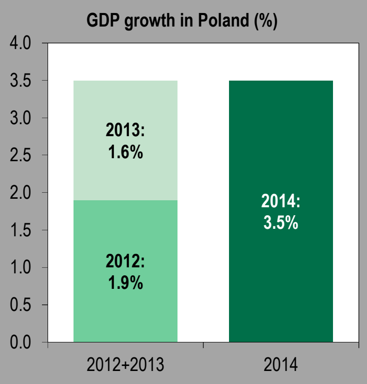
Bank Zachodni WBK
Grupa Santander

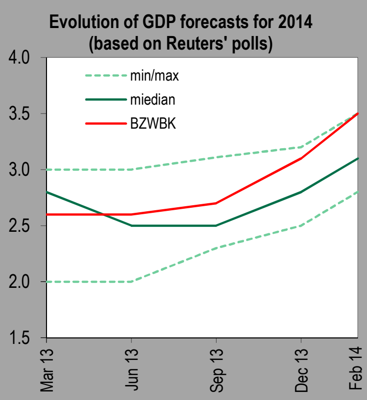
MACROscope

Polish Economy and Financial Markets

February 2014

2012 + 2013 = 2014 ?





Economic growth amounted to 1.6% in 2013 as compared with 1.9% in 2012. As positive signals about the economic recovery strengthened in the final quarter of 2013, we decided to change our forecast for 2014. It seems that economic growth in 2014 may be equal to the sum of the GDP growth rates in two previous years (1.9%+1.6%=3.5%). According to our estimates, the GDP growth in Q4-2013 was close to 3%YoY and to 1% in quarterly terms (seasonally adjusted). Not only the growth itself, but also its breakdown surprised positively. Especially, private consumption growth, which in Q4 amounted to almost 2%YoY, as compared to a stagnation only two quarters ago.

Economic results of the Q4 were also surprising due to the fact that data on industrial output and retail sales for December were not overly optimistic. Obviously, these numbers were actually quite robust and fitting into the trend of gradual recovery, but readings were below our forecasts. However, PMI index surprised on the other side (again). This gauge reached the highest level in three years and improvement was visible in all main components of the index (output, orders, employment at the highest levels ever). What is interesting, a substantial rebound in these indices has not been recently accompanied by a cost pressure as opposed to economic recoveries witnessed in the past. CPI inflation keeps running at a very low level.

When after February's meeting the NBP President, Marek Belka described the current situation of the Polish economy (which we present in more details on next pages of this report), he stated that a central banker "dreams about such a situation". Indeed, currently there is no significant threat as regards inflation outlook. We uphold our stance that further improvement on labour market, revival in private consumption and narrowing demand gap in upcoming quarters would result in increasing the inflation rate later during the year. It should be confirmed by the new NBP's inflation projection. In our opinion the MPC's meeting in March will not be crucial. We think it is possible that only in July (when the suggested period of stable rates will end) the MPC would say what next with official rates. In other words, after July's meeting the relatively long (as for Poland) *forward guidance* might be abandoned to the benefit of "meeting to meeting" analysis of situation.

The Polish FX market is surely not keeping the NBP awake at night. A temporary zloty weakening observed in January was not strong enough to threaten the stability of the economy, while it gave exporters a chance to hedge future inflows at a higher EURPLN rate. Surely, the zloty may be still vulnerable to further possible turmoil on the emerging markets. However, when we compare Poland to countries of the so-called "fragile five", which show high fiscal and current account imbalances, the Polish macroeconomic fundaments are more positive. Additionally, they are supported by the IMF's flexible credit line. This does not change the fact we have mentioned many times in the past, that Poland does not rank high as regards cumulated negative net international investment position and external debt (details on page 4). Overall, FX market turmoil observed in January does not change our forecasts and we still think that the clash of local and global factors will yield a moderate zloty strengthening over the year (to ca. 4.0 against the euro at the end of 2014).

In this issue:

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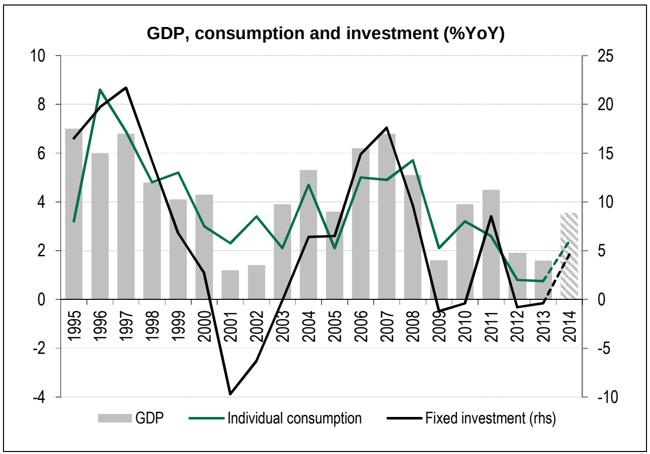
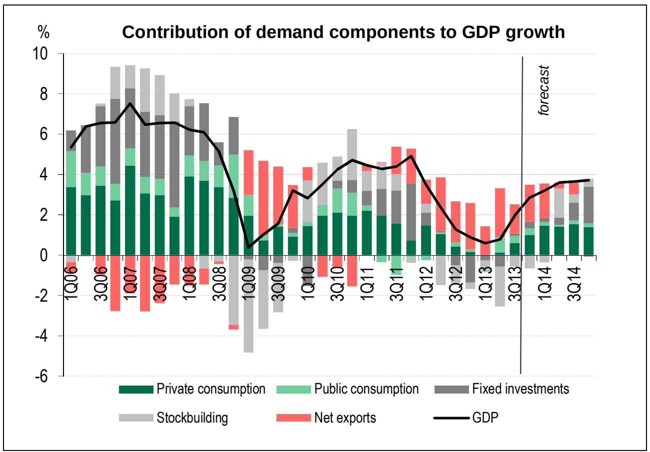
Financial market on 10 February 2014:

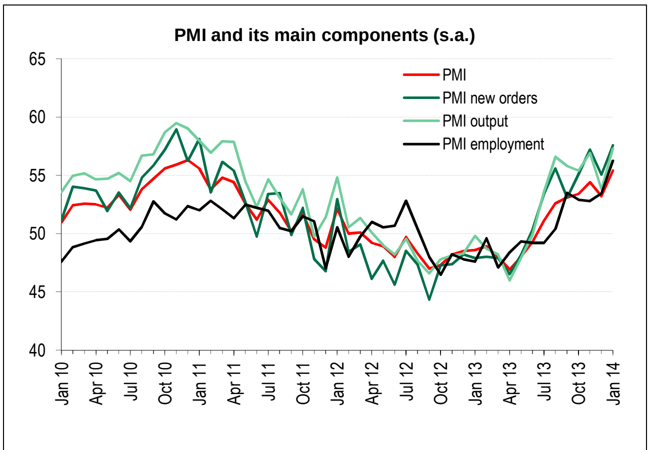
NBP deposit rate	1.00	WIBOR 3M	2.71	EURPLN	4.1822
NBP reference rate	2.50	Yield on 2-year T-bond	3.08	USDPLN	3.0683
NBP lombard rate	4.00	Yield on 5-year T-bond	3.76	CHFPLN	3.4196

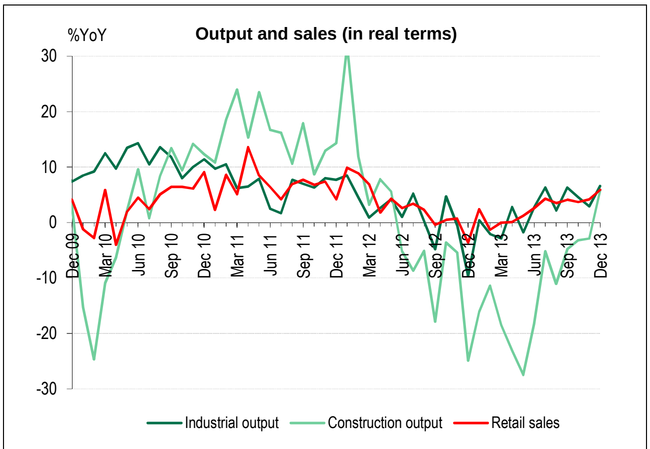
This report is based on information available until 10.02.2014

Economic update









Source: CSO, NBP, Markit, BZ WBK

Economic growth better than expected at the end of 2013

- According to preliminary CSO estimation, GDP growth amounted to 1.6% in 2013 vs. 1.9% in 2012. The figure was slightly better than expected – market consensus and our forecast were at 1.5%. Although the difference for the entire year does not seem to be significant, in our view this implies a quite substantial positive surprise as regards the economic growth in Q4-2013. Assuming no revisions in GDP data for the first three quarters of the year, we estimate that in Q4-2013 the Polish GDP expanded by ca. 2.8%YoY. Seasonally adjusted growth in quarterly terms amounted to ca. 0.9-1.1%, which stands for an annualized economic growth at ca. 4%.
- What is important, not only the pace, but also the breakdown of growth was a positive surprise. The data have shown stronger-than-expected recovery of main components of domestic demand. Individual consumption advanced by 0.8% in 2013, which, according to our estimates, means that it expanded by almost 2%YoY in Q4 (two quarters earlier this sector was in a prolonged stagnation). Fixed investment declined by 0.4%YoY in entire year, and this means they rose by ca. 1.3%YoY in Q4 alone. At the same time, net exports' contribution to the growth was still strong – this factor added 1.8pp in 2013 and 1.7pp in Q4.
- The pace of a rebound of the Polish economy from the through is thus faster than anticipated. At the same time the recovery has broader and more solid fundamentals as the role of domestic demand is rising. Thus, we decided to raise our GDP forecast to 3.5% in 2014 (growth in Q4 may be close to 4%). We are expecting that private consumption will advance by 2.4% and fixed investments by 4.6% and these two elements will take over net exports as the main growth engine.

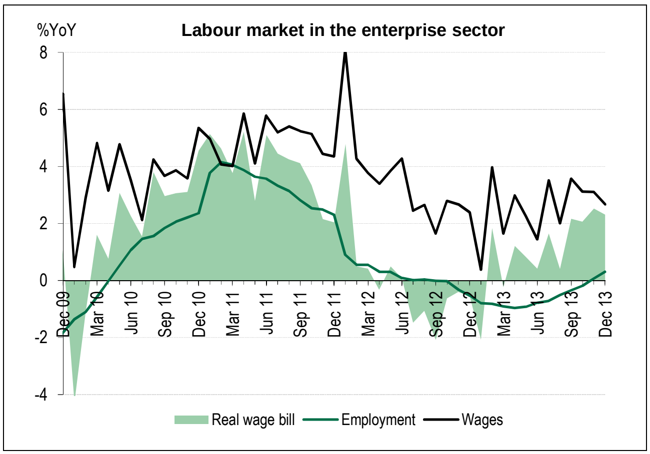
Output below forecast, but PMI suggests further improvement

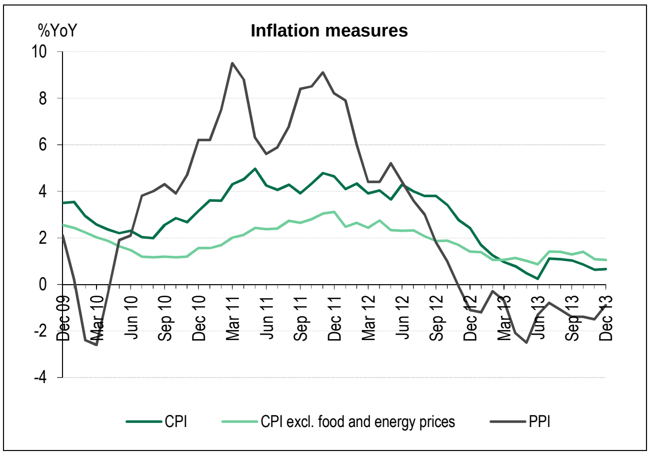
- Industrial output growth in December reached 6.6%YoY, while construction output increased by 5.8%YoY. Although this was the fastest growth rate in industry since January 2012, and in construction since April 2012, the results were below our forecasts. This was partially due to weak result of the energy sector (-9.8%YoY), probably due to relatively mild December. Output in industrial manufacturing advanced by 8.3%YoY.
- January's PMI at 55.4pts (the highest level in three years) confirmed that underlying trend remains robust, with a broad-based improvement in sub-indices (output, orders, export orders, employment at the highest level ever). Business climate indices calculated by the CSO also improved substantially in January.

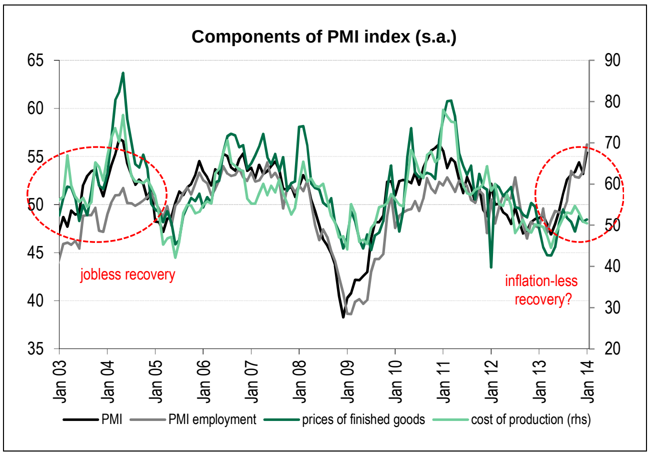
Revival in trade is gaining pace

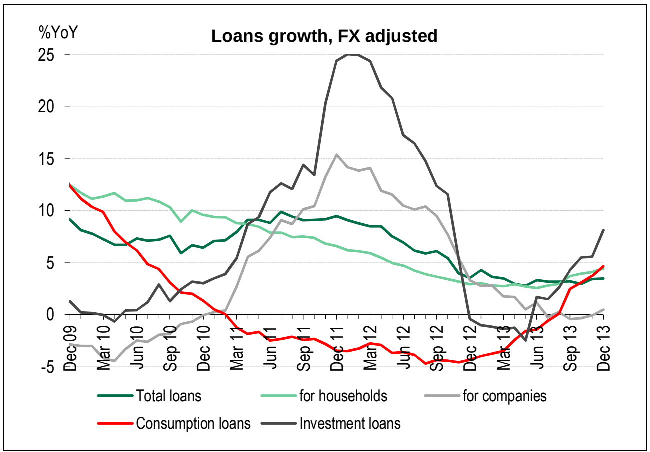
- Growth rate of retail sales accelerated in December to 5.8%YoY and this was the highest growth rate since August 2012. However, in our view this acceleration was partially due to low base effect resulting from delays in direct subsidies' payments for farmers in December 2012. In real terms sales advanced by 5.9%YoY, i.e. at the fastest pace since March 2012. The turnover in retail trade also showed a solid growth in real terms, by 6.5%YoY. The acceleration was recorded also in wholesale trade (10.3%YoY, the fastest growth since December 2011).
- As regards the foreign trade, exports increased by 1.2%YoY while imports contracted by 0.8%YoY in November. The current account deficit reached €984m and was lower than a year ago (€1315m), so 12-month rolling deficit declined to 1.7% of GDP from 3.8% seen a year ago. We expect exports to outperform imports in months to come and this will lead to further reduction of external imbalance on the Polish current account. However, gradual rebound of private consumption shall support imports in coming quarters.

Economic update









Source: CSO, NBP, BZ WBK

Improvement in the labour market accelerating

▪ The average employment in corporate sector in December 2013 was higher than last year by 0.3%. Annual pace of employment growth has been improving for eight straight months, which is showing the improving labour market situation. Since January until December the most visible improvement of employment growth rate was recorded in case of administrative and support service activities (by 6.2pp), manufacturing (1.2pp) and trade (1.0pp). January's release appears to be interesting as it will show the impact of a sample recalculation by the CSO. We expect that pace of employment growth may exceed 1%YoY after this revision.

▪ The average wage growth reached 2.7%YoY in December and 2.6%YoY in the entire 2013. Given very low inflation environment (12M CPI at 0.9% on average) it supported a rebound in real disposable income and private consumption. At the same time, it did not create a cost pressure from companies' point of view.

▪ According to preliminary data of the Ministry of Labour and Social Policy, the rate of registered unemployment increased in January to 14.0%. This means a move up by 0.6pp vs. December and this would be the lowest rebound at this time of the year since 2007/08. Additionally, the unemployment rate may be lower on annual basis for the first time since February 2009.

▪ Better economic outlook encourages companies to increase their demand for labour and this tendency is likely to be continued later in the year. Consequently, we expect further decline of unemployment rate and further rise of employment.

Recovery without inflation?

▪ Inflation increased slightly in December, to 0.7%YoY. As compared to November, average price level increased by 0.1%. Two most important factors that pushed CPI index up in monthly terms were prices of food and non-alcoholic beverages (0.7%MoM) and fuels (0.4%MoM). Core CPI after excluding food and energy prices declined to 1.0%YoY from 1.1%YoY in November.

▪ Data on producer prices continue to show weak inflationary pressure. PPI is still below zero (-0.9%YoY in December) while PMI sub-indices of prices of finished goods (48.5pts) and costs of production (50.5pts) are below long-term averages (by 3pts and 6pts, respectively). It is worth to notice that, when in October 2010 and 2011 the headline PMI index was at similar level as in January, the above-mentioned sub-indices representing cost pressure were at around 53pts and 68pts, respectively. This clearly shows that during the currently observed recovery, inflation pressure is (so far) much weaker than in the past.

Economic situation supports easing of credit conditions

▪ The survey conducted among heads of credit committees in Q4-13 indicated that banks have eased credit conditions and the demand for loan has increased slightly. Expectations for Q1-14 indicate visible increase in demand for loans and further easing of credit conditions.

▪ Banks have relaxed credit conditions for companies and have recorded higher demand, related mainly to financing investments. Data on money supply confirm this tendency – in December pace of investment loans growth reached 8.1%YoY vs. -1%YoY in January 2013. Additionally, anticipated economic conditions have been described as supportive for easing of credit conditions for the first time since Q2-12.

▪ As regards loans for households, higher demand for consumption and mortgage loans has been recorded, but credit conditions have been relaxed only in case of the former. Additionally, banks expect significant tightening of requirements for mortgage loans in Q1-14 given the regulation reducing the maximum level for LtV ratio.

Monetary policy watch

Fragments of MPC communiqué after February's meeting

Growth in global economic activity remains moderate, although the situation varies across countries (…) Moderate growth in global economic activity is conducive to maintaining low inflation in many countries.

The reduction of asset purchases by the Federal Reserve has had an adverse effect on the sentiment in the international financial markets, in particular with regard to some emerging market economies

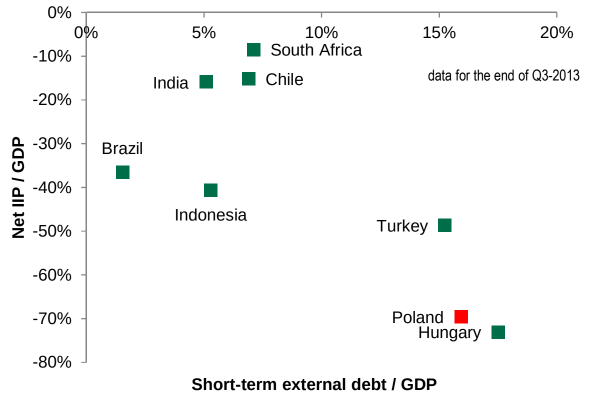
Data on domestic economic activity indicate a continuation of the gradual recovery in Poland. (…) Activity growth in the subsequent quarters is signalled by business climate indicators.

CPI inflation amounted to 0.7% in December 2013, thus remaining markedly below the NBP inflation target of 2.5%. Also core inflation measures remained low, which confirms that demand pressure continues to be weak. In turn, weak cost pressure in the economy is manifested in a further decline in producer prices. This is accompanied by low inflation expectations.

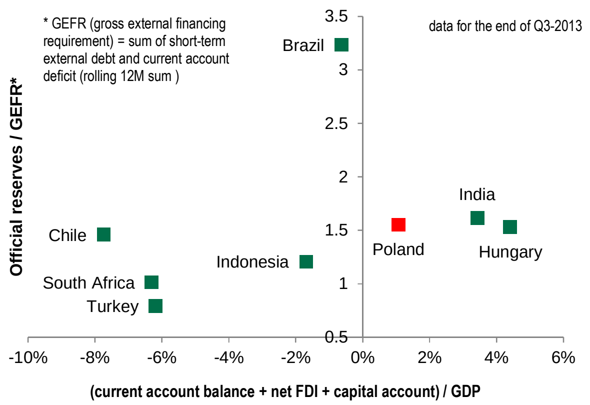
In the recent period, lending to the private sector has accelerated slightly while remaining limited. In December 2013, the annual growth in lending to enterprises and households was still low. At the same time, since mid-2013, there has been a gradual acceleration in consumer loans.

In the opinion of the Council, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressures will remain subdued. Therefore, the Council decided to keep NBP interest rates unchanged. **The Council maintains its assessment that NBP interest rates should be kept unchanged at least until the end of the first half of 2014.**

Net IIP and short-term external debt in relation to GDP



Short-term external financing requirements



Sources: NBP, BZ WBK

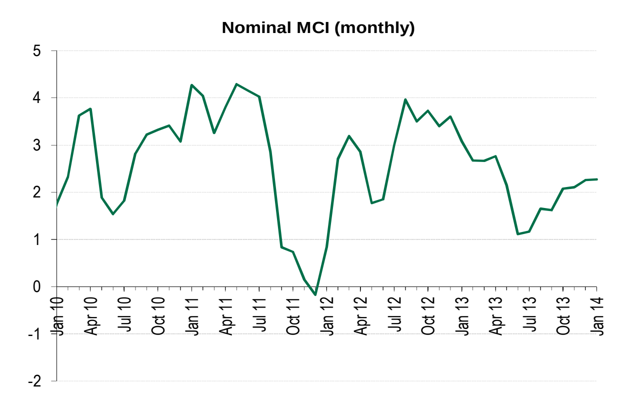
March will be more interesting, not necessarily critical

- In line with expectations the Monetary Policy Council left the interest rates unchanged in February, the reference rate is still at 2.50%. Main fragments of the statement have not changed and the NBP Governor called them a sound copy of last month's statement. According to him, this was a strong signal for the market that the Council feels comfortable with current macro conditions.
- Some slight changes regarding the assessment of economic conditions to more optimistic may be found in the statement. This is particularly visible in the case of the labour market. However, this does not change the general MPC's opinion saying that "unemployment persists at elevated levels, which is hampering wage pressure in the economy". Additionally, the Council noticed some acceleration in loans.
- The importance of March projection was stressed once again as one that may shed more light on longer time horizon (forecasts for 2016 will be presented for the first time). We can imagine, however, that March meeting will bring no breaking solutions. In April-May period the Council may stick to its current rhetoric, while in May-June period the Council may state that it would like to wait for the new projection in July. In such a scenario, only in July (when suggested period of stable rates ends) the MPC would have to say what it is going to do next. In other words, after July's meeting the relatively long (as for Poland) *forward guidance* might be abandoned to the benefit of "meeting to meeting" analysis of situation. We do not think there would be a majority within the Council to extend the suggested period of stable rates (details on the next page).
- We do not change our forecast of first rate hike in autumn this year.

Poland on the map of emerging markets' risk

- Under impact of January's turmoil on the emerging markets, investors re-started to scrutinise statistics of emerging markets as regards their exposure to possible outflows of foreign capital.
- Among the countries the most vulnerable to risk the so-called "fragile five" is mentioned the most frequently. This includes countries (Brazil, India, Indonesia, Turkey, South Africa) with high balance of payments and fiscal imbalances. However, there are also opinions suggesting that this high-risk group should be expanded by Poland, Hungary and Chile (to the "exposed eight"). This was due, among other factors, to relatively low FX reserves in these countries in relation to their external financing needs.
- While Poland indeed does not rank high as regards cumulated negative net investment position (we noted that back in April 2013), but it seems that exposure of our country to swings in investor moods is rather limited.
- First, current account deficit narrowed substantially in recent period (from 5% of GDP in 2011 and 3.7% of GDP in 2012 to ca. 1.5% of GDP in 2013) and in our view this trend will be continued also this year.
- Second, the current account deficit is covered by inflow of long-term capital. Total 12-month inflow of net direct investment and EU funds amounted to ca. €13bn at the end of September, i.e. to ca. 170% of 12-month current account deficit.
- Third, taking into account the IMF flexible credit line, Polish FX reserves in relation to gross external financing needs (sum of current account deficit and short-term external debt) is one of the highest among the so-called "exposed eight".

Restrictiveness of the Monetary Policy (Council)



MCI index stable, but will go up

- The MCI monetary policy restrictiveness index was stable in January and this was due to insignificant changes in average WIBOR and PLN exchange rate (despite high volatility of the rate, average was similar as in December).
- In February the average PLN exchange rate will probably be weaker than one month earlier, so we may see some decline of the index this month. However, in the longer term we are expecting more restrictive monetary conditions, given rising WIBOR rates due to hikes of the MPC interest rates and strengthening of the zloty, given improving economic prospects and better moods on the global markets.

Index is between 0 and 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights, more distant – lower.

Numbers directly by the name are values of the index for period since the beginning of current term of office of the current MPC and NBP governor.

Direction of the restrictiveness axis reflects our expectations regarding direction of interest rate changes in the nearest 12 months.

As there was no vote on the rate change for a long time, the positioning of MPC members on the axis is based mainly on our assessment, as we took into account comments of MPC members in recent period.

The MPC has a lot of time to make a decision

NBP President Marek Belka stated during the press conference after the MPC meeting that a central banker dreams about such a situation that we have now in Poland: economic growth is accelerating while inflation is not only under control, but seems to be running at extraordinary low level. (…) Acceleration of the growth starts from very low level. Demand gap is still substantial and will close only gradually. According to him, this all suggests that we have “plenty of time” (to make a decision on monetary policy parameters). We think that this is coherent with our scenario assuming that no sooner than in July the MPC may suggest the direction for further changes in monetary policy and to hike rates first in autumn.

… but extending *forward guidance* under question mark

Differences of opinion on further direction for the monetary policy gradually start to be observed among MPC members that have been surprisingly unanimous during the past few months when talking on the need of stabilization of interest rates until mid-2014. Some of them (Glapiński, Chojna-Duch) already in January claimed for extending the forward guidance until the end of the year. At the same time, at least three members (Hausner, Bratkowski, Rzońca) seem not to support such an option. Hausner and Bratkowski have clearly stated that they see room for rate hikes already this year and such a decision should be preceded by a signal from the MPC (change in the statement). Of course, this would not have been coherent with extending forward guidance until the end of 2014. At the same time, we agree with Andrzej Bratkowski that extending forward guidance by just one quarter would not make much sense.

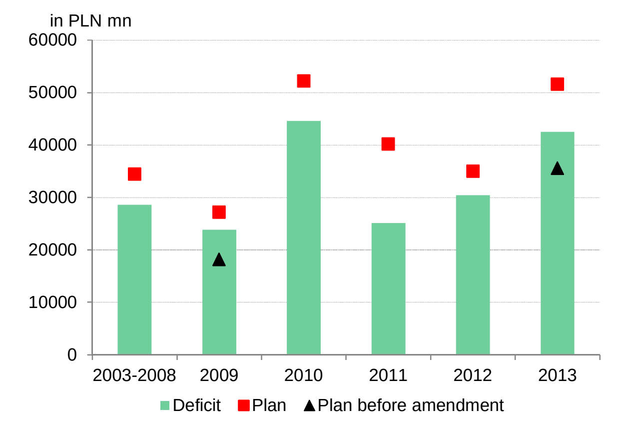
Differences of opinions between MPC members on the possibility of extending forward guidance originate from their expectations regarding the pace of economic growth – Hausner, Bratkowski and Rzońca anticipate rather fast and strong acceleration of pace of GDP growth (to ca. 4%YoY already in Q3-14) and fast closing of demand gap, as a consequence. This seems to confirm that data on economic performance and new NBP forecasts might have a significant impact on the Monetary Policy Council point of view.

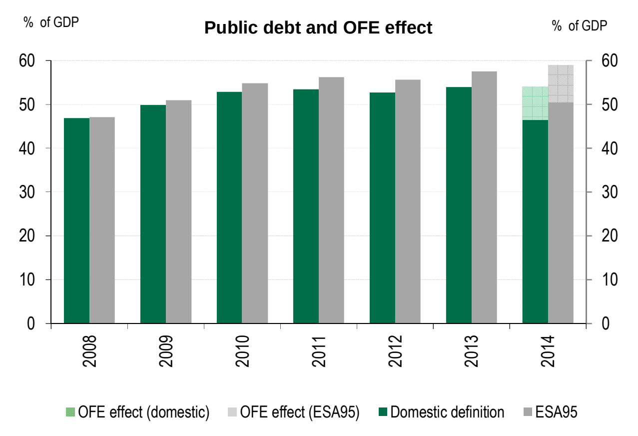
The NBP not impressed by situation on the FX market

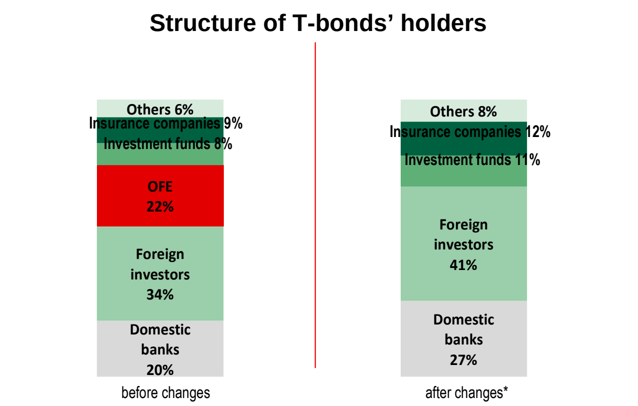
Central banks in our region acted in different ways in response to January’s strong weakening of EM currencies. We saw FX interventions in Romania and Croatia, while head of the Hungarian central bank did not exclude further rate cuts making the forint suffer more after his remarks. The Polish bank refrained from any nervous actions, though the member of NBP board reminded that activity of the central bank on the market cannot be excluded amid extensive volatility of currency exchange rate. After the MPC meeting, the Governor Belka said that on the Polish foreign exchange market have been no changes that could encourage the central bank to step into action and we fully agree with his opinion.

Source: NBP, Reuters, BZ WBK

Fiscal policy watch







*BZ WBK forecast

	Spread vs Bunds (10Y) in bps			CDS (5Y USD)		
	10.02	change since 13.01.14	change since 31.12.13	10.02	change since 13.01.13	change since 31.12.13
Poland	276	23	38	81	4	2
Czech	62	-8	4	59	-1	-1
Hungary	447	76	70	261	26	5
Greece	611	6	-49	53	15	17
Spain	192	-11	-29	129	-1	-25
Ireland	162	15	10	100	-6	-20
Portugal	328	-23	-81	264	-19	-83
Italy	202	-7	-13	162	10	-7
France	60	7	11	54	2	0
Germany	-	-	-	25	1	-1

Source: MoF, Reuters, GUS, BZ WBK

Lower the 2013 budget deficit in line with expectations

- Poland's Ministry of Finance estimates that budget deficit in 2013 reached the level of PLN42.5bn and accounted for 82.4% of annual plan after amendment. The budget gap lower by PLN9bn resulted from the better realisation of revenues by PLN3bn (or 101.1% of annual plan), in which higher incomes from corporate tax income were significantly above the plan (realisation at 105.4% of plan). Overall spending was lower by ca. PLN6bn (98.2% of plan).
- After this preliminary estimate we still expect the public finance deficit in 2013 to amount to 4.4% of GDP (vs. 3.9%of GDP in 2012).
- Minister of finance Mateusz Szczurek said that initial estimates of January's budget revenues suggest improvement in tax incomes, with a marked increase in VAT receipts. We think that continuation of GDP growth and quite considerable rebound in private consumption should support this year budget revenues. On the other hand, we do not expect budget expenditure to increase significantly. Minister of finance predict that in 2014-2015 realisation of budget deficit could be lower than planned.

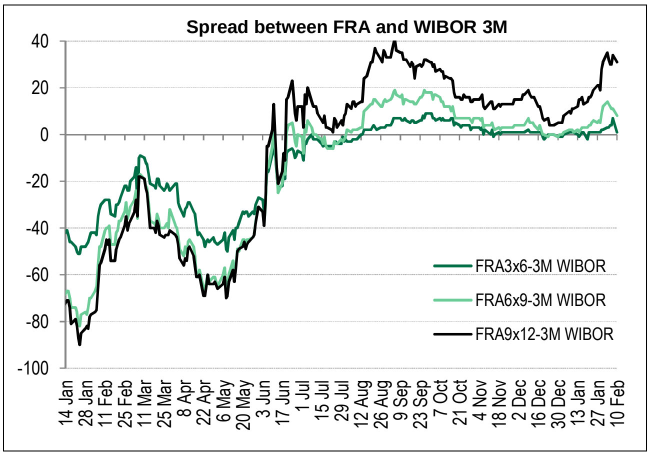
Pension funds reform lowers public debt

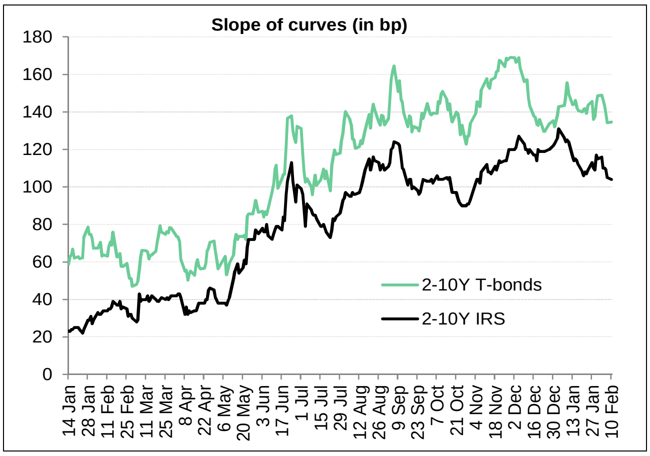
- In line with the act from December 2013 on February 3, 2014 open pension funds (OFE) transferred to the Social Insurance Institution (ZUS) 51.5% of their assets (or PLN153.2bn, in which PLN130.2bn were Treasury securities). The cancellation of OFE's T-bonds portfolio was higher than assumed by the Ministry of Finance, which results in lower not only debt servicing cost, but also borrowing requirements. Savings will be higher in 2015, the first full year of the changes being in effect, and it will amount to PLN6bn in debt servicing and PLN18bn in borrowing needs.
- The cancellation of Treasury securities handed by OFE results in reduction of State Treasury debt by ca. 7.6% of GDP and decrease of the general government debt by ca. 8.5% of GDP. Minister of finance estimates that public debt according to the domestic methodology will decline below 47% of GDP till the term of government office, while it will amount to some 50% of GDP according to the EU methodology. What is more, the cabinet's standing committee adopted a draft bill reducing debt thresholds, which are used in the spending rule, by 7pp to 43% of GDP and 48% of GDP, respectively. Changes in pension system will lower the general government debt and also generate a one-off surplus in the public finance sector at ca. 4.4% of GDP. We uphold our stance that in 2015 the general government deficit will decline to ca. 3% of GDP.
- The breakdown of domestic debt holders changed quite visibly as a result of transferring OFE's portfolio to ZUS. According to the Ministry of Finance estimation, the share of foreign investors in total Treasury holdings rose to 41% from 34% as of end-2013. Consequently, it increases sensitivity of domestic assets to changes in global investors' mood. The state-owned bank BGK is expected to take over the role of market stabiliser as it will have all types of T-bonds at its disposal, even the least liquid ones.

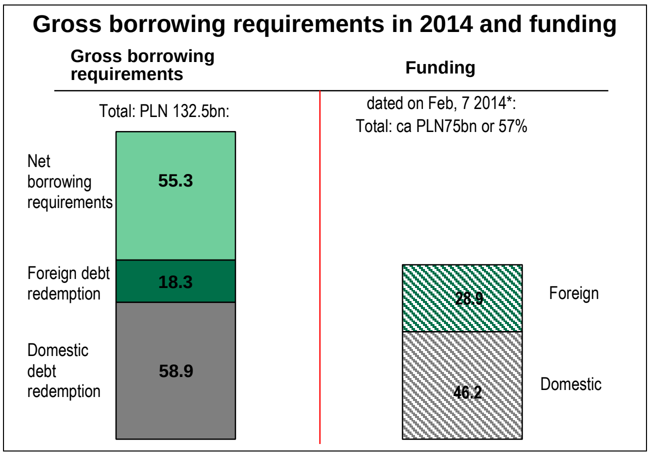
Calmer global moods

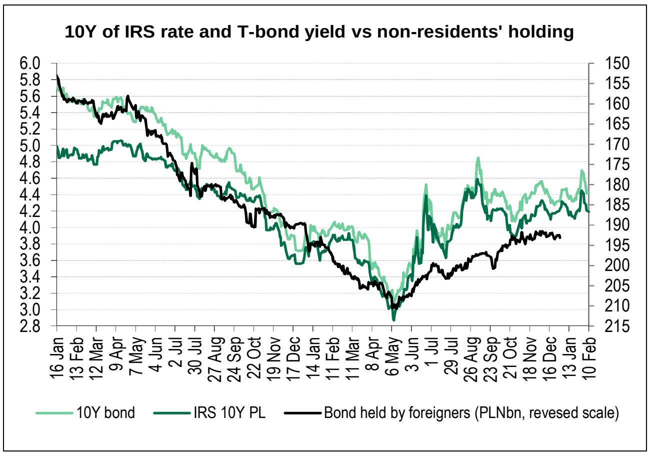
- Rise in risk aversion on the global markets encouraged the demand for safe assets. Despite continuation of gradual reduction of QE3 by the Fed, yields of German and US bonds fell considerably, reaching the lowest levels in three (2.75%) and six months (1.63%), respectively. As investor moods calmed at the start of February, core market yields climbed again.
- Bonds of the euro zone peripheries were relatively stable to swings in moods. Yields climbed temporarily by 10bp on average. Global moods improvement gave an impulse for further decline of yields of these papers, which are highly demanded by investors also on the primary market. If the ECB maintains its dovish rhetoric, then Bunds may outperform the US bonds. This can generate an upward impulse for spread between these papers considerably above 100bp in 10Y sector.

Interest rate market









Source: Reuters, BZ WBK

Increase of interest rate hikes expectations in 2H 2014

▪ In January WIBOR rates between 1M and 12M did not change significantly. Market was supported by comments of the MPC's members, who pointed out that the Council would keep its forward guidance unchanged, but March's projection (CPI and GDP) will determine the direction of further interest rate path. Also inflation data and outlook stabilised rates near current levels.

▪ As in previous months, FRA rates were more vulnerable to macro data releases and situation on domestic debt market. Significant increase in both IRS rates and T-bonds yields due to high risk aversion resulted in FRA rates growth. Consequently, spread between FRA and WIBOR3M widened substantially, particularly for 9x12 tenor. Rates rebounded at the beginning of February, however FRA9x12 rate stayed above 3%.

▪ Last changes in macro data (substantial increase in GDP growth without strong inflation pressure) and on the financial markets caused that investors have started pricing-in earlier tightening in monetary conditions (in 9 months period instead of 12 months horizon). This scenario is close to our expectations.

Calm after the storm

▪ January was very volatile on the debt market. IRS and T-bonds suffered from a sharp sell-off of emerging markets' currencies, including the zloty, due to risk aversion. What is more, changes in pension funds added volatility on the debt market. Stop-losses in the last day of January (the day of OFE's portfolio valuation before transferring to ZUS) pushed yield of 10Y T-bond to 4.70%, while 10Y IRS rate climbed to 4.45%. Consequently, in January yield curve shifted up by 20-50bp, while IRS curve by 20-35bp.

▪ Calmer moods on the global markets triggered a rebound on bond and IRS markets. Favorable auction results (especially taking into account that it was the first auction without OFE) also supported positive mood and caused further decline in yields/rates along the curves. Consequently, it has erased almost all losses incurred at the end of January. What is more, both curves flattened, mainly due to 2-5Y spread narrowing.

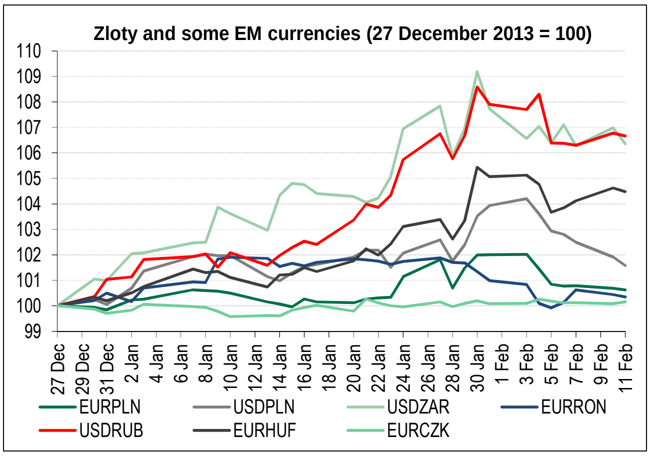
▪ Poland's Ministry of Finance decided to significantly limit its issuance plan for February. This month the Ministry wants to collect PLN4-9bn at two regular auctions. The first February's auction, which took place in new market environments (without OFE), was very successful. The ministry sold T-bonds OK0716 and WZ0119 worth PLN4.81bn in total (with recorded demand at PLN8.42bn on regular auction and valuation below secondary market levels). After this auction this year borrowing needs are financed in nearly 57%. Therefore, we expect the ministry to cover 60% of this year target at the end of February.

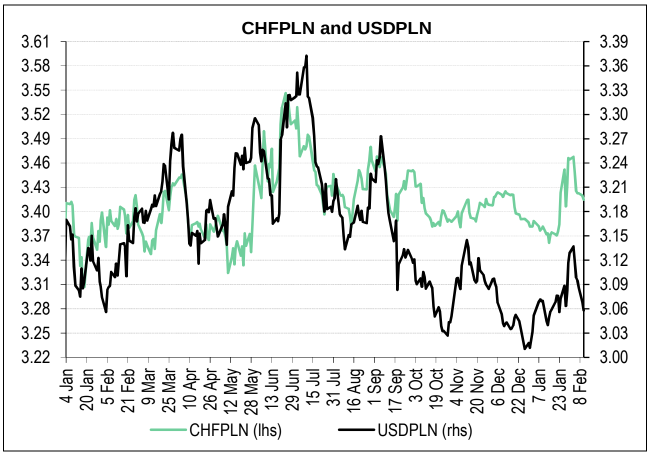
Debt market more than ever exposed to global trends

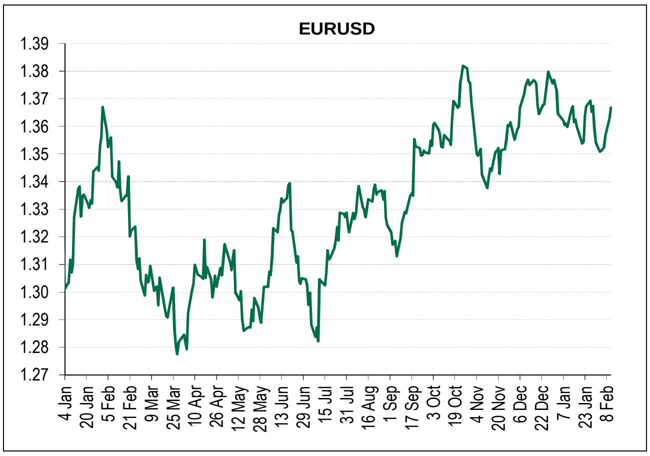
▪ Investors breakdown on the domestic debt market changed considerably after OFE's T-bond portfolio transferring to ZUS. The share of foreign investors climbed to ca. 41%, up from 34% at the end of December 2013. As the role of foreign investors on the Polish debt market rose, domestic bonds will be more than ever exposed to global trends. However, continuation of positive mood on global market should cause further decline in IRS rates and T-bonds yield, but potential for further decrease is rather limited in the short-term taking into account relatively strong rebound in the first week of February.

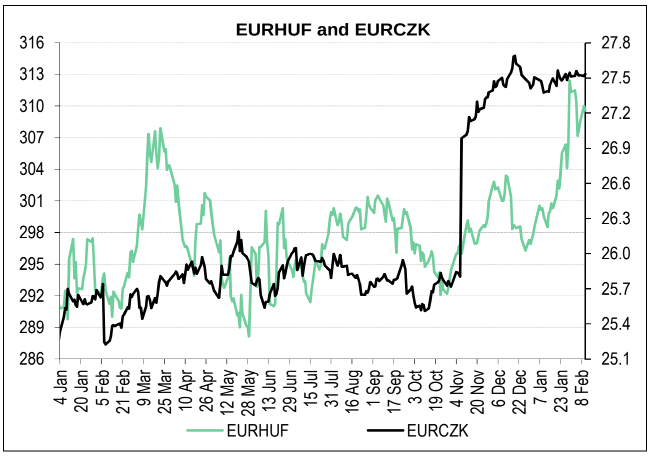
▪ Limited offer of T-bonds should be a supportive factor for bonds. High covering of this year borrowing needs allows the Ministry to be more flexible in offering T-bonds in more vulnerable market conditions.

Foreign exchange market









Sources: CSO, Reuters, BZ WBK

High volatility of the zloty…

▪ Next days following the publication of January's MACROscope showed that depreciation of the zloty, as well as other emerging market currencies seen at the very beginning of the year has been only an omen of further surge of risk aversion and that strengthening after weak December US nonfarm payrolls has been only temporary. Worries over pace of economic growth in China and negative impact of QE3 tapering on currencies of developing countries triggered a significant weakening and such currencies as the forint, ruble, Turkish lira or LatAm currencies reached multi-month (or even record) lows. Local factors, next to global market turmoil, also weighed on those currencies. The Polish data on December's industrial output and retail sales proved weaker than expected and this also did no not help the zloty. Consequently, EURPLN, USDPLN and CHFPLN reached temporarily the highest levels since September, at 4.26, 3.16 and 3.49, respectively. GBPPLN reached 5.20, highest since November 2012.

▪ In early February global mood stabilised and January's PMI for the Polish, Hungarian and Czech manufacturing surprised clearly to the upside. This helped the zloty to terminate the weakening trend vs. the euro observed for already three consecutive weeks and EURPLN retreated to 4.17.

▪ FOMC reduced the scale of monthly bond purchases further by US$10bn, in January it was deterred neither by disappointing December's US nonfarm payrolls number nor by sudden weakening of EM currencies. Thus, it seems that QE3 tapering will be continued in coming months and market sentiment will depend on picture drawn by US macro data. Recent releases were not too optimistic (clearly below consensus ISM for manufacturing and next disappointing labour market numbers, poor consumers income and spending) and this may make investors cautious and constrain the pace of appreciation of risky assets in the nearest future. That is why we expect stable EURPLN around 4.20 in February and only in coming months the domestic currency should regain its appreciation trend.

… and relatively stable EURUSD

▪ EURUSD stayed in the 1.35-1.37 range in the second half of January and the first decade of February. The single currency was supported by strong PMI data for German and euro zone manufacturing in January, lack of ECB rate cut in February and weak US labour market data. The room for appreciation was limited by flash January's HICP data showing very low pace of prices growth (0.7%YoY).

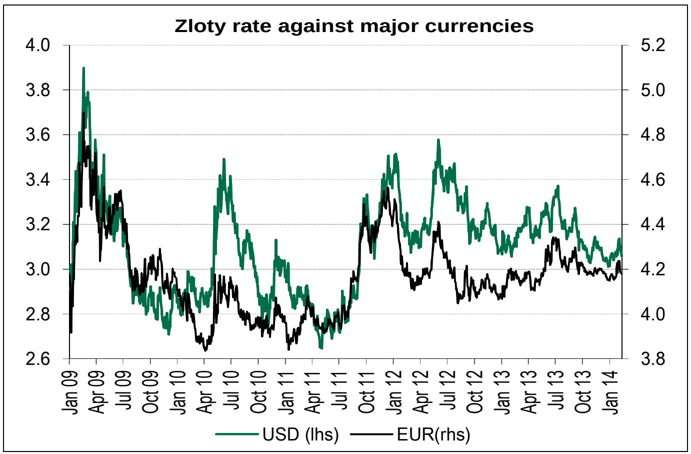
In early February the exchange rate hovers slightly 1.36 and we expect EURUSD to end the month close to this level. Two forces will continue clashing on the market – decent data from the euro zone with expectations for further QE3 tapering by FOMC and risk of ECB taking further actions towards monetary policy easing. The March ECB meeting may be crucial for EURUSD as the central bank will have updated CPI and GDP forecasts at its disposal and may decide to take some actions relying on those new estimates.

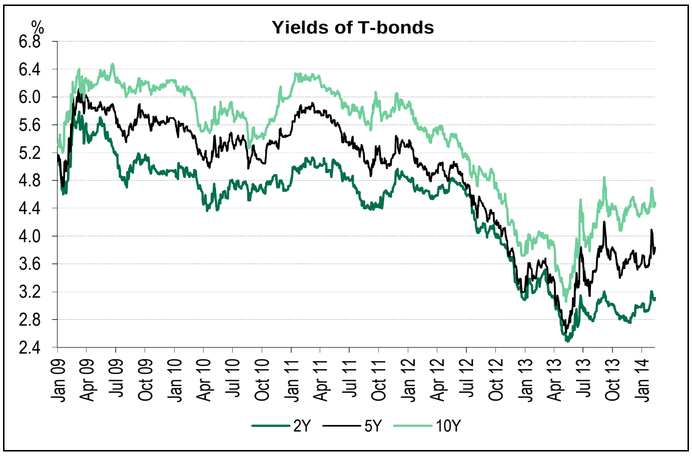
No big changes of koruna, forint unstable

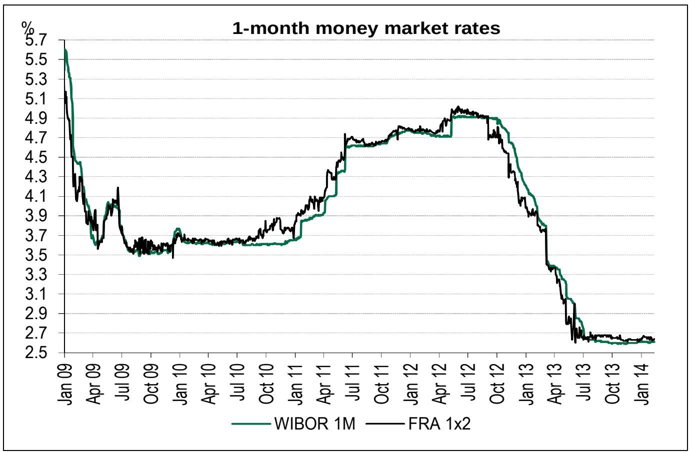
▪ Global market turmoil had a significant impact on the Hungarian currency. Sudden withdrawal of foreign investors from emerging markets, further rate cuts (and potential for more easing) as well as still unsolved issue of FX mortgage loans pushed EURHUF above 314, the highest for a year. In early February, the forint, just like the zloty, recovered slightly, EURHUF reached ca. 306.

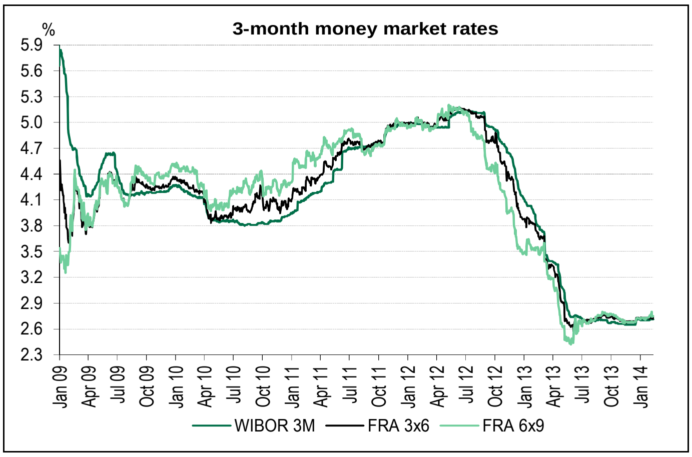
▪ At the same time, data on better than initially estimated pace of GDP growth in Q4 and visible rebound of inflation in January was released in Czech Rep. This reduced slightly the risk of increasing the floor for EURCZK and supported the koruna amid quite volatile period in the region. The Czech currency might have also be backed by the fact, that foreign investors have relatively low share on the Czech debt market.

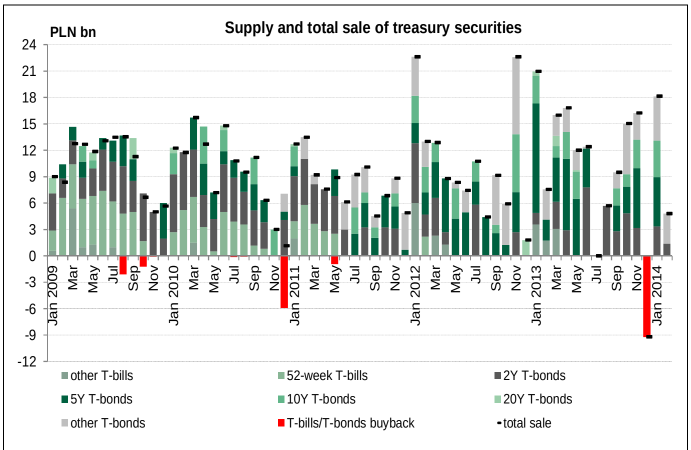
Market monitor











Treasury bill auctions in 2012/2013 (PLNm)

Auction date	OFFER	DEMAND/SALE
09.01.2012	49-week: 1000-2000	5402/2223
30.01.2012	30-week: 1000-2000	3249/1997
30.01.2012	51-week: 1000-2000	4225/1592
27.02.2012	52-week: 1000-2000	6711/2190
26.03.2012	52-week: 1000-3000	5402/2223
23.04.2012	31-week	3117/1332
07.01.2013	20-week: 2000-3000	10967/3602
04.02.2013	20-week: 1000-2000	7728/1747
04.03.2013	25-week: 2000-3000	7324/3084

* based on data of the Ministry of Finance

Treasury bond auctions in 2012/2013 (PLNm)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
February	7.02	PS0418/WZ0117	4000-6000	5806.5	13.02	OK0715/WZ0124	3000-5000	4584.7			
March	20.03	OK/PS/WZ	2000-6000	8080.6					7.03	PS0413/OK0713/DS1013	DS/WS/WZ
April	11.04	DS1023/WZ0124	3000-5000	5029.1	23.04	OK/WZ/PS	5000-10000	11788.6			
May	9.05	PS0718	3500-5500	6498.0	16.05	DS/WZ/WS	2000-6000	5505.4			
June	6.06	PS0718/WZ0119	3000-5000	4606.5					19.06	OK0713/DS1013	
July	-	-	-	-	-	-	-	-	-	-	-
August	7.08	OK0116	3000-5000	5695.0							
September	5.09	OK0112/PS0718	5000-7000	5706.8					25.09	DS1013/OK0114	WZ0119/DS1023
October	3.10	PS0718	2500-4500	3008.0	22.10	OK0116/IZ0823/DS1023	6000-12000	12019.9	16.10	EUR20140203**	445.0
November	7.11	OK0116/PS0718	4000-7000	7964.2	13.11	USD20140115**	100	132.2	20.11	OK0114/PS0414	DS1023/WS/WZ/IZ
December									5.12	OK0114/PS0414	PS0416/WZ0119
January ‘14	9.01	PS0718/WZ0124	3000-5000	6013.0	23.01	OK/PS/WZ/DS	6000-10000	12129.7			
February	6.02	OK0716/WZ0119	2000-4000	4810.0	13.02	PS0718/DS1013	3000-5000				

** with supplementary auction, ** buy-back auction, *** demand/sale,*

Source: MoF, Reuters, BZ WBK

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
10 February	**11**	**12** CZ: CPI (Jan) EZ: Industrial output (Dec) ***PL: Balance of payments (Dec)***	**13** US: Retail sales (Jan)	**14** ***PL: CPI (Jan)*** ***PL: Money supply (Jan)*** **PL**, HU, CZ, DE, EZ: Flash GDP (Q4) US: Industrial output (Jan) US: Flash Michigan (Feb)
17	**18** ***PL: Wages and employment (Jan)*** DE: ZEW index (Feb) HU: Central bank decision	**19** ***PL: Industrial output (Jan)*** ***PL: PPI (Jan)*** US: House starts (Jan) US: Building permits (Jan) US: FOMC minutes	**20** **PL: MPC minutes** CN: Flash PM – manuf. (Feb) DE: Flash PMI – manuf. (Feb) EZ: Flash PMI – manuf. (Feb) US: CPI (Jan) US: Philly Fed index (Feb)	**21** US: Home sales (Jan)
24 ***PL: Retail sales and unemployment rate (Jan)*** DE: Ifo (Feb) EZ: HICP (Jan)	**25** DE: GDP (Q4) US: S&P/Case-Shiller (Dec) US: Consumer confidence index (Feb)	**26** US: New home sales (Jan)	**27** US: Durable goods orders (Jan)	**28** ***PL: GDP (Q4)*** ***PL: Inflation expectations (Feb)*** EZ: Flash HICP (Feb) US: Preliminary GDP (Q4) US: Pending home sales (Jan)
3 March ***PL: PMI – manufacturing (Feb)*** CN: PMI – manufacturing (Feb) DE: PMI – manufacturing (Feb) EZ: PMI – manufacturing (Feb) US: ISM – manufacturing (Feb) US: Personal income (Jan) US: Consumer spending (Jan)	**4** HU: Central bank decision	**5** ***PL: MPC decision*** DE. EZ: PMI – services (Feb) HU: GDP (Q4) EZ: GDP (Q4) US: ADP report (Feb) US: ISM-services (Feb) US: Fed Beige Book	**6** EZ: ECB decision DE: Industrial orders (Jan) CZ: GDP (Q4) US: Industrial orders (Jan) CN: Flash PMI – manuf. (Jan) DE: Flash PMI – manuf. (Jan) EZ: Flash PMI – manuf. (Jan)	**7** DE: Industrial output (Jan) US: Non-farm payrolls (Feb) US: Unemployment rate (Feb)
10 CZ: CPI (Feb)	**11** DE: Exports (Jan) HU: CPI (Feb)	**12** EZ: Industrial output (Jan)	**13** US: Retail sales (Feb)	**14** **PL: CPI (Feb)** ***PL: Money supply (Feb)*** CZ: Industrial output (Jan) US: Flash Michigan (Mar)
17 **PL: Core inflation (Feb)** ***PL: Balance of payments (Jan)*** EZ: HICP (Feb) US: Industrial output (Feb)	**18** ***PL: Wages and employment (Feb)*** DE: ZEW index (Mar) US: CPI (Feb) US: House starts / Building permits (Feb)	**19** ***PL: Industrial output (Feb)*** ***PL: PPI (Feb)*** US: Fed decision	**20** ***PL: MPC minutes*** US: Philly Fed index (Mar) US: Home sales (Feb)	**21**

MPC meetings and data release calendar for 2014

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
ECB meeting	8	6	6	3	8	5	3	7	4	2	6	4
MPC meeting	7-8	4-5	4-5	8-9	6-7	2-3	1-2	19	2-3	7-8	4-5	2-3
MPC minutes	23	20	20	17	22	20	-	21	18	23	20	18
Flash GDP*	-	14	-	-	15	-	-	14	-	-	14	-
GDP*	-	28	-	-	30	-	-	29	-	-	28	-
CPI	15	14[a]	14[b]	15	14	13	15	13	15	15	13	15
Core inflation	16	-	14	16	15	16	16	14	16	15	17	16
PPI	21	19	19	17	20	18	17	20	17	17	20	17
Industrial output	21	19	19	17	20	18	17	20	17	17	20	17
Retail sales	24	24	-	-	-	-	-	-	-	-	-	-
Gross wages,employment	20	18	18	16	19	17	16	19	16	16	19	16
Foreign trade						about 50 working days after reported period						
Balance of payments*	2											
Balance of payments	17	12	17									
Money supply	14	14	14									
Business climate indices	23	21	21	23	22	23	22	22	22	22	21	19

* quarterly data. [a] preliminary data for January. [b] January and February; *Source: CSO, NBP, Ministry of Finance, Reuters, Bloomberg*

Economic data and forecasts

Monthly economic indicators

		Jan 13	Feb 13	Mar 13	Apr 13	May 13	Jun 13	Jul 13	Aug 13	Sep 13	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14
PMI	pts	48.6	48.9	48.0	46.9	48.0	49.3	51.1	52.6	53.1	53.4	54.4	53.2	55.4	55.0
Industrial production	%YoY	0.4	-2.1	-2.9	2.8	-1.8	2.8	6.3	2.2	6.3	4.6	2.9	6.6	3.1	7.7
Construction production	%YoY	-16.1	-11.4	-18.5	-23.1	-27.5	-18.3	-5.2	-11.1	-4.8	-3.2	-2.9	5.8	0.0	7.3
Retail sales [a]	%YoY	3.1	-0.8	0.1	-0.2	0.5	1.8	4.3	3.4	3.9	3.2	3.8	5.8	3.1	5.9
Unemployment rate	%	14.2	14.4	14.3	14.0	13.5	13.2	13.1	13.0	13.0	13.0	13.2	13.4	14.0	14.1
Gross wages in enterprises sector [a]	%YoY	0.4	4.0	1.6	3.0	2.3	1.4	3.5	2.0	3.6	3.1	3.1	2.7	3.1	3.3
Employment in enterprises sector	%YoY	-0.8	-0.8	-0.9	-1.0	-0.9	-0.8	-0.7	-0.5	-0.3	-0.2	0.1	0.3	1.2	1.4
Export (€)	%YoY	6.4	4.3	-1.2	11.0	0.3	5.4	6.6	1.9	8.1	0.7	1.2	8.1	1.7	1.6
Import (€)	%YoY	1.1	-6.2	-1.3	1.6	-6.1	-1.9	2.8	-0.9	3.2	2.8	-0.8	1.7	6.6	7.6
Trade balance	EURm	-64	426	-502	630	1	570	78	264	677	68	7	-500	-664	-278
Current account balance	EURm	-1 375	-668	-272	569	-176	100	-661	-533	-877	-213	-984	-1 083	-1 885	-694
Current account balance	% GDP	-3.5	-3.3	-3.1	-2.8	-2.8	-2.3	-1.9	-2.0	-1.9	-1.8	-1.8	-1.6	-1.7	-1.7
Budget deficit (cumulative)	PLNbn	-8.4	-21.7	-24.4	-31.7	-30.9	-26.0	-25.9	-26.8	-29.6	-39.5	-38.5	-42.5	-6.0	-20.0
Budget deficit (cumulative)	% of FY plan	16.4	42.0	47.3	61.6	60.0	50.4	50.3	51.9	57.4	76.6	74.7	82.4	12.6	41.9
CPI	%YoY	1.7	1.3	1.0	0.8	0.5	0.2	1.1	1.1	1.0	0.8	0.6	0.7	0.7	0.9
CPI excluding prices of food and energy	%YoY	1.4	1.1	1.0	1.1	1.0	0.9	1.4	1.4	1.3	1.4	1.1	1.0	1.3	1.6
PPI	%YoY	-1.2	-0.3	-0.7	-2.1	-2.5	-1.3	-0.8	-1.1	-1.4	-1.4	-1.5	-0.9	-0.9	-0.8
Broad money (M3)	%YoY	4.4	5.5	6.6	7.4	6.5	7.0	6.6	6.1	6.1	5.9	5.7	6.1	6.4	6.1
Deposits	%YoY	5.0	5.2	6.6	7.1	6.0	6.5	5.6	5.8	6.0	5.9	5.2	6.1	6.0	5.4
Loans	%YoY	3.6	3.7	3.5	2.3	1.4	3.5	3.7	3.3	3.7	2.9	3.8	4.1	3.5	4.4
EUR/PLN	PLN	4.14	4.17	4.16	4.14	4.18	4.28	4.28	4.23	4.24	4.19	4.19	4.18	4.18	4.20
USD/PLN	PLN	3.11	3.12	3.21	3.18	3.22	3.25	3.27	3.18	3.17	3.07	3.10	3.05	3.07	3.10
CHF/PLN	PLN	3.37	3.39	3.39	3.39	3.36	3.47	3.46	3.43	3.43	3.40	3.40	3.41	3.39	3.42
Reference rate [b]	%	4.00	3.75	3.25	3.25	3.00	2.75	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
WIBOR 3M	%	4.03	3.80	3.48	3.29	2.86	2.74	2.70	2.70	2.69	2.67	2.65	2.67	2.70	2.71
Yield on 2-year T-bonds	%	3.25	3.36	3.26	2.89	2.55	2.86	2.87	2.98	3.07	2.90	2.80	2.94	2.99	3.10
Yield on 5-year T-bonds	%	3.46	3.56	3.46	3.03	2.80	3.43	3.36	3.67	3.86	3.62	3.64	3.65	3.67	3.90
Yield on 10-year T-bonds	%	3.91	4.00	3.93	3.50	3.28	3.95	3.97	4.31	4.50	4.28	4.38	4.41	4.42	4.55

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; [a] in nominal terms, [b] at the end of period

Quarterly and annual economic indicators

		2011	2012	2013	2014	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
GDP	PLNbn	1 523.2	1 595.2	1 628.2	1 702.9	377.9	395.7	404.3	450.3	392.9	413.8	422.7	473.5
GDP	%YoY	4.5	1.9	1.6	3.5	0.5	0.8	1.9	2.8	3.2	3.6	3.6	3.7
Domestic demand	%YoY	3.6	-0.2	-0.2	3.0	-0.9	-1.7	0.5	1.0	1.5	3.4	3.1	3.8
Private consumption	%YoY	2.6	0.8	0.8	2.4	0.0	0.2	1.0	1.9	2.2	2.3	2.5	2.6
Fixed investments	%YoY	8.5	-0.8	-0.4	4.6	-2.1	-3.2	0.6	1.3	1.5	2.0	5.0	7.0
Industrial production	%YoY	7.7	1.0	2.3	7.2	-2.0	1.2	4.9	4.6	6.4	7.1	7.0	8.3
Construction production	%YoY	12.3	-1.0	-10.3	8.8	-15.6	-22.9	-7.0	0.0	6.4	16.9	12.0	2.0
Retail sales [a]	%YoY	11.2	6.0	2.6	5.1	0.9	0.8	4.0	4.5	3.6	5.1	4.8	6.9
Unemployment rate [b]	%	12.5	13.4	13.4	12.8	14.3	13.2	13.0	13.4	14.0	12.7	12.5	12.8
Gross wages in national economy [a]	%YoY	5.2	3.7	3.4	4.5	2.6	3.3	4.0	3.6	4.0	4.7	4.5	4.7
Employment in national economy	%YoY	0.6	0.0	-0.8	0.9	-0.7	-1.1	-1.2	-0.1	0.8	1.0	1.0	0.9
Export (€)	%YoY	12.1	5.9	4.3	11.4	3.2	5.5	5.6	2.9	11.0	11.4	11.8	11.5
Import (€)	%YoY	12.2	2.3	-0.3	9.8	-2.0	-2.2	1.7	1.2	7.0	11.0	10.0	11.0
Trade balance	EURm	-10 059	-5 175	1 656	4 389	-139	1 203	1 017	-425	1 345	1 489	1 829	-273
Current account balance	EURm	-18 519	-14 191	-6 179	-3 423	-2 313	486	-2 072	-2 280	-526	-22	-845	-2 031
Current account balance	% GDP	-5.0	-3.7	-1.6	-0.8	-3.1	-2.3	-1.9	-1.6	-1.1	-1.2	-0.9	-0.8
General government balance	% GDP	-5.0	-3.9	-4.4	4.4	-	-	-	-	-	-	-	-
CPI	%YoY	4.3	3.7	0.9	1.2	1.3	0.5	1.1	0.7	0.9	1.2	1.0	1.8
CPI [b]	%YoY	4.6	2.4	0.7	1.9	1.0	0.2	1.0	0.7	1.0	1.4	1.3	1.9
CPI excluding food and energy prices	%YoY	2.4	2.2	1.2	1.6	1.2	1.0	1.4	1.2	1.5	1.6	1.4	1.8
PPI	%YoY	7.6	3.4	-1.3	0.6	-0.7	-2.0	-1.1	-1.3	-0.6	0.6	0.5	1.9
Broad money (M3) [b]	%YoY	12.5	4.5	6.2	7.0	6.6	7.0	6.1	6.1	5.4	4.8	6.2	7.2
Deposits [b]	%YoY	11.7	4.7	6.0	6.7	6.6	6.5	6.0	6.1	4.8	4.8	6.0	6.7
Loans [b]	%YoY	14.4	1.2	3.6	5.4	3.5	3.5	3.7	4.1	4.3	3.2	3.3	5.4
EUR/PLN	PLN	4.12	4.19	4.20	4.07	4.16	4.20	4.25	4.19	4.18	4.09	4.04	3.99
USD/PLN	PLN	2.96	3.26	3.16	2.97	3.15	3.22	3.21	3.08	3.07	3.00	2.94	2.86
CHF/PLN	PLN	3.34	3.47	3.41	3.24	3.38	3.41	3.44	3.40	3.39	3.27	3.21	3.11
Reference rate [b]	%	4.50	4.25	2.50	3.00	3.25	2.75	2.50	2.50	2.50	2.50	2.75	3.00
WIBOR 3M	%	4.54	4.91	3.02	2.88	3.77	2.96	2.70	2.66	2.71	2.74	2.92	3.17
Yield on 2-year T-bonds	%	4.81	4.30	2.98	3.30	3.29	2.77	2.98	2.88	3.08	3.18	3.37	3.58
Yield on 5-year T-bonds	%	5.44	4.53	3.46	4.04	3.49	3.09	3.63	3.64	3.86	4.07	4.09	4.13
Yield on 10-year T-bonds	%	5.98	5.02	4.04	4.68	3.95	3.58	4.26	4.36	4.54	4.65	4.72	4.82

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; [a] in nominal terms, [b] at the end of period

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EXPLANATION OF THE RECOMMENDATION SYSTEM

DIRECTIONAL RECOMMENDATIONS IN BONDS		**DIRECTIONAL RECOMMENDATIONS IN SWAPS**	
	Definition		**Definition**
Long / Buy	Buy the bond for an expected average return of at least 10bp in 3 months (decline in the yield rate), assuming a directional risk.	**Long / Receive fixed rate**	Enter a swap receiving the fixed rate for an expected average return of at least 10bp in 3 months (decline in the swap rate), assuming a directional risk.
Short / Sell	Sell the bond for an expected average return of at least 10bp in 3 months (increase in the yield rate), assuming a directional risk.	**Short / Pay fixed rate**	Enter a swap paying the fixed rate for an expected average return of at least 10bp in 3 months (increase in the swap rate), assuming a directional risk.

RELATIVE VALUE RECOMMENDATIONS	
	Definition
Long a spread / Play steepeners	Enter a long position in a given instrument vs a short position in another instrument (with a longer maturity for steepeners) for an expected average return of at least 5bp in 3 months (increase in the spread between both rates).
Short a spread / Play flatteners	Enter a long position in given an instrument vs a short position in other instrument (with a shorter maturity for flatteners) for an expected average return of at least 5bp in 3 months (decline in the spread between both rates).

FX RECOMMENDATIONS	
	Definition
Long / Buy	Appreciation of a given currency with an expected return of at least 5% in 3 months.
Short / Sell	Depreciation of a given currency with an expected return of at least 5% in 3 months.

NOTE: Given the recent volatility seen in the financial markets, the recommendation definitions are only indicative until further notice.

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