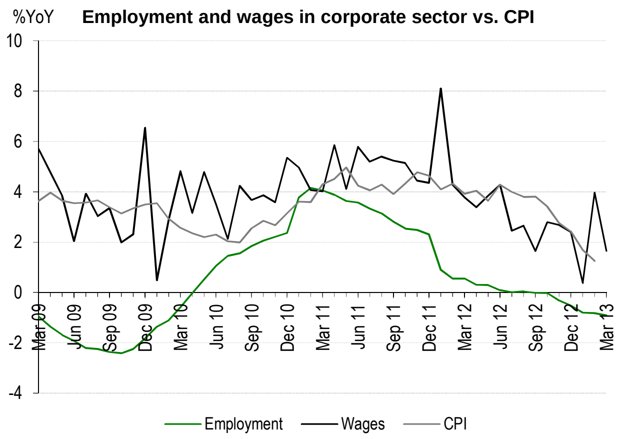
What's hot this week – Important data on fiscal deficit for 2012

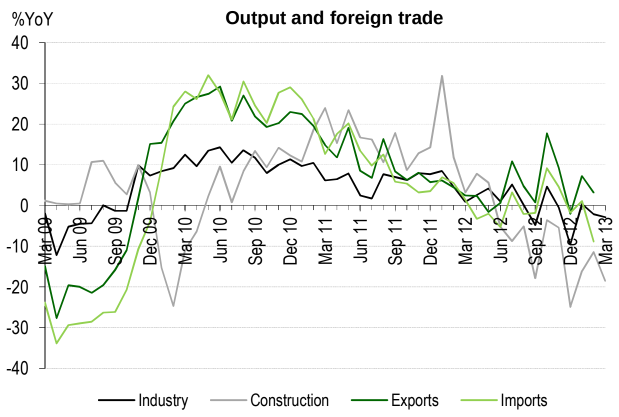


- This week we will see data on general government deficit in 2012. According to unofficial information, deficit was higher than 3.5% of GDP expected by the Finance Ministry, but did not exceed 4%. If these rumours prove true, then prospects that procedure of excessive deficit will be lifted in 2013 will become rather obscure (earlier comments from the government were suggesting that the procedure is expected by the officials to be lifted).
- We are expecting that retail sales accelerated to 0.1%YoY in March from -0.8%YoY in February. However, this will not be an effect of improving underlying consumer demand, but will be due to pre-holiday shopping (Easter was scheduled for 1 April).
- In our view, registered unemployment rate declined in March to 14.3% and will decrease further in the following months, in line with seasonal pattern.

Last week in the economy – No change of economic outlook



- Inflation rate declined in March to 1%YoY. In monthly terms prices increased by 0.2%. Clear decline of CPI was due to base effect – in March 2012 prices increased by 0.5%MoM mainly due to increase in food prices. This year food prices climbed by only 0.2%MoM. Data for the upcoming month will also bring a considerable decline of inflation, due to high base effect from the past year (increase of gas prices in April 2012!). On the other hand, in the second half of the year inflation will rise due to low base effect (average monthly change of prices in 2H2012 was negative!).
- Employment in the enterprise sector declined in March by 0.9%YoY so the pace of cutting workplaces in corporate sector does not abate. Wages expanded only by 1.6%YoY in March. Reading proved to be lower than average wage growth in January-February (2.2%YoY), so the underlying trend may be weaker than we expected.



- February brought an improvement in balance of payments. Current account deficit narrowed to €854m from €1546m in the previous month. It came mainly from significant improvement in trade balance – surplus amounted to €602m (!), with exports growing by 3.2%YoY and imports declining by 8.8%YoY.
- In March industrial output declined by 2.9%YoY and construction output by 18.5%YoY. In whole 1Q industrial output contracted by 1.6%YoY, i.e. almost by the same number as in 4Q2012 (-1.7%). Situation in construction is considerably worse: in 1Q output fell by 15.7%YoY, which is a deeper drop than in 4Q2012 (-12.7%YoY). These data confirm our baseline scenario, assuming bottoming of economic activity in 1Q2013. We expect that upcoming quarters will bring gradual, yet still very slow improvement in economic activity.

Quote of the week – It is worth waiting with (potential) cuts

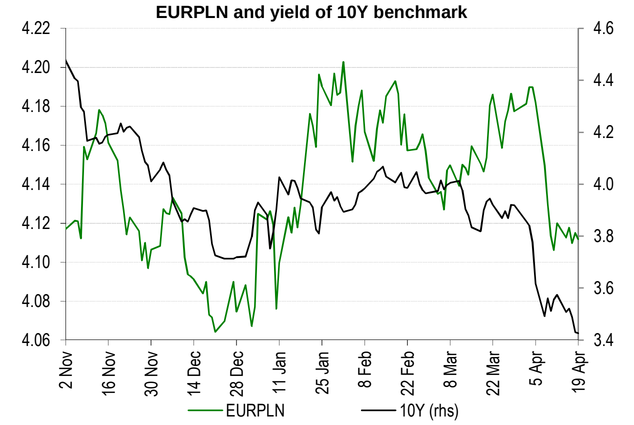
Elżbieta Chojna-Duch, MPC member, 15 April, Reuters
It is difficult to draw an unambiguous picture of the economy, based on upcoming data. This is why we should wait with further potential cuts.

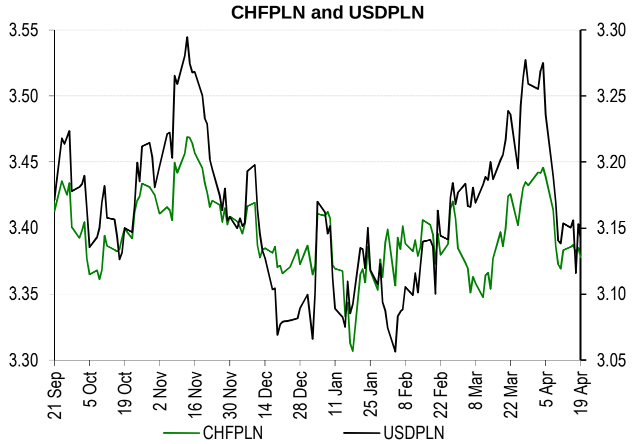
Adam Glapiński, MPC member, 15 April, Reuters
I'd rather wait at least one quarter with assessment of economic situation after last cut. July will be crucial due to projection release. If GDP growth will run at as low levels as currently and inflation will be declining, then we might consider another rate cut.

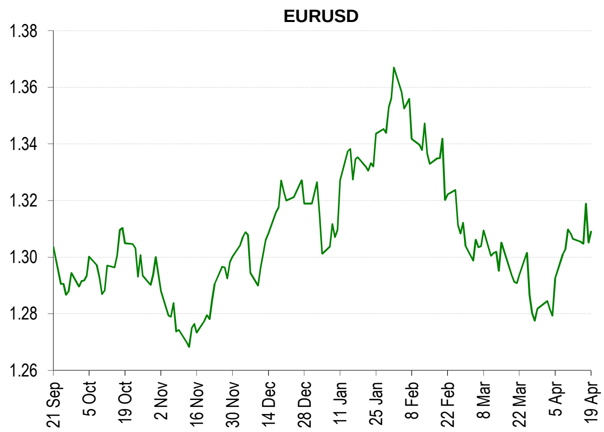
Anna Zielińska-Głębocka, MPC member, 15 April, Reuters
If it turns out that medium-term inflation is running considerably below target, or even below 1.0%, then there is room for further cuts. I think that this room may appear in June. In June-July.

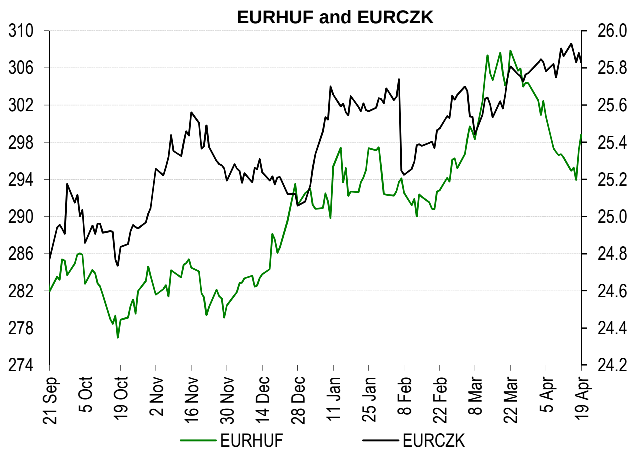
Ahead of the release of data on Polish labour market and output, MPC's Andrzej Bratkowski said that if these numbers prove to be weak, then they will justify rate cut by 50bps in May. These data were not positive and this will probably encourage Bratkowski to file in a motion for a cut at the upcoming meeting. However, in our view such a motion will not gather much support, which is shown by comments of Chojna-Duch and Zielińska-Głębocka – most dovish MPC members (apart from Bratkowski) – that the Council should wait with cuts. We think that most of the MPC members want to wait at least until June-July (it is worth noting that even Adam Glapiński is stressing that the monetary authority should consider cuts), when some signals of recovery will be already visible. We maintain our forecast that rates will remain unchanged until the year-end, but we do acknowledge some risk of cut.

Foreign exchange market – EURPLN waiting for an impulse









Bonds stabilize the zloty

- After a visible increase of volatility in the first half of April, during the past week the EURPLN stabilized. Though considerable intraday moves occurred on the EURSUD and stock market, the zloty remained surprisingly stable versus the euro in the range of 4.093-4.12 (the upper band was broken only temporarily). Domestic currency remained resilient also to dovish data from Poland (and comments of MPC members suggesting room for more NBP rate cuts) as well as to depreciation of forint recorded at the end of the week.
- For numerous months the room for zloty's appreciation has been limited by the outlook for more rate cuts by the MPC. Lack of negative reaction to domestic data and dovish comments of Council members suggests that the zloty is still benefitting from decision of Bank of Japan and strengthening of Polish bonds.
- The range trading of the EURPLN narrows gradually and this suggests that a bigger move may occur soon. At the beginning of the week data on 2012 public finance deficit is due for release and this may have an impact on Polish bonds and then on the zloty. For a few months some comments from the government have indicated that it is expected that the EC lifts the excessive debt procedure this year. If data show deficit above planned 3.5% of GDP (this week there were some press rumors that this actually going to happen), then this may hit the zloty.
- Vital levels for the EURPLN are 4.13 (next resistance at 4.16) and 4.10 (next support at 4.086).

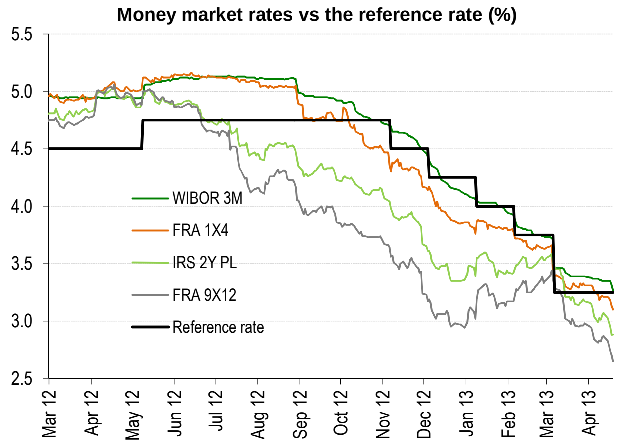
High volatility of the EURUSD

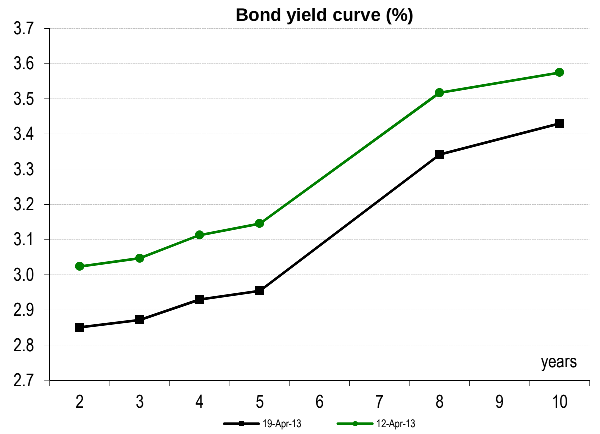
- Even though the volatility of the EURUSD increased temporarily during the past week, in some broader time frame the horizontal trend is still valid (1.30-1.32). The euro gained temporarily after dovish signals from the Fed (exchange rate reached 1.32) and then slid to 1.30 due to plunge of stock prices.
- During the past week rather not too many vital data were released, and the upcoming days may be much more interesting from this point of view. Flash April's PMI for manufacturing and Ifo will be released in Europe and advance GPD for 1Q in the USA. Accumulation of vital data may fuel the volatility of the market. In contrast to the EURPLN, the EURUSD stays in the horizontal trend after a surge due to BoJ's decision, but the range trading widens gradually.
- Vital levels for this week are 1.32 and 1.30.

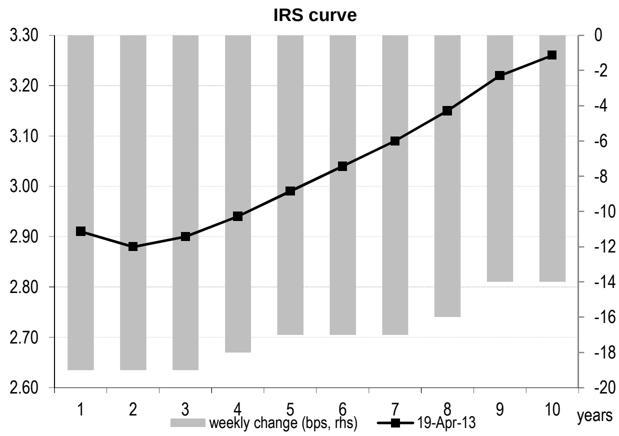
Forint again under pressure from central bank

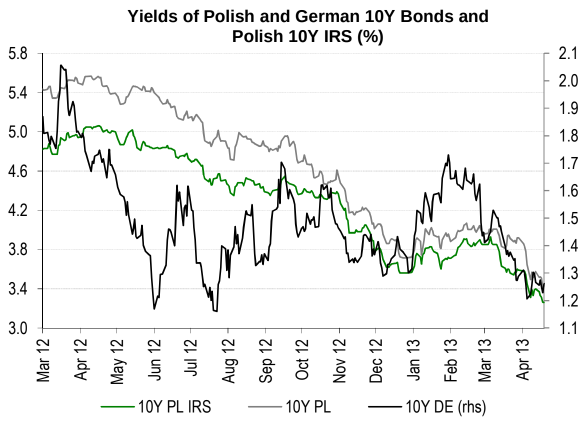
- In the CEE3 region, the biggest volatility was recorded in case of the EURHUF. The forint depreciated visibly versus the euro due to controversial, in investors' opinion, decision of Hungarian Central Bank. Monetary authority announced plans to limit foreign investors' access to 2-week money market tenders (T-bills auctions) carried on a regular basis. Next to worries that the central bank will continue with controversial decisions, the forint was also under pressure because lower demand for T-bills from the abroad may mean lower demand for the currency. Consequently, EURHUF increased temporarily to 299.
- Czech koruna, just like the zloty, remained stable.

Interest rate market – New all-time lows









Market is pricing-in cuts more aggressively …

▪ Last week brought more significant decline in both WIBOR and FRA rates. This development was due to dovish statements of the MPC members (especially A. Bratkowski, who said that he would file in a motion for a cut by 50bps in May) and macro data releases, which support market expectations that the Council will continue monetary easing in coming months. WIBOR rates fell by 5-11bps in weekly terms, with the highest decline in rates from 6M to 1Y (longer term rates again are lower that WIBOR 1M and 3M).

▪ FRA rates, as in previous weeks, were more volatile. Bratkowski's statement caused that FRA3x6 fell below 3%, while FRA6x9 and 9x12 ended the week slightly below 2.70%. They clearly show that now market is pricing-in rate cuts by 75bps in 6M perspective.

▪ This week the last set of domestic data from real economy for March will be released. We expect some improvement in retail sales (as compared to February) due to Easter's shopping. However, if data surprise negatively (as industrial production or data from labour market), FRA rates might continue to decline, but scope of downward move is rather limited.

… curves up to 5Y below 3%. Auction and data crucial

▪ Domestic debt market has continued its rally. Yields of bonds, but also IRS rates reached fresh all-time lows. Downward trend was supported by (1) domestic macro data releases, which fuel market expectations for further monetary easing in coming months (market does not exclude that the Council might cut rates in May), (2) strong demand from non-residents and also (3) domestic investors.

▪ We would like to point out that IRS rates (but also bond yields) up to 5Y are below 3%. It means that investors believe that official interest rate will stay below 3% through this period. It is possible, assuming a scenario of stagnation in GDP growth in coming years, but it is not our baseline scenario. Therefore, we think that signals of economic activity rebound in 2H2013 should result in increase of IRS rates later in the year.

▪ This week the last set of data from real economy for March is due for release. If our scenario, assuming some rebound in retail sales, materializes, we cannot rule out some-profit taking after recent strengthening. Increase of yields will be a good opportunity to cumulate debt instruments.

▪ The long end of the curve will stay under influence of external factors (Bund yields are stabilising around their minimum due to uncertain global economy outlook). In the short run the release of the general government deficit figure for 2012 might be important for the market, especially for 10Y sector, as this will determine whether the European Commission will lift the excessive deficit procedure. Higher than expected reading (above 3.5% of GDP) might result in some profit-taking at the long end of the curve.

▪ This week investors also focus on T-bonds auction. As announced, the Ministry will offer OK0715, WZ0117 and PS0418 worth PLN7-10bn (narrowed range in comparison with preliminary planned). Market situation and liquidity situation (inflows due to redemption of PS0413 and coupon payments amount to ca. PLN24bn) will be supportive for auction results. However, the bid-cover ratio might be most important for investors.

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 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl