Bank Zachodni WBK

Weekly economic update

1 – 7 April 2013

Last-minute deal between the Cypriot government and Troika, reached late night on Sunday, had positive, yet temporary impact on market moods last week. Investors got really concerned that the way of solving problems in Cyprus (restructuring banks at expense of creditors rather than taxpayers) could become a template for potential future actions in other troubled countries. Moreover, the political gridlock in Italy had increasingly negative impact on moods, as unsuccessful efforts to form a ruling coalition may finally result in necessity to hold another election in June. Operation of opening Cypriot banks after two-week closure succeeded without major problems, which – together with encouraging data from the US – contributed to improvement of moods at the end of the week (S&P500 on Thursday broke all-time record from 2007).

In the first week of April the number of data releases and events in Poland will be very limited – the only important publication is the PMI index for manufacturing, which in our view will confirm that March saw no major revival in this sector. Moreover, activity of investors in the domestic market may be limited in expectation for the next meeting of the Monetary Policy Council. However, the nearest days in global markets may be actually quite busy. Indicators of activity in manufacturing and services will be important hints regarding pace of economic growth in world's most important economies. Also, data from the US labour market will be crucial, not only because they will hint about condition of the economy, but also because they may shape investors' expectations regarding pace of potential Fed's withdrawal of the QE3.

Domestic macro calendar, excluding PMI, is light this week. Therefore we expect the zloty to stay under influence of external factors, including macro data and news from Italy. Uncertainty on the global market still prolongs, thus we foresee the EURPLN to be traded between 4.15-4.20. On the interest rate market the still alive interest rate cuts expectations should support front ends of curves, while the long end will depend on the situation on Bunds.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		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
14:00	**PL**	**Inflation expectations**	**Mar**	**%YoY**	**-**	**-**	**2.2**
14:55	US	Michigan index	Mar	pts	72.8	-	71.8
		MONDAY (1 April)					
	PL	**Easter Monday**					
3:45	CN	PMI – manufacturing	Mar	pts	51.5	-	50.4
16:00	US	ISM – manufacturing	Mar	pts	54.2	-	54.2
		TUESDAY (2 April)					
9:00	**PL**	**PMI – manufacturing**	**Mar**	**pts**		**48.9**	**48.9**
9:53	DE	PMI – manufacturing	Mar	pts	48.9	-	50.3
9:58	EZ	PMI – manufacturing	Mar	pts	46.6	-	47.9
16:00	US	Industrial orders	Feb	%MoM	2.5	-	-2.0
		WEDNESDAY (3 April)					
11:00	EZ	Flash HICP	Mar	%YoY	1.6	-	1.8
14:15	US	ADP report	Mar	k	198	-	198
		THURSDAY (4 April)					
9:53	DE	PMI – services	Mar	pts	51.6	-	54.7
9:58	EZ	PMI – services	Mar	pts	46.5	-	47.9
13:00	GB	BoE decision		%	0.50	-	0.50
13:45	EZ	ECB decision		%	0.75	-	0.75
14:30	US	Initial jobless claims	week	k	-	-	
		FRIDAY (5 April)					
12:00	DE	Industrial orders	Feb	%MoM	1.0	-	-2.5
14:30	US	Non-farm payrolls	Mar	k	190	-	236
14:30	US	Unemployment rate	Mar	%	7.7	-	7.7

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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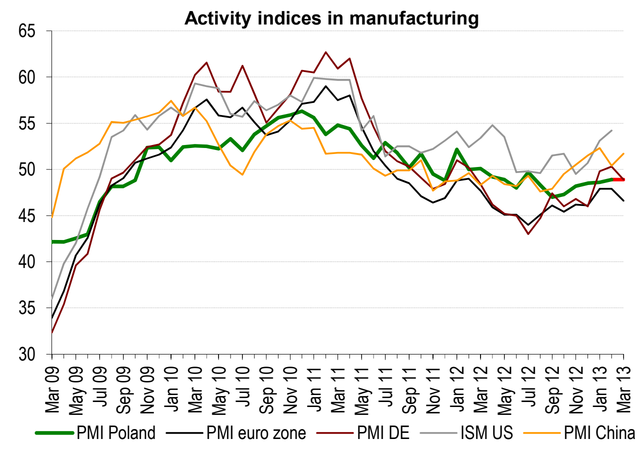
What's hot this week – Decline of PMI?

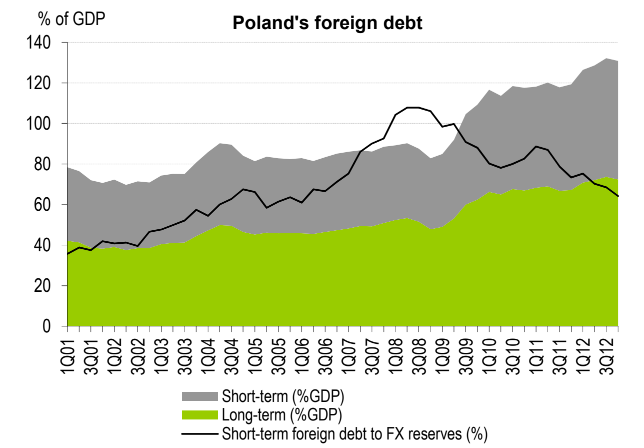


▪ Shortly after Easter the market will focus on final PMI releases for European manufacturing. Flash estimates proved to be surprisingly weak, awaking worries about economic recovery in the euro zone. Let us remind that one month ago final estimates were markedly revised upwards after disappointing flash readings.

▪ PMI report for Poland will be a single important domestic release this week. A significant deterioration of moods in European economies may break the six-month long upward march of the domestic index (mainly due to deterioration of export orders), but decrease should be small, if any. Our forecasts indicate a stabilisation of the gauge on February's level.

▪ Apart from the PMI, a row of important data will be released abroad, including employment figures in the USA.

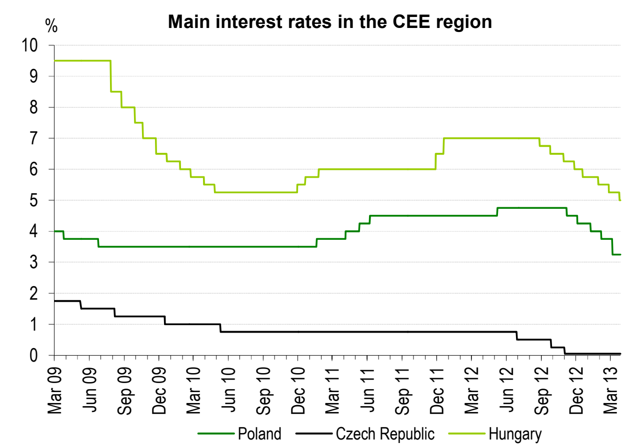
Last week in the economy – Hungarian central bank did not surprise



▪ Current account deficit for 4Q 2012 amounted to €3.48bn, slightly more than monthly data showed. On the other hand, the 12-month cumulated deficit to GDP ratio declined to 3.5% from 4.1% after 3Q, to lowest level since 2005.

▪ Polish foreign debt reached all-time high at the end of 2012 and amounted to €276bn. The increase in the final quarter of the year was driven mainly by the government sector. Still, compared to GDP, the ratio declined slightly – to 72.3% from 73.6% after 3Q.

▪ Same tendencies were recorded in case of Polish international investment position. Its negative balance increased to -€256.2bn while in relation to GDP it declined slightly (to 67.1%), but this is still one of bigger numbers in history.



▪ The Hungarian central bank, in line with expectations, cut interest rates by 25bps, to the lowest level in history (5.00%). Market worried that the new governor (and former minister of economy) will be implementing excessively loose monetary policy. That is why lack of surprise as regards scale of the cut and no announcements of additional economic stimulus were supportive for the forint.

▪ Czech central bank did not change rates at its meeting in March and – according to the central bankers – these will remain at all-time low (0.05%) for a longer time, unless a considerable inflationary pressure emerges. However, a rather opposite tendency is expected, so the governor Singer did not rule out further monetary easing in shape of FX intervention aimed at weakening the koruna.

Quote of the week – End of the cutting cycle or only a pause?

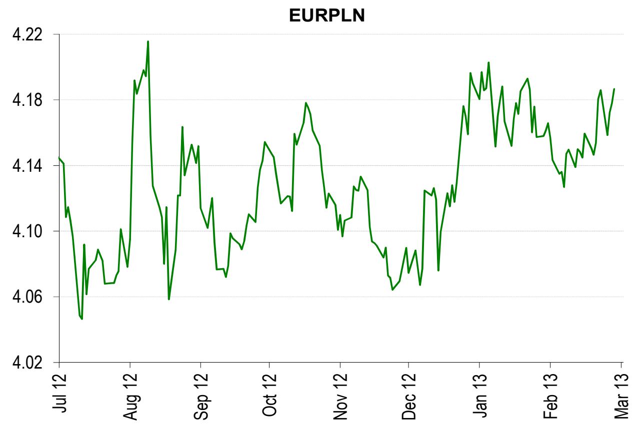
Andrzej Bratkowski, MPC member, Radio PiN, March 26
If we conclude that a rebound (in economy) is not coming, then in my opinion there is room for more rate cuts. However, if we see some signs of recovery, then it is likely to be the end of the cycle.

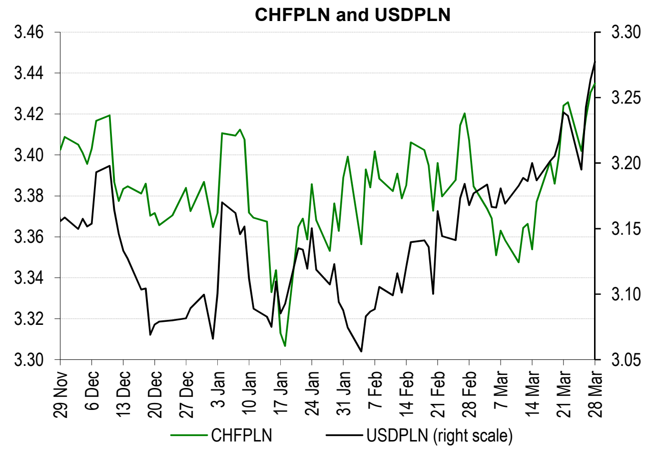
Anna Zielińska-Głębocka, MPC member, TVN CNBC, March 27
I don't expect (lack of VAT reduction) will be decisive for the MPC. (…) It seems to me there is still some space for rate cuts, but we want to see what short-term effects of our actions are. It is worth to wait, but it is hard to say whether this will be 2-3 months.

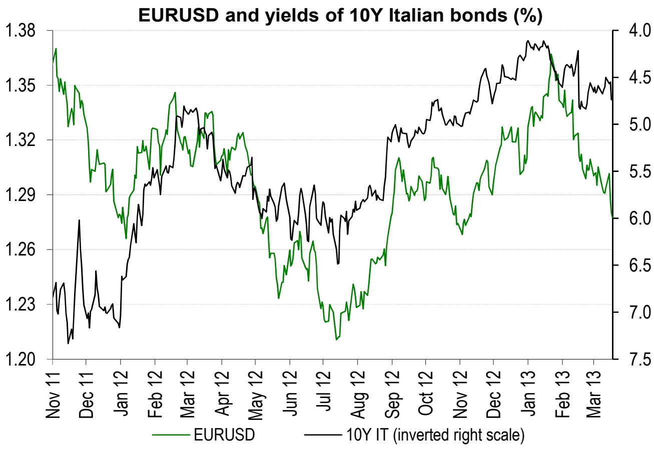
Donald Tusk, Polish PM, Reuters, March 26
Unless a radical improvement of economic situation in H2 occurs, the reduction of VAT rates in 2014 seems unlikely.

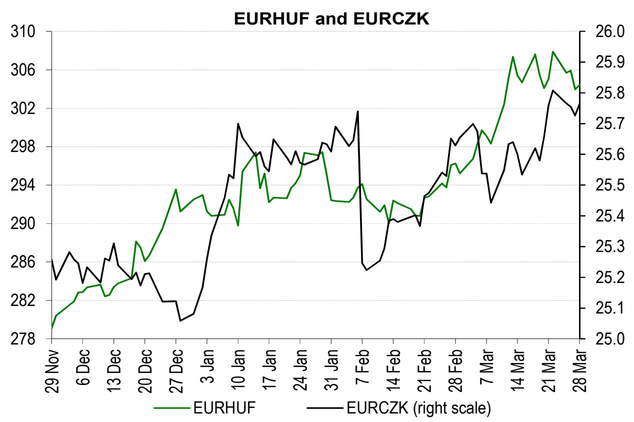
MPC members are reiterating that their further decisions will depend on the fact if upcoming data confirm chances for economic recovery later in the year. The question remains, however, how long would the MPC members like to wait with their assessment of the situation. A. Zielińska-Głębocka and A. Bratkowski suggested recently that maybe 2-3 months of pausing will be enough. Most probably, some members will be eager to wait with decisions until July's projection. We are still assuming that if the MPC does not cut until July, then there will be difficult to find majority willing to support more easing, as signals of economic recovery will remain more obvious. Even the most dovish A. Bratkowski admitted that such a scenario will constitute and end of cutting cycle. At the same time, new NBP projection may show a higher CPI path in the upcoming year, among others due to lack of VAT cut in 2014 (projection assumed that such a cut will be implemented).

Foreign exchange market – Zloty in horizontal trend









Zloty is under pressure of global mood

▪ The beginning of the week was relatively optimistic (as Cyprus and Troika reached a deal) for the zloty. However, increasing worries about resurgence of the euro zone debt crisis have negatively influenced the domestic currency. Consequently, the EURPLN increased towards 4.19 – this level was tested during Thursday's session, but market was not strong enough to break it.

▪ To sum up, last week the EURPLN was traded between 4.15-4.19, while the USDPLN exchange rate was more vulnerable to global situation. The USDPLN increased slightly above 3.28 (up from 3.20 at the beginning of the week) during Thursday's session due to euro weakening against the US dollar (the EURUSD fell below 1.28). Zloty also lost against other main currencies, in which by 0.3% against the CHF and by nearly 1% against the GBP.

▪ Technical situation on the EURPLN does not change significantly. Worries about situation in Cyprus and Italy will strongly influence market mood. This together with expectations on the MPC's meeting in April should result in the EURPLN consolidation between 4.15-4.20 in coming days. The USDPLN might be more volatile. In our opinion the exchange rate might stay between 3.20-3.30, but we think the rate will be traded in the upper limit of the channel.

Situation on peripheries strongly affect the euro

▪ Situation on the global financial markets was very unstable last week. Information that Cyprus and Troika had reached a bailout deal supported the euro at the beginning of the week. However, during next days the fears returned, fuelling risk-averse mood. Investors have worried not only about Cyprus (on Thursday Cypriot banks have opened their doors again to customers), but also about Italy (attempts to form a new government collapsed, therefore risk of new election increased). Consequently, peripheries debt lost (results of Italian debt were weak), but also euro weakened against the main currencies. The EURUSD fell towards 1.275 (important technical support level), but it was rather a short-lived move and the exchange rate again increased above 1.28.

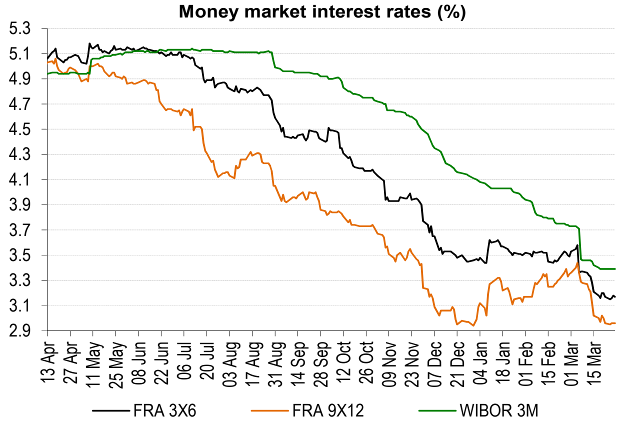
▪ Pressure on the euro still persists. In our opinion, consolidation channel between 1.28-1.32 is still valid. We think that breaking the support level at 1.275 will open the way to further decline below 1.27. In coming week the crucial events will be the ECB meeting and macro data releases (PMI indices, non-farm payrolls in the US). However, weak macro data for the euro zone might result in tests of this important support level.

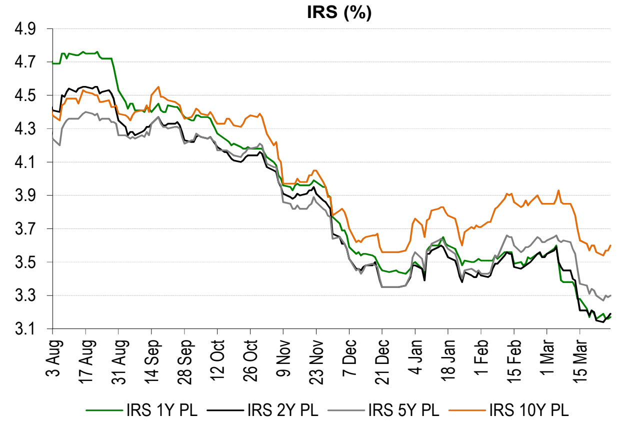
HUF under impact of central bank decision

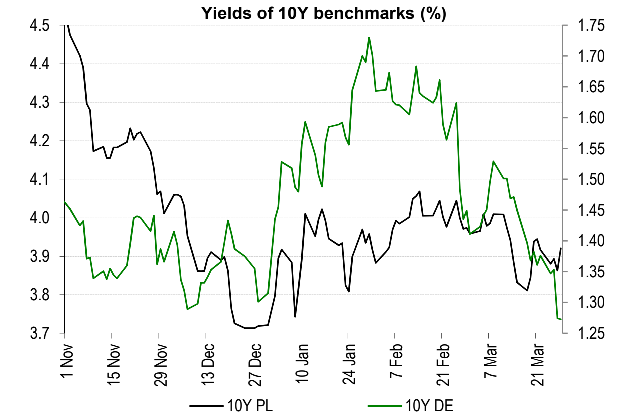
▪ Last week investors focused on meetings of Hungarian and Czech central banks. Decisions proved in line with expectations. In due course, the forint weakened temporarily, but later EURHUF returned to downward trend. Changes were inconsiderable in case of Czech koruna.

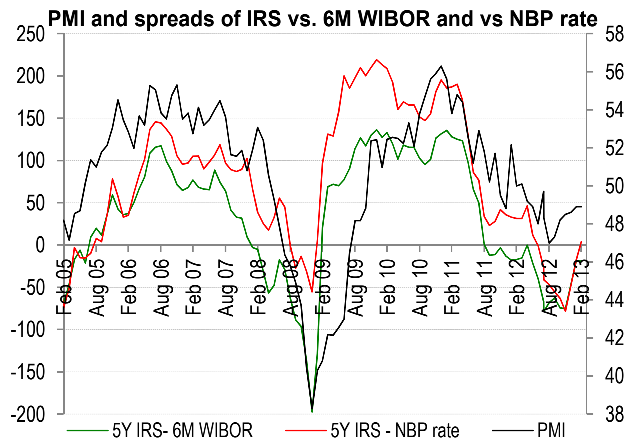
▪ This week situation of Hungarian and Czech FX markets should not change significantly. The forint will remain under pressure of expectations for further rate cuts, while EURCZK should remain rather stable.

Interest rate market – Stabilization ahead of data and MPC's comments









Stabilisation of WIBOR and FRA rates

▪ During four sessions of the week WIBORs 1-12M did not change, so they have been stable for 9 sessions in a row. WIBOR 1 and 3M sit at 3.39%, while 6-12M run at 3.40%. FRA also stabilized recently.

▪ It seems that the market – similarly as the MPC – decided to wait for next domestic macro data releases. The nearest significant publications are scheduled for the beginning of the next week (inflation), and we do not expect the PMI for manufacturing in March to affect the front end of the curve markedly. Some rise in volatility may be fuelled by MPC members' comments prior to the inflation release, but only as regards these members, whose views on further changes of rates are unclear for the market players.

High volatility on the bond market

▪ Even though bond yields are on levels observed one week ago, volatility was quite high during the last few sessions. Beginning of the week was marked by a continuation of yields' decline across the curve, due to disappointing data on retail sales and strengthening of Bunds. German bonds gained thanks to sentiment deterioration after decision on Cyprus. As a result, yield of 2Y paper was temporarily only 4bps above all-time low from the end of the year (3.12% versus 3.08%). However, in the following days a profit-taking occurred and yields returned to levels from last Friday.

▪ Last week showed that the longer end of the domestic bond curve is heavily dependent on core market situation. This week there are several data releases, which can affect the German debt. Flash PMI for manufacturing disappointed strongly, while non-farm payrolls surprised to the upside one month ago. Front end of the bond curve should remain rather stable while awaiting the data and possible comments of the MPC members.

IRS at the all-time low, again

▪ IRS with maturities between 1 and 10Y set new record lows (3.14% for 2Y, 3.27% for 5Y and 3.54% for 10Y), following falling bond yields. This week we will see PMI for March, but we do not expect that these data may cause a strong market reaction. However, it is worth noting that earlier the spread between IRS and WIBOR6M / NBP reference rate was following the business cycle. We are expecting – similarly as the market – that we will reach a bottom of the annual GDP growth in Q1. Thus, following quarters may bring further narrowing of spreads between IRS and WIBOR / reference rate (IRS market can begin to price-in improvement of economic situation and lower chances for interest rate reductions).

▪ Although we see some risk of more easing of monetary policy, our base-case scenario assumes stable NBP rates. Our forecasts of economic growth are roughly in line with NBP projections and the path of inflation may be higher in the medium term. Thus, we do not expect that motions for rate cuts at the scale the market is pricing-in find enough support. It is worth to notice the market has already priced in 50bps rate cut.