Bank Zachodni WBK

Weekly economic update

28 January – 3 February 2013

The set of much better than expected data from Germany (ZEW, PMI, Ifo), decent quarterly results of US companies (among others by Google, IBM) and the fact that this week commercial banks will pay back only €137bn to the ECB (from over €1trn borrowed around a year ago in two 3Y LTROs) were supporting global moods during the whole past week. Still, this was not reflected on the Polish FX market. Depreciation of the domestic currency due to clearly below market consensus data on retail sales confirmed our opinion that currently internal factors are much more important for the zloty than global events. Polish bonds gained, mainly due to strong demand at auctions.

After a domination of European data releases, this week investors' attention is likely to switch to US events. The minutes of December's FOMC meeting revealed that some members suggested termination of bond buying program at the end of this year. For this reason, the market will closely watch a statement from January's meeting of the US central bank, looking for clues on the outlook for QE3. Additionally, many macro data will be released (with the advance Q4 GDP data in the foreground), which might be helpful to determine the direction where the world's biggest economy is heading. Flash data on Polish GDP for 2012 will show that during the last year the performance of domestic economy clearly faded and in the last quarter the pace of GDP growth was clearly below 1%. In our opinion domestic data shall (again) confirm the persistence of economic slowdown (minutes from the last MPC meeting showed some Council's members still need further evidence for that) and may support Polish bonds.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (28 January)					
14:30	US	Durable goods orders	Dec	%MoM	1.7	-	0.8
16:00	US	Pending home sales	Dec	%MoM	0.6	-	1.7
		TUESDAY (29 January)					
10:00	**PL**	**GDP**	**2012**	**%YoY**	**2.0**	**1.8**	**4.3**
15:00	US	S&P/Case-Shiller home price index	Nov	%MoM	0.6	-	0.7
16:00	US	Consumer confidence index	Jan	pts	64.0	-	65.1
		WEDNESDAY (30 January)					
14:15	US	ADP report	Jan	k	165	-	215
14:30	US	Advance GDP	Q4	%YoY	1.2	-	3.1
20:15	US	Fed decision		%	0.0-0.25		0.0-0.25
		THURSDAY (31 January)					
14:00	**PL**	**Inflation expectations**	**Jan**	**%YoY**	**-**	**-**	**3.4**
14:30	US	Personal income	Dec	%MoM	0.8	-	0.6
14:30	US	Consumer spending	Dec	%MoM	0.3	-	0.4
14:30	US	Core PCE	Dec	%MoM	0.1	-	0.0
14:30	US	Initial jobless claims	week	k	350	-	330
		FRIDAY (1 February)					
2:45	CN	PMI – manufacturing	Jan	pts	52.0	-	51.5
9:00	**PL**	**PMI – manufacturing**	**Jan**	**pts**	**48.6**	**49.1**	**48.5**
9:53	DE	PMI – manufacturing	Jan	pts	48.8	-	46.0
9:58	EZ	PMI – manufacturing	Jan	pts	47.5	-	46.1
11:00	EZ	Flash HICP	Jan	%YoY	2.2	-	2.2
14:30	US	Non-farm payrolls	Jan	k	155	-	155
14:30	US	Unemployment rate	Jan	%	7.8	-	7.8
16:00	US	ISM – manufacturing	Jan	pts	50.5	-	50.7

Source: BZ WBK, Reuters, Parkiet, Dow Jones

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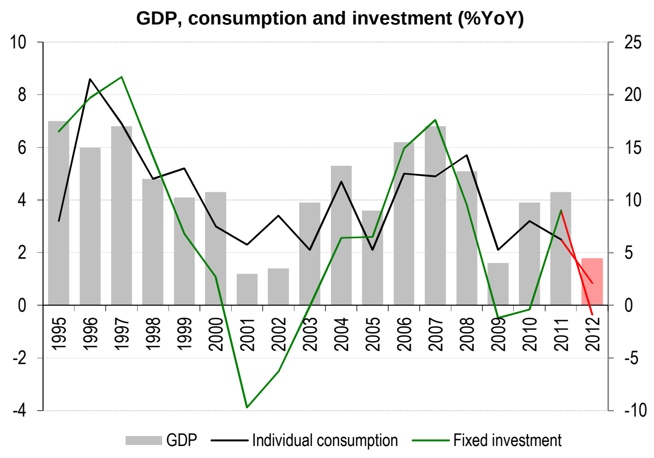
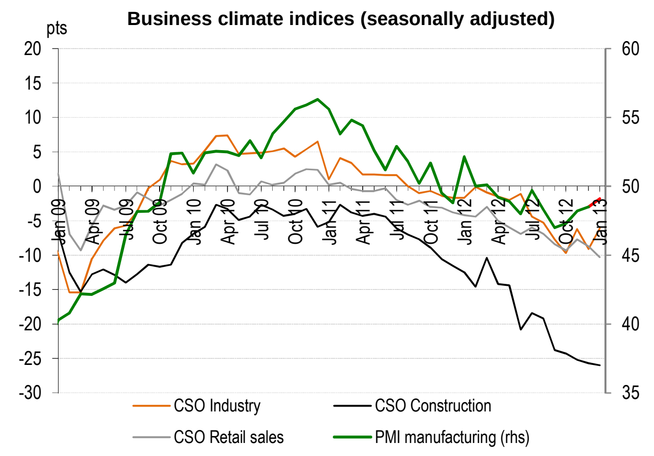
What's hot this week – Low GDP, slight increase of PMI



▪ After recent row of very weak economic data for December some analysts have revised down their GDP growth estimates for 2012, towards our forecast, which until recently was the most pessimistic on the market. Yet, most of the forecasts still sit above our prediction at 1.8%, which is suggesting that a release in line with our estimate may have an important impact on market quotations.

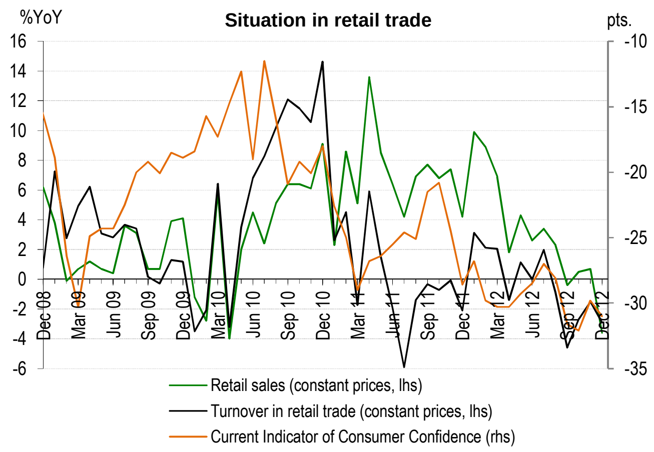
▪ The whole-year result at 1.8% will imply a strong deceleration of economic growth in the fourth quarter to ca. 0.5%YoY. This rapid slowdown of growth at the year-end was in our view primarily due to collapse in domestic demand – decline in investments and inventories and stagnation of consumer demand. Still, some positive contribution to the GDP growth was delivered by net exports.



▪ CSO business climate indicators (seasonally adjusted) recorded in January further drops in most economic sectors. Export-oriented branches: transport and industrial manufacturing were an exception. We are expecting that the PMI index, reflecting economic activity in the manufacturing sector, will post a slight increase in January, taking cue from economic activity gauges in Germany and in the euro zone. Still, pace of growth of industrial output will stay, according to our flash estimates, in negative territory (in spite of higher number of working days), confirming that the situation in the Polish industry in Q1 is still unfavourable.

▪ Households' inflation expectations probably posted another drop in January, mainly due to a marked decline of inflation recorded during the survey (from 3.4%YoY to 2.8%YoY).

Last week in the economy – Collapse of consumer demand



▪ Retail sales plunged in December by 2.5%YoY in current prices and by 3.6%YoY in real terms. Such a disappointing result, much below forecasts, was mainly due to a collapse on car market (-12.4%YoY), but it has to be noted, that growth rate decelerated in most categories, this showing a broad-based weakening of consumer demand, resulting from declining real incomes and uncertain situation of the labour market.

▪ Weak consumer sentiment in January (leading indicator of consumer confidence at the lowest level since March 2009) is showing that we cannot count for a considerable improvement of demand at the beginning of 2013.

▪ Registered unemployment rate climbed in December to 13.4%, suggesting further deterioration of labour market situation. One should expect further increase of unemployment rate (above 14% in January).

Quote of the week – No risk of return of inflationary trends

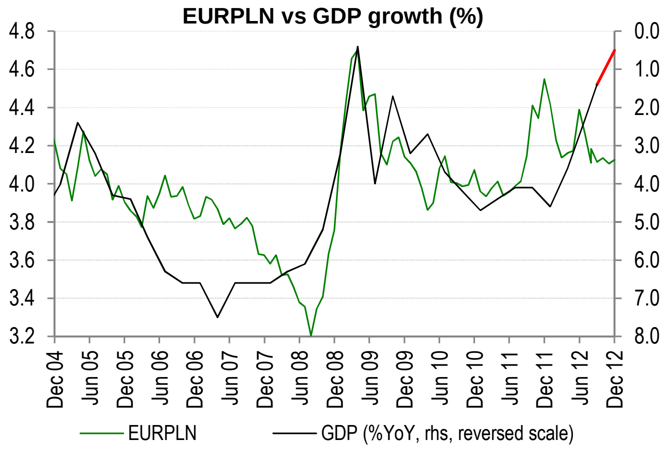
Marek Belka, NBP President, PAP, 23.01
In monetary policy we are trying to balance between keeping positive real interest rate and not allowing the disparity between Poland and, say, the euro zone, to grow too big.

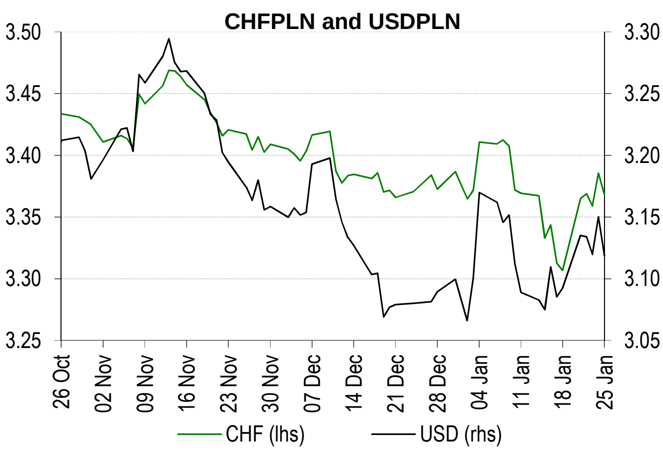
Jerzy Hausner, MPC member, PAP, 21.01
It should be noticed that for the first time for a long time we have met the target. Forecasts show that today there is no risk that we will face a return of inflationary trends. (...) If the next projection, which will arrive in March – despite interest rates made so far – would maintain this scenario, then it will certainly justify further policy easing. (...) As regards February, I don't know what I will vote for. Both a rate cut and keeping rates on hold is possible.

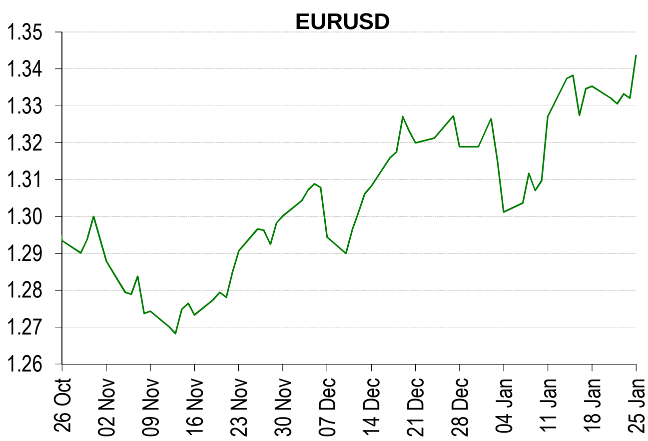
Adam Glapiński, MPC member, Reuters, 21.01
I will probably back the interest rate cut in February, then a pause.

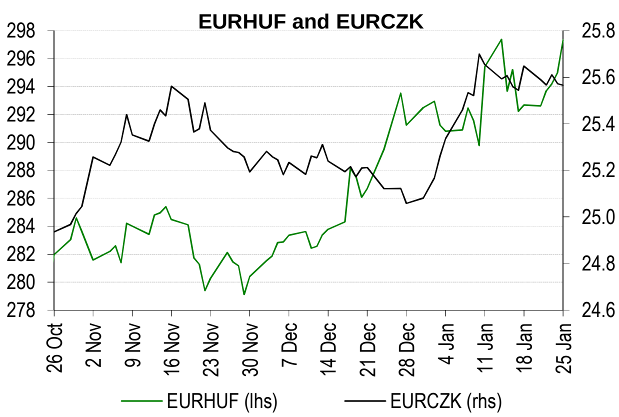
According to the minutes of the last MPC meeting, in January some MPC members thought that further cuts will not affect the economic activity so they are not necessary. Some stated that core inflation in 2013 "would probably stay elevated considering this business cycle stage" (please recall that core inflation fell from 1.8% to 1.4% in January!). Still, most MPC members did not rule out further cuts, depending on the upcoming data, especially on GDP. Meanwhile, recent data from the domestic economy are clearly suggesting that a pause in easing cycle makes no sense, and data on GDP will confirm these conclusions. Thus, interest rate cut in February seems very likely, especially as even these MPC members, who earlier did not support easing, did not rule out such a move.

Foreign exchange market – Further EURPLN increase after GDP data?









Zloty is closer and closes to 4.20 per euro

▪ Last week the zloty was more dependent on domestic macro data releases than on situation in global markets. Significant decline in retail sales resulted in the zloty deprecation, in which the EURPLN increased towards 4.20 (the highest level since the beginning of September 2012). On the other hand, investors' mood improvement on global market due to better than expected leading indicators for Germany was rather ignored by market players.

▪ In relation to other main currencies, the zloty slightly strengthened in relation to GBP (by only 0.2% in weekly terms), while it lost 0.8% against the US dollar and 1.9% against the CHF. One should notice that thanks to upward move of the EURUSD, the USDPLN rate fell to near 3.10.

▪ Despite the zloty weakening last week, technical situation on the EURPLN chart has remained unchanged. This week investors on the financial markets focus on the 2012 GDP data, which will be released on 29 January. Our forecast at 1.8%YoY is below market consensus, which was slightly revised downward to 2.0%YoY from 2.1%YoY expected at the beginning of January. If our scenario materialises, we do not exclude the EURPLN to increase above 4.20 (current strong resistance level). Breaking this level would open the room for further increase towards 4.24. The first support level for the rate is at 4.15.

EURUSD is close to 1.35, supported by data and ECB

▪ Last week brought further strengthening of the euro. It came from better than expected readings of leading indicators for Germany (ZEW, PMI, Ifo indices). The EURUSD, after some consolidation slightly below 1.34, on Friday broke that level and increased towards 1.35. The upward move was supported by information from the ECB, which informed that 287 commercial banks decided for earlier repayment of LTRO, paying back €137.2bn.

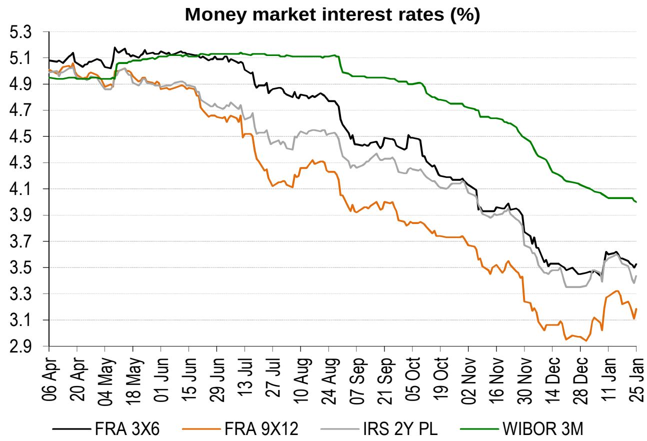
▪ This week investors' attention will focus on the US market – preliminary reading of the Q4 GDP data, Fed's meeting, non-farm payroll data. We do not exclude some profit taking after euro strengthening in last days. However, we think that the EURUSD decline below strong support level of 1.3350 might result in change of trend.

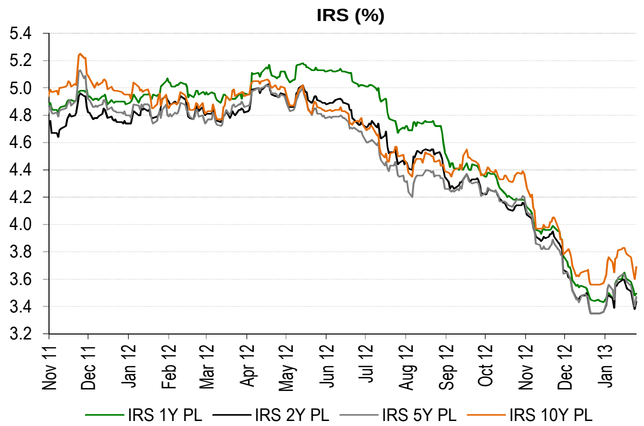
The Hungarian currency still under pressure

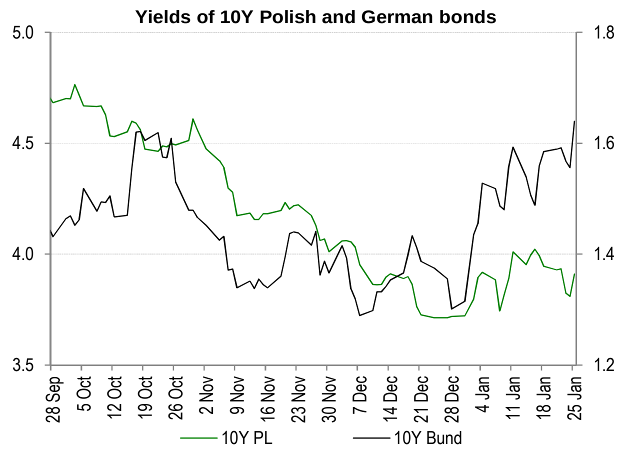
▪ Last week the CZK quotations were relatively stable in weekly changes. The Hungarian currency, as the Polish zloty, was under pressure of domestic factors. During the Friday's session the EURHUF increased slightly above 298 (the highest level since the mid of 2012). Information that Hungary repaid IMF loan tranche worth €607m of 2008 loan ahead of time was ignored by the market. The HUF reacted negatively on the weak retail sales data (decline by 4.1%YoY in November).

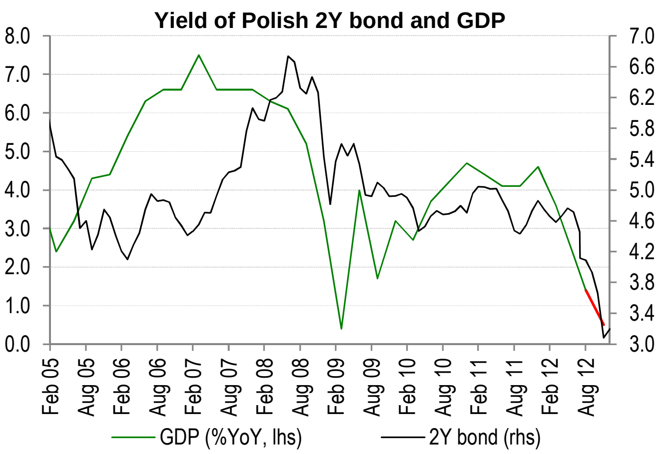
▪ This week the most crucial will be the NBH meeting. It is widely expected the bank to cut rates by other 25bps, trimming the reference rate to 5.50% from 5.75% currently. We do not exclude the EURHUF to increase further towards 300.

Interest rate market – GDP data may reinforce yields' downward trend









Lower scale of decline of WIBOR

- During the past week money market rates declined by 2 to 4 bps, biggest move was recorded in case of 6M rate. It is worth to notice that since the January's meeting of the MPC the weekly pace of decline of WIBOR rates clearly faded. In the previous week this was only 1bps (3M and 6M rates were even stable) while earlier (in December and at the very beginning of 2013) the average weekly scale of decline was 9bps.
- Slower pace of decline of money market rates may be due to the change of market expectations regarding the scale of rate cuts by the MPC after the January's meeting. Since late August the 3M WIBOR declined by 111bps while NBP rates were reduced by 75bps.

Successful auction supported Polish bonds…

- Domestic bond curve moved down during the past week by 5-11bps, most visibly in case of the short- and medium-term bonds. The biggest impact on the market was provided by the very successful auction of bonds. December's data on retail sales supported the downward trend persisting on the market. 10Y bond pared some part of gains on Friday due to higher yields of 10Y Bund (after German data).
- The Ministry of Finance successfully tapped a new 2Y bonds OK0715 worth PLN1.3bn (on both standard and top-up auctions) with yield at 3.285% and 5Y benchmark PS0418 worth PLN12.4bn with yield at 3.437%. Total demand on both auctions amounted to PLN28.1bn (in which on 5Y bonds - PLN23.2bn). According to the Ministry of Finance a record high demand was generated by both domestic and foreign investors. After yesterday's auction the 2013 borrowing requirements are financed in ca. 40% and scenario presented by the Ministry that after Q1 2013 it will be 50% is most likely.

… and data on GDP may strengthen this trend

- During the first two weeks of 2013, yields of Polish bonds surged by 30bps for 2Y and 10Y sectors and by 40bps in case of 5Y ones. In reaction to dovish data on inflation and poor data on industrial output and retail sales the upward momentum was reversed. Since mid-January yields declined by 20bps for 2Y and 5Y and 13bps for 10Y (at the end of this week Polish bonds pared some gains due to weaker 10Y Bund after German data).
- IRS followed the downward move of yields, though in this case the scale of a decline was quite equal along the curve (by 16-17bps for 2Y and 5Y and 14bps for 10Y since mid-January and ca. 10bps for the whole curve this week).
- This week's data on Polish GDP for 2012 may provide positive impulse for bonds. Data will confirm that during the last year the performance of domestic economy clearly faded and in the last quarter the pace of GDP growth was clearly below 1%. Such data may (again) strengthen expectations for more rate cuts, including the February's one. This will be another very weak release for Polish economy in a very short period of time and the publication may strengthen the downward trend of yields observed since two weeks. If optimism persists on the global market (continuation of upward move of Bund's yields), then long-end of the curve may benefit only slightly from the release. Regarding other tenors, yields may approach levels seen in late December 2012.