Bank Zachodni WBK

Weekly economic update

25 – 31 March 2013

Situation of Cyprus was the main driver of global market development during the last week. Lack of agreement on bailout package caused a major rise in risk aversion. Business climate indexes for the euro zone and for Germany disappointed, as they recorded drops after a few months of increases. Still, this does not mean that euro zone's economic outlook deteriorated significantly, but causes that investors may become more vulnerable to the upcoming data from the real economy. Nevertheless, information on the PMI, similarly as the message of the Fed meeting, were overshadowed by upcoming news about Cyprus. The pessimism, present throughout the week, has undermined the zloty and other CEE currencies. Domestic data showed that sentiments remain cold in the Polish economy, and singular upward surprises (like January's retail sales or February's wages) were due only to one-off distortions. In general, the data were rather weak, confirming our assumptions that the economic situation was still deteriorating in Q1. However, we still hope that an economic thaw will begin in Q2 and from that moment on we will see a gradual yet sluggish warming of economic climate.

The case of Cyprus will remain crucial factor the market this week. ECB announced that if there is no final deal on bailout until Monday, then it halts the liquidity provision for Cyprian banks. This would lead to sudden collapse of the national banking system and would increase the risk of Cyprus leaving the euro zone, hence fuelling the global risk aversion. Reaching an agreement with Troika (which we expect) should have a positive impact on global moods. Set of US data (final 3Q GDP, consumer spending and income and housing market releases) may influence market expectations regarding the time of ending the QE3. This week Hungarian and Czech central banks will make decisions on interest rates. This will be a debut of Matolcsy as a new governor of Hungarian central bank and investors will watch closely whether he will be willing to run excessively loose monetary policy. No important data will arrive in Poland.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (25 March)					
		No important data releases					
		TUESDAY (26 March)					
13:30	US	Durable goods orders	Feb	%MoM	3.9	-	-4.9
14:00	HU	Decision of Hungarian Central Bank		%	5.00	-	5.25
14:00	US	S&P/Case-Shiller home price index	Jan	%MoM	1.0	-	0.9
15:00	US	Consumer confidence index	Mar	pts	68.3	-	69.6
15:00	US	New home sales	Feb	k	425	-	437
		WEDNESDAY (27 March)					
15:00	US	Pending home sales	Feb	%MoM	-0.9	-	4.5
		THURSDAY (28 March)					
13:00	CZ	Decision of Czech Central Bank		%	0.05	-	0.05
13:30	US	Final GDP	Q4	%QoQ	0.5	-	3.1
13:30	US	Initial jobless claims	week	k	338	-	336
14:00	**PL**	**Current account**	**Q4**	**€m**	**-**	**-3436**	**-3367**
		FRIDAY (29 March)					
13:30	US	Personal income	Feb	%MoM	0.8	-	-3.6
13:30	US	Consumer spending	Feb	%MoM	0.6	-	0.2
13:30	US	Core PCE	Feb	%MoM	0.1	-	0.1
14:00	**PL**	**Inflation expectations**	**Mar**	**%YoY**	**-**	**-**	**2.2**
14:55	US	Michigan index	Mar	pts	72.8	-	71.8

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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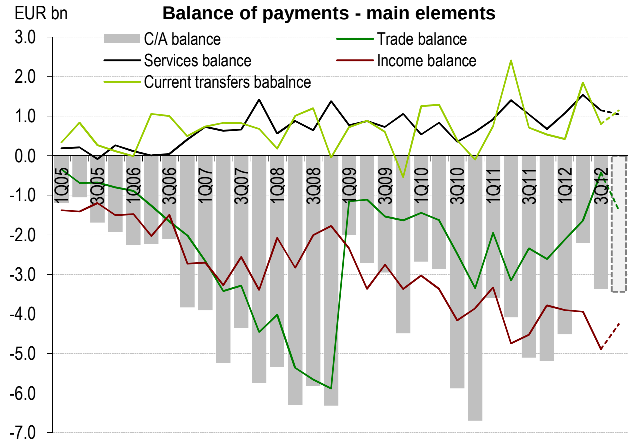
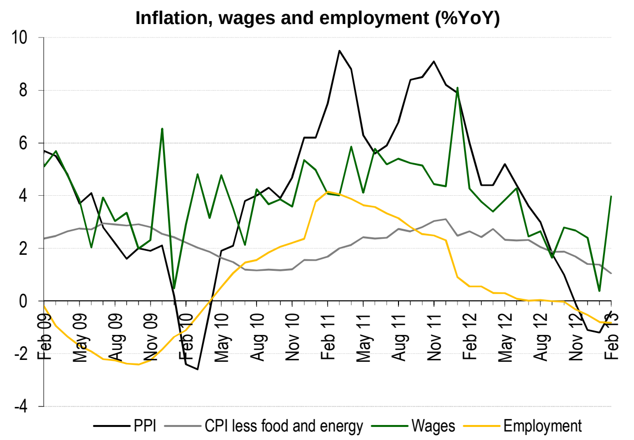
What's hot this week – Quarterly data on balance of payments, inflation expectations

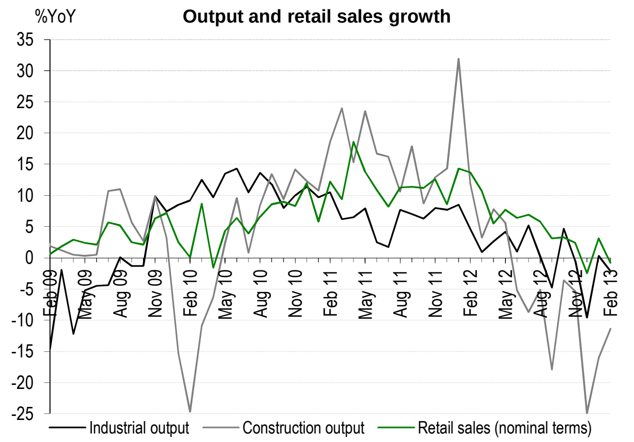


- There are no important data releases in domestic macroeconomic calendar this week.
- As usual, the quarterly data on balance of payments might show some revisions as compared with monthly releases. In our view these figures will show a slight widening of current account deficit in Q4 versus Q3, but it will remain significantly lower than one year ago.
- We guess that data on Poland's foreign debt and international investment position at the end of 2012 may be more important, especially for the foreign investors.
- We are expecting further declines of households' inflation expectations. They will probably slide to ca. 1.5% in March, which will be another factor showing lack of inflationary pressures in the Polish economy.

Last week in the economy – No spring in the Polish economy



- Wage growth in corporate sector accelerated in February to 4%YoY, while employment fell by 0.8%YoY. The higher-than-predicted wage growth was mainly the effect of low statistical base from February 2012. Situation in the labour market is still weak – in the nearest months the growth in employment will remain below zero amid still very limited growth in wages. On the other hand, real wage bill growth accelerated, in line with expectations. Still, we believe that private consumption growth will be capped by rising households' saving rate.
- As we expected, registered unemployment rate climbed in February to 14.4%.
- In line with expectations, February saw further fall in core inflation, although the pace of decline proved even faster than we expected.



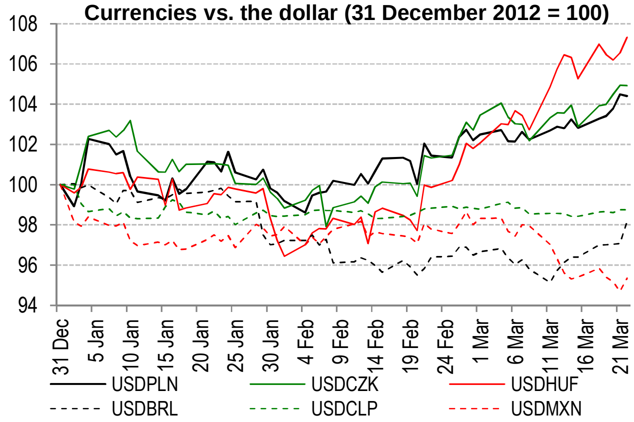
- Industrial output declined in February by 2.1%YoY and by 2.4%YoY after seasonal adjustment. Construction and assembly output recorded another deep contraction (by 11.4%YoY). The pace of drop was lower than in last two months, but two-digit plunges were recorded in all branches of construction.
- Retail sales dropped in February by 0.8%YoY. The data confirmed that the rebound of retail sales in January (to +3.1%YoY) was a one-off effect and the underlying consumers' demand remains weak at the beginning of 2013.
- All in all, these data confirm that slowdown of the Polish economy has continued in 1Q, but the pace of deterioration is abating. We do not change our forecast of GDP growth in 1Q at 0.5%YoY. We still expect this to be a trough of the cycle.

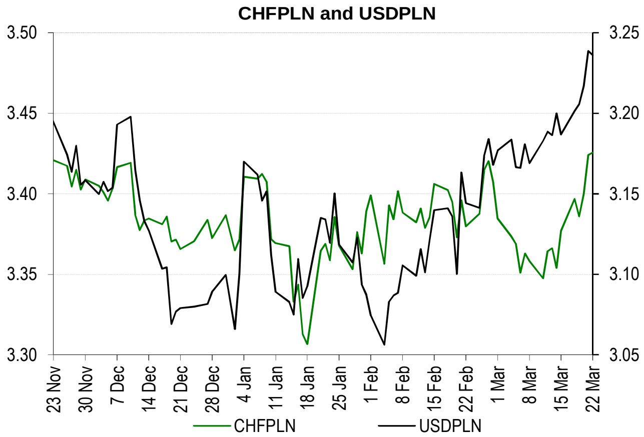
Quote of the week – If data will be worse, then room for cuts will appear

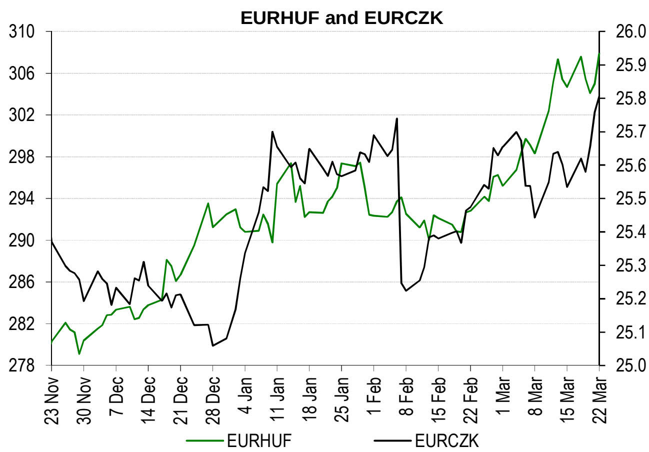
Anna Zielińska-Głębocka, MPC member, Reuters, 19.03
We have to see what happens in the economy in Q1 and Q2. In my view we should wait until July's projection and this will be the right moment to change either the rates or the bias.
Andrzej Bratkowski, MPC member, TVN CNBC, 20.03
I am a pessimist. It is not sure if we will see a recovery in H2. If it turns out that data incoming in the nearest one or two months will be worse than expected in the projection, then some room for further cuts may appear, maybe in May, maybe in June.
Minutes from the March;s MPC meeting
A few Council members did not rule out the possibility of a further interest rate adjustment, should the incoming data point to weaker economic activity or lower inflation than in the March projection.

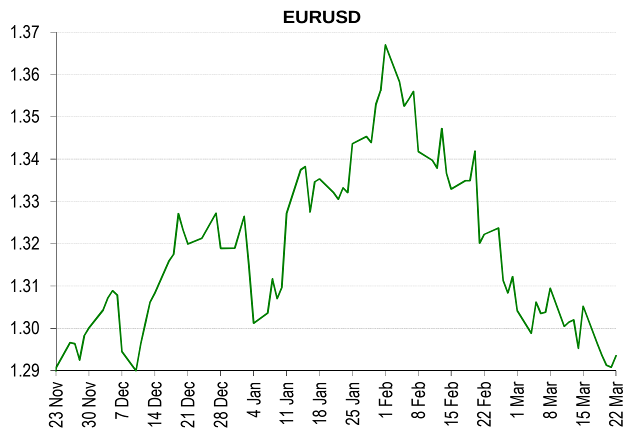
Minutes of the last Monetary Policy Council meeting showed that some members are not ruling out further rates adjustment, should either the growth or the inflation prove lower than expected by the NBP projection. Comments from the recent weeks show that this may be an opinion of at least four MPC members. We are expecting that the inflation path will lie below this projected, at least in the short-term and our forecasts were confirmed in the last days. We are still anticipating that GDP growth will be more or less in line with projection, but recent data from the real economy (and deterioration of activity indexes abroad) are fuelling uncertainty about pace of recovery. Change of interest rates in April is very improbable, but if upcoming data are similarly negative as the recent ones, then the MPC may seriously consider whether to cut in May-June.

Foreign exchange market – Decisions of CEE central banks vital for the zloty









CEE currencies under pressure

▪ During the past week market conditions were highly unfavourable for CEE3 currencies. The risk aversion fuelled by situation in Cyprus has been putting negative pressure on the zloty, Czech koruna and Hungarian forint since the very beginning of the week. Additionally, currencies were hit by disappointing data from Europe (PMI, Ifo) and factors specific for particular countries. In Poland, expectations for more rate cuts continue to weigh on the zloty, koruna is under pressure of possible intervention of central bank and political situation in Hungary has negative impact on forint. Furthermore, S&P cut outlook for Hungarian rating to negative. Consequently, EURPLN broke 4.19, EURHUF increased above 308 and EURCZK above 25.85 (two latter exchange rates reached the highest levels since January 2012).

▪ The first chart shows exchange rates since the beginning of the year, i.e. when the upward wave on the US stock exchange started and pushed Dow Jones to all-time high. It is visible that the uncertainty regarding further developments in Europe amid more and more signals from the US indicating clear improvement of situation (the unemployment rate lowest for 4 years) determines that currencies of countries with tighter economic relations with the USA perform better than the CEE currencies. We do not see much room for stronger zloty in the nearest future. Only in coming months, if the economic growth is recorded in more countries of the euro zone and NBP rate cuts became less likely, the domestic currency may start to gain gradually.

▪ This week Czech and Hungarian central banks are holding their rate-setting meetings. Recently, the forint was under pressure of expectations for excessive easing of monetary policy that may be conducted under new governor of the central bank (and former minister of economy). The statement form the meeting will show whether investors' worries were justified. Until then, the forint is likely to stay under pressure and this should also weigh on the zloty. Important levels for this week for the EURPLN are 4.16 and 4.20-4.214.

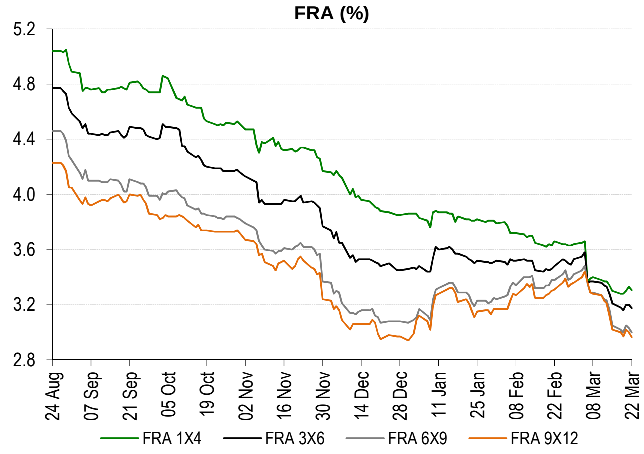
Cyprus in the spotlight

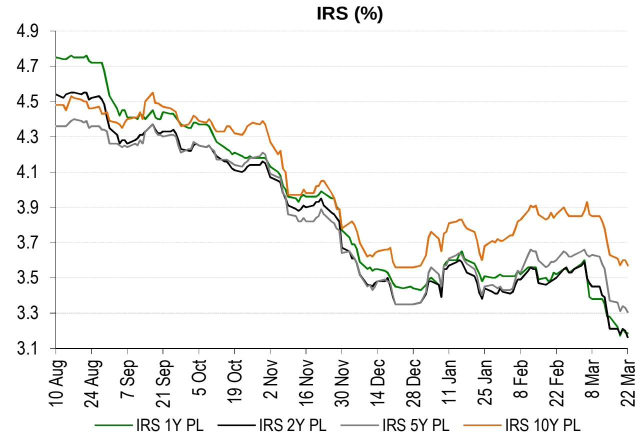
▪ Controversial idea on imposing tax on deposits in Cyprus caused EURUSD to open with a downward gap compared to closing level from the past week (1.296 vs. 1.308). Investors worried that acceptance for such a solution would trigger massive withdrawals of bank deposits in other euro zone's countries if the debt crisis strengthens considerably due to the case of Cyprus. In the following days the exchange rate stayed in the range of 1.284-1.296 and only at the end of the week reached temporarily 1.30 after rumours that deal on aid may be reached within a few hours.

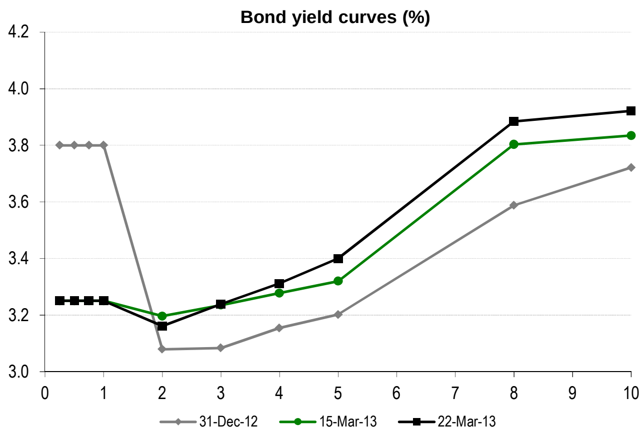
▪ The ECB announced it will provide liquidity to Cypriot banks until Monday. Further actions of the European central bank will be dependent on final deal on aid for Cyprus. Thus, the case of Cyprus – just like during the past week – may be the most important factor for the market after the weekend and is likely to show direction for the EURUSD at least in the coming week.

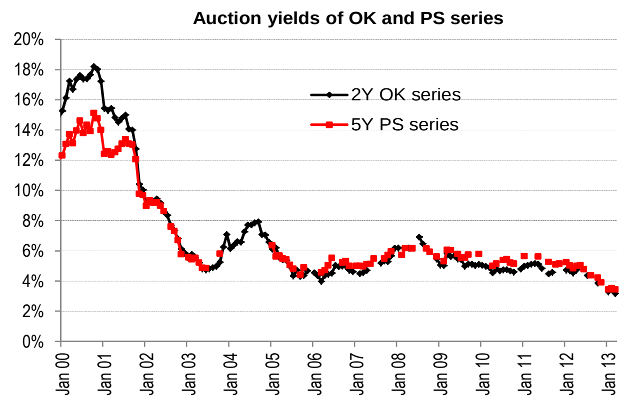
▪ In the following days many US macro data will be released. The Fed indicated in the statement from the last meeting that the unemployment rate remains high and it does not plan to end QE3 soon. US data may have some impact on the market, but just like we pointed above, the situation on the Cyprus shall be key.

Interest rate market – Higher volatility in the last week of 1Q









Lower WIBOR, FRA rates are pricing-in further cuts

▪ Last week brought further declines in both WIBOR (to fresh minimum levels) and FRA rates. Renewed interest rate cuts expectations, supported by MPC members' statements pushed FRA9x12 below 3% at the beginning of the week. However, this move was only short-lived and in the following days the rate stabilized around 3%, showing that in investors' opinion the MPC might reduce official interest rates later this year.

▪ Strengthening belief that the Council may continue monetary policy easing (currently FRA market is pricing-in rate cut by nearly 50bps in 9 months period) will support further gradual decline in WIBOR rates in coming days/weeks, including WIBOR 3M decline towards 3.35% at the end of March.

Macro data support the front end of curves

▪ Last week the front ends of curves strengthened, underpinned by positive reaction after CPI inflation reading and then by weaker-than-expected retail sales figure for February. Consequently, IRS 2Y reached a new all-time low, while yield of 2Y T-bond declined below 3.15% after retail sales release.

▪ Situation on the long end of the curve was more vulnerable to investors' mood on core markets. 10Y sector was more volatile, depending on the news flow. Still, Bund strengthening has supported Polish 10Y paper, stabilizing its yield slightly above 3.90%.

▪ Widening of asset swap spread in 10Y sector (to nearly 35bps, the highest level since the beginning of October 2012) caused some sell-off of floating-rate T-bonds. One should notice that some investors used the opportunity of falling prices to cumulate these bonds.

Costs of T-bonds issue lower and lower

▪ Poland's Ministry of Finance successfully launched bonds OK0715 and PS0418 worth PLN8.1bn (with demand at PLN11.2bn in total). T-bonds were sold with the lowest yields in history at 3.17% for 2Y and 3.432% for 5Y (slightly below levels on the secondary market).

▪ Auction results clearly suggest that demand was generated by both foreign and domestic investors. Piotr Marczak, the head of Public Debt Department in Ministry of Finance said that auction results confirmed investors' assessment of Poland as a local safe haven.

▪ This week will be the last one of the month and of the quarter. It might generate higher volatility on the market, in particular as investors' activity will be subdued due to Easter holiday. However, the Ministry of Finance will publish its issuance plan for 2Q 2013. The Ministry is in a comfortable situation as an issuer due to the completion rate at 60% of this year borrowing requirements target. This gives also a lot of flexibility to offer T-bonds. April's supply will be higher in comparison with value of offered bonds in the following months. It will be a result of high liquidity inflow in the coming months due to redemptions of PS0413 worth PLN16bn and coupon payments from April's series of PS and WS worth ca. PLN8bn. Current amount outstanding of PS0418 (worth PLN24.3bn in total) suggests that the Ministry can offer a new 5Y benchmark in 2Q 2013 and in this way it will try to activate demand in 5Y sector.

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