

Weekly economic update

25 February – 3 March 2013

Last week was rich in events and information important for the financial markets. The positive message delivered by considerable improvement of ZEW and Ifo business climate surveys for Germany was offset by the weaker-than-forecast flash PMI indices and downward revision of European Commission's forecasts, suggesting slower economic growth and worse fiscal outlook for many EU countries, including Poland. Still, as regards our country, the higher path of fiscal deficit (3.4% of GDP in 2013 and 3.3% in 2014) does not necessarily have to prevent the European Council from lifting the excess deficit procedure in the spring, which was admitted by the Commissioner Olli Rehn. Domestic data on industrial output was better than expected, but – similarly as data from the labour market – they were distorted by statistical effects – so it is difficult to agree with MPC's Adam Glapiński, who said that they were "the light in the tunnel". The market was more significantly affected by Fitch's decision to upgrade Poland's rating outlook to positive than by the data. Some MPC members view this decision as an additional argument for a rate cut in March. Others think that there is no more room for interest rate cuts. Even though we think that a deeper one-off cut as an ending move in the cycle would be a good decision, we will probably see again a compromise of -25bps and a declaration of a 'wait-and-see' mode.

Results of elections in Italy will influence the market moods at the beginning of the week. In the following days we will see a row of data crucial from the point of view of the global recovery prospects. Domestic data on retail sales should be supportive for the zloty, but this again will be an erratic signal (data under influence of delayed payments for farmers). Change in the PMI index will be a hint on how much is the revival in German economy translating into orders for Polish industry.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (25 February)							
2:45	CN	Flash PMI – manufacturing	Feb	pts	-	-	52.3
10:00	PL	Retail sales	Feb	%YoY	0.7	3.0	-2.5
10:00	PL	Unemployment rate	Fed	%	14.2	14.2	13.4
TUESDAY (26 February)							
15:00	US	S&P/Case-Shiller home price index	Dec	%MoM	0.5	-	0.6
16:00	US	Consumer confidence index	Feb	pts	60.6	-	58.6
16:00	US	New home sales	Jan	k	380	-	369
WEDNESDAY (27 February)							
14:30	US	Durable goods orders	Jan	%MoM	-4.7	-	4.3
16:00	US	Pending home sales	Jan	%MoM	1.8	-	-4.3
THURSDAY (28 February)							
11:00	EZ	HICP	Jan	%YoY	2.0	-	2.0
14:00	PL	Inflation expectations	Feb	%YoY	-	-	2.7
14:30	US	Preliminary GDP	Q4	%QoQ	0.5	-	3.1
14:30	US	Initial jobless claims	week	k	360	-	362
FRIDAY (1 March)							
2:45	CN	PMI – manufacturing	Feb	pts	-	-	52.3
9:00	PL	PMI – manufacturing	Feb	pts	49.0	49,2	48.6
8:53	DE	PMI – manufacturing	Feb	pts	50.1	-	49.8
9:58	EZ	PMI – manufacturing	Feb	pts	47.8	-	47.9
10:00	PL	GDP	Q4	%YoY	0.9	1,0	1.4
10:00	PL	Fixed investments	Q4	%YoY	-	-0,4	-1.5
10:00	PL	Private consumption	Q4	%YoY	-	-1,0	0.1
11:00	EZ	Flash HICP	Feb	%YoY	2.0	-	-
14:30	US	Personal income	Jan	%MoM	-2.0	-	2.6
14:30	US	Consumer spending	Jan	%MoM	0.2	-	0.2
15:55	US	Michigan index	Feb	pts	76.3	-	73.8
16:00	US	ISM – manufacturing	Feb	pts	52.5	-	53.1

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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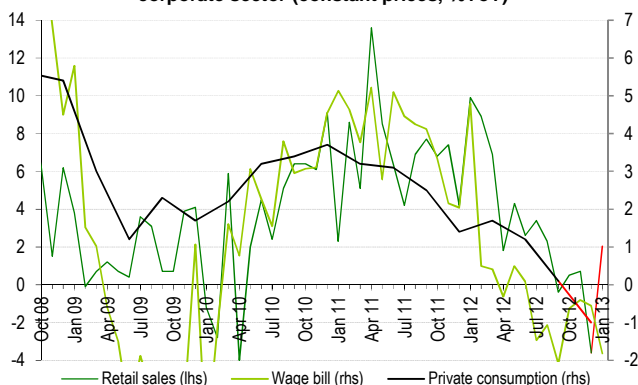
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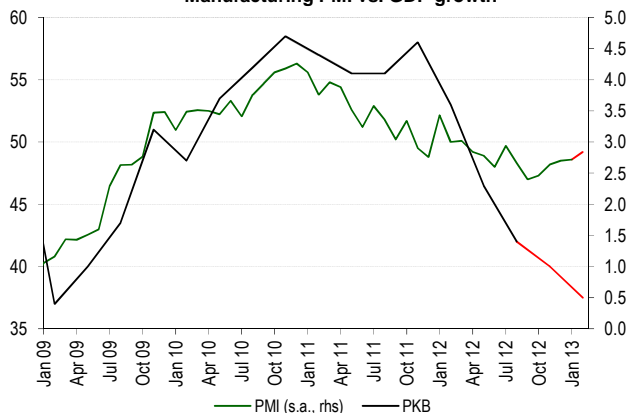
What's hot this week – Rebound in retail sales in January, weak consumption in Q4

Retail sales, private consumption, wage bill in corporate sector (constant prices, %YoY)



- We are expecting a rebound in retail sales in January to +3.0%YoY from -2.5%YoY in December. In our view December's data were lowered by a delay in payments of farmers' direct subsidies and we will see a reversal of this effect in January. Our forecast is underpinned by a strong rise in car sales, shown by SAMAR.
- Registered unemployment rate climbed in January to 14.2% in January (our prediction is in line with Ministry of Labour and Social Policy). This will be the highest reading since January 2007.
- PMI index for manufacturing probably posted a fifth growth in a row in February, but still running below neutral level of 50pts. We are expecting an improvement of new export orders subindex, which – in our view – will be the main driver of the whole index in the upcoming months.

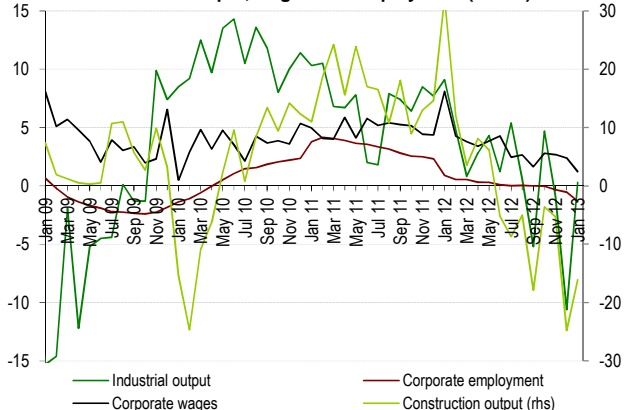
Manufacturing PMI vs. GDP growth



- Based on data for the entire year, we estimate that GDP growth in Q4 decelerated to ca. 1%YoY (from 1.4%YoY in Q3). According to our calculations, individual consumption plunged by ca. 1%YoY in Q4 and this was the first quarter since mid-nineties (i.e. since quarterly GDP data are available), with negative annual pace of consumption growth. On the other hand, investments surprised on the upside, as they contracted by only ca. -0.5%YoY (versus -1.5%YoY in Q3). Contribution of net exports to GDP growth in Q4 was, according to our estimates, still positive, but slightly lower than in the previous quarter.
- We think that data on private consumption in the last quarter of 2012 do not fully reflect the underlying trends. The decline (as in case of retail sales) could have been caused by a delay in payment of direct subsidies for farmers. Consumption growth will remain weak in the upcoming quarters.

Last week in the economy – Better than expected in industry, weak on the labour market

Industrial output, wages and employment (%YoY)



- Average employment in corporate sector fell in January by 0.8%YoY, while wage growth decelerated to a mere +0.4%YoY. Data on employment were distorted by effect of CSO's sample recalculation, and wage statistics by high base from January 2012 (earlier bonus payments due to hike of disability contribution), but they still show that labour market situation does not give many reasons for optimism.
- Output in construction fell in January by 16.1%YoY. Situation in this sector is still very negative and we expect no recovery in the upcoming quarters.
- Data on January's industrial output surprised on the upside, showing an increase by 0.3%YoY. Still, improvement against December was partly due to working days effect and it is too early to say, based on these figures, that Polish industry is recovering.

Quote of the week – March's MPC meeting is particularly important

Jerzy Hausner, MPC member, Reuters, 21.02

March's MPC meeting is particularly important, not only as regards decision on interest rates. More important is that we agree how to end the current monetary easing cycle (...) There can be a situation that we will be forced to hike rates unnecessarily high if we go too low right now.

Elżbieta Chojna-Duch, MPC member, Reuters 20.02

It would be optimal to end the cutting cycle in April at 3%. Later 'wait and see' mode. (...) Cut in March may not find enough votes, which would not be favourable for the economy.

Andrzej Bratkowski, MPC member, TVN CNBC, 18.02

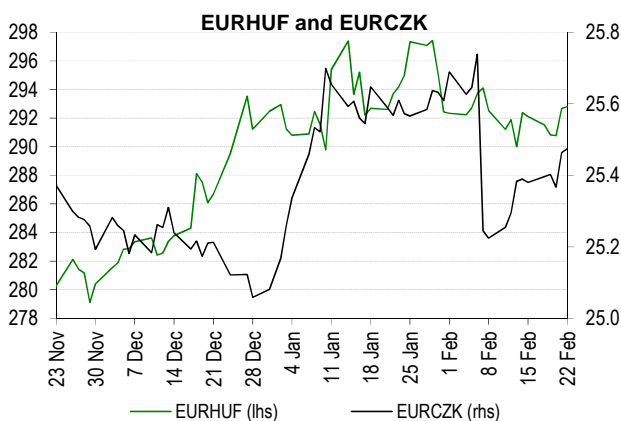
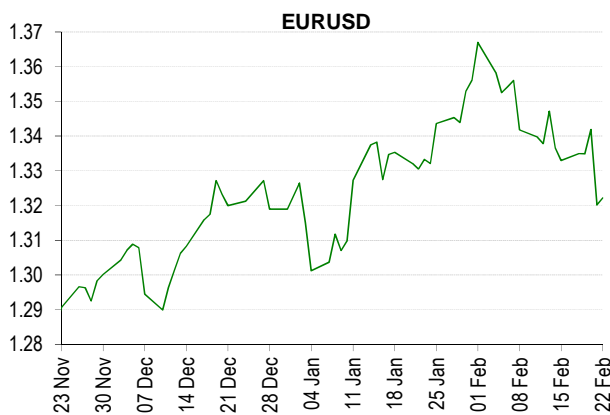
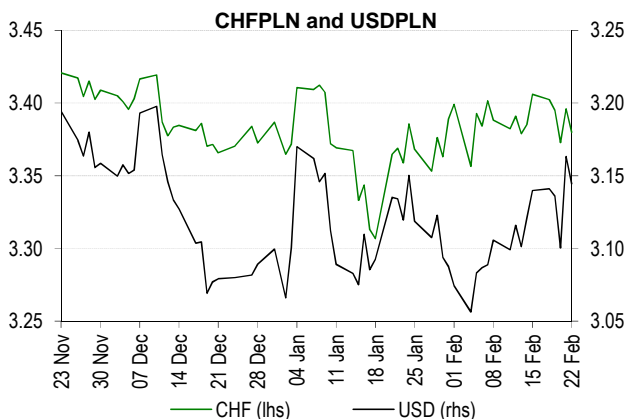
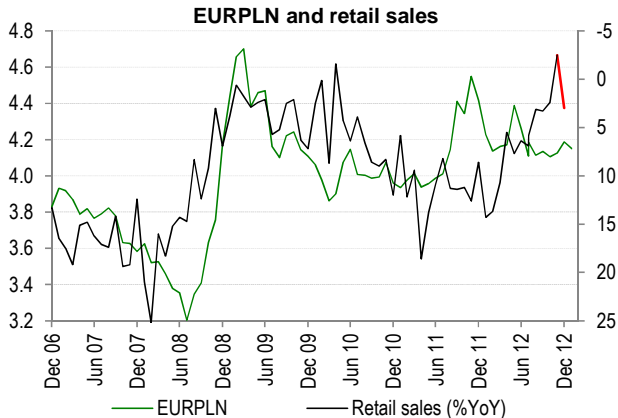
As regards current economic situation, interest rate is too high, there is room for a cut to 3%.

Jan Winiecki, MPC member TVN CNBC, 18.02

I can hardly see any room (for cuts).

Numerous last week's comments of the MPC members have been reiterating an opinion, expressed earlier by Marek Belka: March's MPC will be important, the Council should clearly define (and communicate to the markets) the rates strategy for the upcoming months, and what level of rates is adequate for the economy. As for the time being, MPC members' opinions on this matter vary significantly – hawks (Winiecki, Glapiński) see no manoeuvre for rate cuts, but doves (Bratkowski, Chojna-Duch) find it clear that the NBP rate should be reduced to 3% as soon as possible. What do other think? Even though we think that a deep one-off cut as an ending move would be a good decision, we doubt if such a motion will gain majority. Elżbieta Chojna-Duch even doubted if there will be majority to support any cut at March's meeting. Still, we think that a cut will actually be implemented, but again only by 25bps and will be accompanied by a declaration of a 'wait-and-see' mode.

Foreign exchange market – Polish data may support the zloty



Retail sales data may support the zloty

▪ The situation on the EURPLN did not change significantly during the past week. The exchange rate first approached the upper band of range trading (4.20), but due to domestic data and decision of Fitch at the end of the week the EURPLN was close to support at 4.14-4.15. USDPLN surged to the highest level since mid-December (temporarily slightly above 3.17) due to euro's weakening versus the dollar.

▪ Data to be released in Poland this week may be again better than expected (after higher industrial production). We expect the January's retail sales may surprise on the upside. Together with latest data from industrial sector and comments of MPC members (it seems that the market pays attention mainly to the headlines suggesting the end of the easing cycle is looming, and less to the fact that a cut is possible in March) the Monday's publication may support the zloty versus the euro. The market impact of this data may be strengthened by last decision of Fitch. Data on GDP shall not trigger any move of the EURPLN as this will have only a historical character.

▪ Since the end of January the EURPLN stays in the wide range of 4.14-4.21 and if our forecast proves correct, then the lower band of this range may be tested.

Results of Italian election vital for the euro

▪ The EURUSD stayed in the downward trend during the past week. Depreciation of the single currency was initiated by hawkish minutes from last Fed's meeting and weaker than expected flash PMI for Germany and the euro zone. Consequently, the EURUSD reached temporarily ca. 1.315, lowest level since first decade of January, below vital support at just above 1.33.

▪ Investors hope that after Italian elections there will be a possibility of creating a coalition that will continue reforms started by PM Monti. If those expectations materialize, then the euro may benefit versus the dollar. Upcoming week will be rich of US data. Given minutes from last Fed's meeting, any disappointing releases may not necessarily trigger deterioration of global sentiment as this may be interpreted as a rationale for not terminating (limiting) the QE3 in 2013.

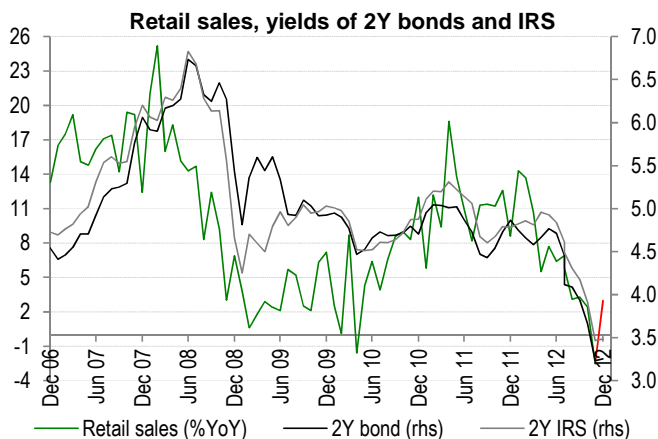
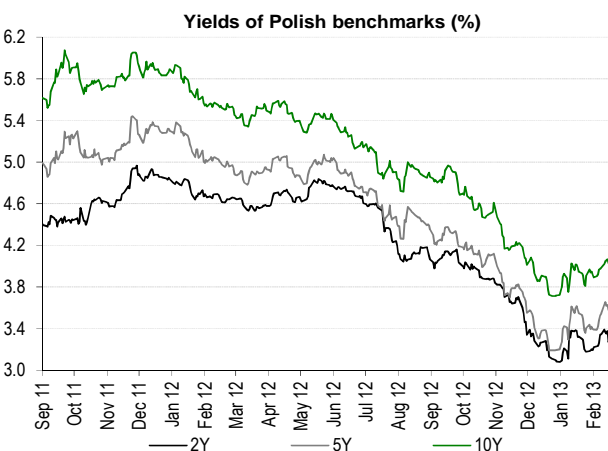
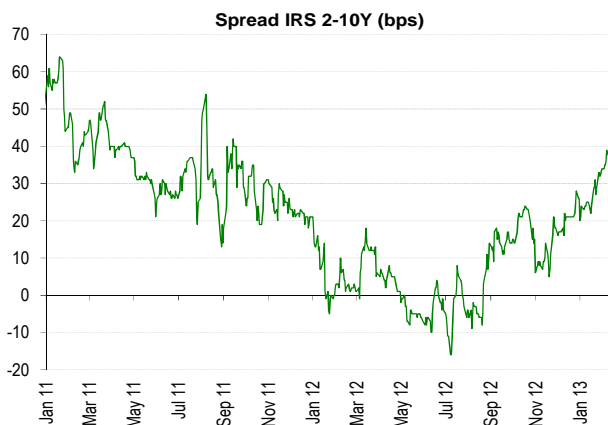
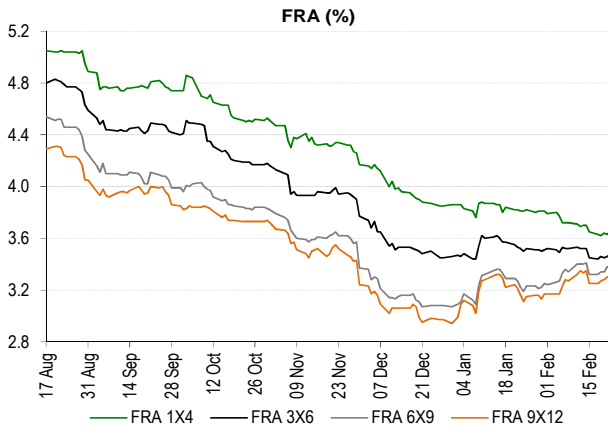
▪ The EURUSD broke the support at ca. 1.332 and next vital level is at 1.307.

European data hit koruna

▪ PMI for German and euro zone's manufacturing constrained expectations for a rebound of the export-oriented economy of Czech Republic. The market interpreted this as rising changes for the intervention of the central bank to weaken the koruna. Consequently, the EURCZK increased from 25.3 to 25.5.

▪ On the Hungarian FX market no major changes occurred. The forint depreciated slightly amid deterioration of global market sentiment. The EURHUF increased from 291 to 294. On Tuesday the Hungarian monetary policy council will decide on the interest rates (a rate reduction by 25bps to 5.25% is expected) while on Friday the PM Orban will name the new central bank governor.

Interest rate market – Retail sales may push the short end of the curve up



Further decline of WIBOR and continuation of higher FRA

During the past week the 3-12M WIBOR rates reached fresh all-time lows, 3M rate at 3.70%. Weekly scale of the decline amounted to 3bps for 12M WIBOR and 5bps for 6M and 9M WIBOR. Comments of MPC members indicating the end of the easing cycle is looming had no visible impact on the money market rates.

FRA market was clearly much more volatile. Better than expected data on industrial output for January and comments of MPC members pushed FRA6x9 and FRA9x12 up by 2bps and 3bps, respectively. On weekly basis these rates increased by 5bps and 6bps, respectively.

Fitch decision supports Polish debt

At the beginning of the past week positive sentiment that emerged after the CPI data persisted on the market. There was no reaction to labour market data. Interestingly, there was also no bigger move after better than expected data on industrial output – only some marginal weakening was recorded amid very thin trade volume. Also comments of the MPC members (suggesting the upcoming end of the easing cycle and possible lack of rate cut in March) did not trigger any more visible weakening of the short end of the curve.

The event that had biggest impact on Polish long term debt was decision of Fitch that upgraded outlook of domestic rating. Earlier in the week, Moody's released the report saying that the external imbalance of Polish economy constrains the potential for a change of rating. After decision of Fitch the yield of 10Y domestic bond plunged by 7bps, to 3.97%.

The IRS curve flattened slightly; the move came after a week when the 2-10 spread reached the highest level since September 2011 (+39bps). The scale of changes was muted. Yield at the short end of the curve increased slightly after macro data while long end moved down after decision of Fitch. The trend for further flattening of the curve may be continued in the coming days, particularly after Monday's data on retail sales.

Data and supply plan in the spotlight

This week investors' attention will be focused on macro releases. The data on retail sales may surprise to the upside (out forecast is clearly above market expectations) and this may be next impulse for higher yields after recent decline triggered by decision of Fitch. GDP data shall not have much impact on the market due to showing rather too distant historical perspective.

At the end of the week the Ministry of Finance will show its supply schedule for March. One may expect that next to standard auction the Ministry will decide to carry the switch auction at which it will attempt to repurchase PS0413 and OK0713. There is currently PLN20.5bn and PLN13.4bn respectively outstanding on the market. As the sentiment improved after Fitch decision, the Ministry may decide to offer 10Y bond at the switch.

At the last day of February the Ministry will publish data on bond holdings among group of investors at the end of January.

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