Bank Zachodni WBK

Weekly economic update

13 – 19 May 2013

Beginning of the week on financial markets was marked by rising uncertainty about the pace of global economic recovery (this was due to next weak readings of PMI indexes) and wave of further monetary policy easing by the central banks around the world. Official interest rates were cut not only but the ECB and the Polish MPC, but also by central banks of India, Australia, South Korea, Vietnam and Sri Lanka.

Polish Monetary Policy Council trimmed interest rates by 25bps because recent data have worsened the MPC's assessment of economic situation and lowered its expected inflation path. Marek Belka underlined that this was not the beginning of the new easing cycle but only a correction of March decision (when the MPC cut rates by 50bps and announced that it "complemented the cycle"). In our opinion, the move still does not mark the end of easing cycle and until July rates may be trimmed further by 25-50bps. Such scenario will be supported by next macro data (lower and lower inflation, lack of visible revival in the economy). However, we still think the market is pricing-in further policy easing (by nearly 100bps) too aggressively.

This week we will see new data supportive for further rate cut, especially CPI inflation and core inflation excluding food and energy prices, which, in our view, posted further considerable drops in April. Numbers showing surplus in trade balance and current account balance in March may underpin the zloty, but this effect will probably be weakened by the fact that improvement in balance was due mainly to weak imports, rather than strong exports. The CSO is going to release flash GDP data for Q1 for the first time in history. Market moods will be also affected by numerous releases abroad, which will verify market's expectations for global recovery.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (13 May)					
14:30	US	Retail sales ex autos	Apr	%MoM	-0.2	-	-0.4
		TUESDAY (14 May)					
10:00	**PL**	**Flash GDP estimate**	**1Q**	**%YoY**	**0.7**	**0.8**	**0.7**
11:00	EZ	Industrial output	Mar	%MoM	0.4	-	0.4
11:00	DE	ZEW index	May	pts	40.0	-	36.3
14:00	**PL**	**Money supply**	**Apr**	**%YoY**	**7.1**	**7.0**	**6.6**
		WEDNESDAY (15 May)					
8:00	DE	Flash GDP	Q1	%QoQ	0.3	-	-0.6
9:00	HU	Flash GDP	Q1	%QoQ	0.1	-	-0.9
9:00	CZ	Flash GDP	Q1	%QoQ	-0.1	-	-0.2
11:00	EZ	Flash GDP	Q1	%QoQ	-0.1	-	-0.6
14:00	**PL**	**CPI**	**Apr**	**%YoY**	**0.7**	**0.6**	**1.0**
14:00	**PL**	**Exports**	**Mar**	**€m**	**12 780**	**12 756**	**12 090**
14:00	**PL**	**Imports**	**Mar**	**€m**	**12 550**	**12 690**	**11 488**
14:00	**PL**	**Current account**	**Mar**	**€m**	**-33**	**146**	**602**
15:15	US	Industrial output	Apr	%MoM	-0.1	-	0.4
		THURSDAY (16 May)					
11:00	**PL**	**Bond auction**					
11:00	EZ	Flash HICP	Apr	%YoY	1.2	-	1.2
14:00	**PL**	**Core inflation**	**Apr**	**%YoY**	**0.8**	**0.8**	**1.0**
14:30	US	Initial jobless claims	week	k	330	-	
14:30	US	House starts	Apr	k	973	-	1036
14:30	US	Building permits	Apr	k	942	-	907
16:00	US	Philly Fed index	May	pts	2.4	-	1.3
		FRIDAY (17 May)					
15:55	US	Flash Michigan	May	pts	78.0	-	76.4

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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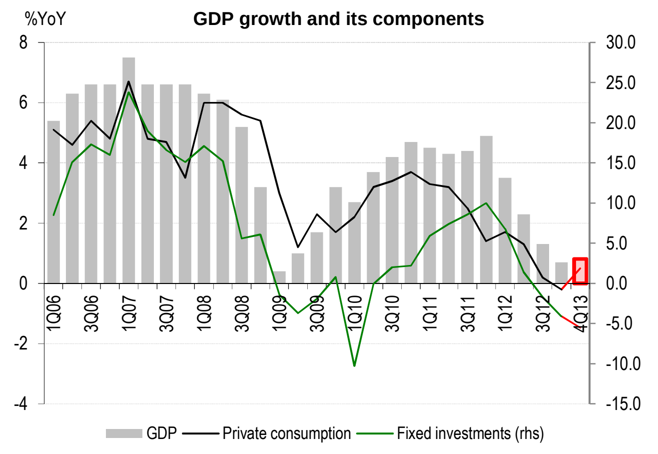
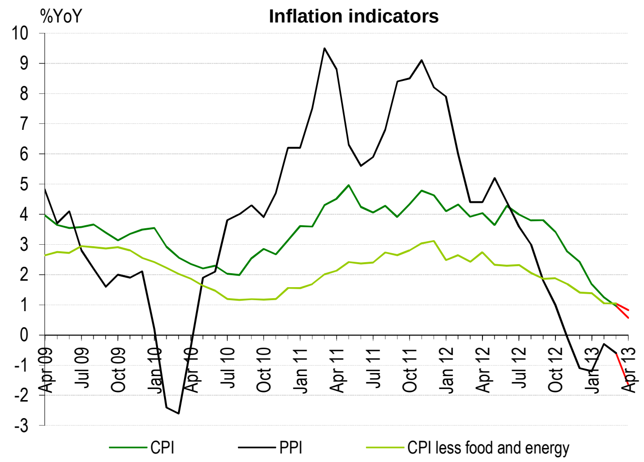
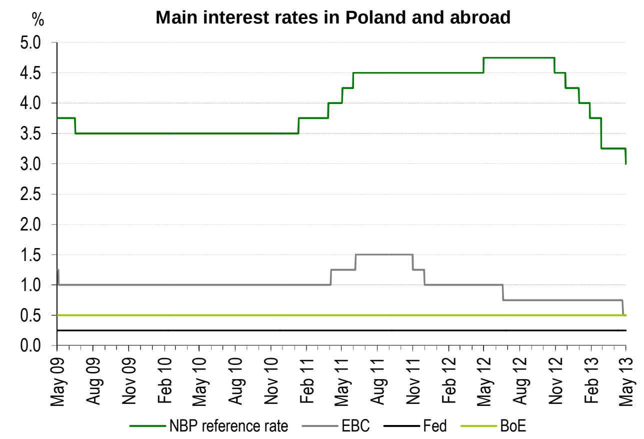
What's hot this week – Flash GDP, inflation and balance of payments





- This week the CSO will release "flash (experimental) GDP estimate" for 1Q2013 for the first time in history. This release is probably due to requirements of the Eurostat, which releases Q1 GDP figures for the European Union earlier than the CSO "standard" release. We suppose that this release will include only headline GDP growth, without a detailed breakdown. We are estimating the GDP growth at 0.8%YoY, which means a minimal acceleration as compared to 4Q2012 (0.7%YoY). This means that economy was still stagnating at the start of the year, and a positive growth rate was generated mostly by net exports.
- According to our forecast, in April the inflation rate continued falling, due to weak price growth given decelerating demand. We are estimating CPI at 0.6%YoY (slightly below market consensus) and core inflation excluding food and energy prices slid to 0.8%YoY. These data will be supportive for further monetary policy easing, showing that upward pressure on prices is still non-existent in the domestic economy. In our view inflation will be running below the NBP target at least throughout the upcoming month.
- We are estimating that a surplus in current account balance was recorded in March. This was primarily due to high surplus in current transfers account (inflows from the EU). Still, we think that also the foreign trade balance was positive, mainly because of weakness in import growth (fall by 4.6%YoY), while exports' growth will be relatively low (increase by 0.0%YoY).
- We are expecting slight acceleration of M3 money growth to 7.0%YoY. Data should show a stagnation in credit sector, yet some signs of light revival cannot be ruled out.

Last week in the economy – PMI show no recovery, correction of the easing cycle



- PMI for Polish manufacturing fell in April to 46.9pts (the lowest level since July 2009) as compared to 48.0pts in March. Further contraction of output and new orders was the main reason behind such a strong decline of the index.
- PMI for Germany fell to 48.1pts and for the euro zone to 46.7pts. As for the time being, April's domestic and foreign PMI index show no signs of the expected improvement of economic situation.
- In May the MPC surprisingly cut interest rates b 25bps. This decision was motivated by deterioration of Council's assessment of economic outlook and lower inflation forecasts, triggered by upcoming data.
- The NBP president Marek Belka stressed that this is not a new easing cycle, but only a correction of March's move (when the MPC cut rates by 50bps and announced a "commencing" of the cycle).

Quote of the week – Council still in easing bias

Marek Belka, NBP president, 8 May, post-meeting press conference

Inflation may run at very low level, even slightly below this shown in recent projection, and this summoned some room for a cut. We decided to consume this room.

Both a cut and keeping rates on hold are equally probable now.

We are stll in easing bias.

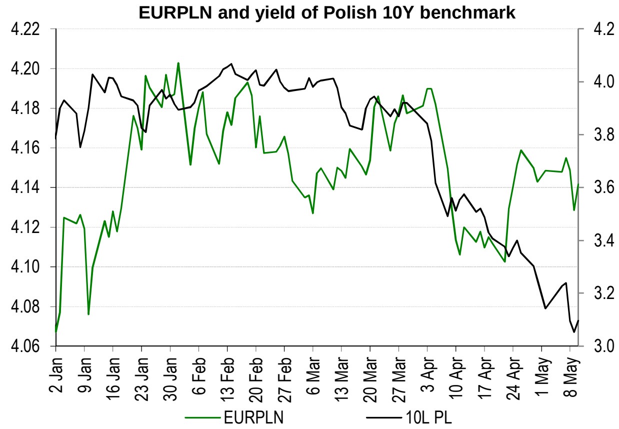
We dropped a part of the sentence [from the statement, stating that decisions of the Council will be dependent on assessment of data from the real economy]. But the Council will not turn a blind eye to events in the real economy.

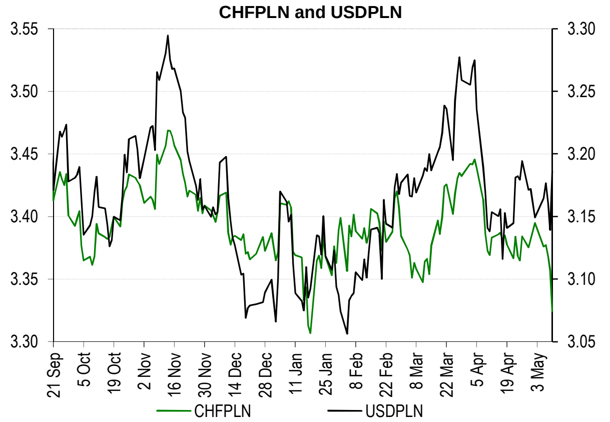
Breakdown of GDP growth is crucial. We will observe private consumption. We do not think that Polish economy can run on one engine, i.e. net exports for a long time.

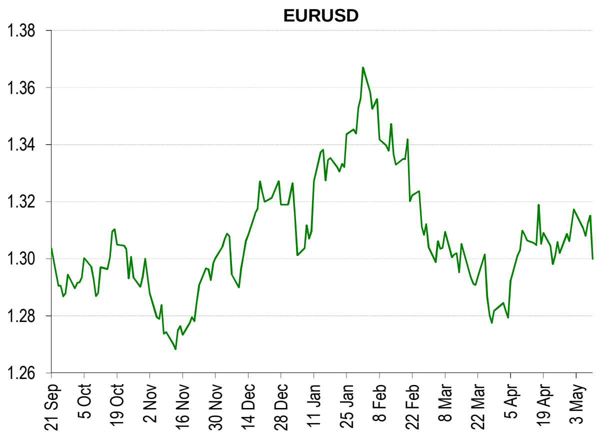
Comments of the president Marek Belka show that the Council does not start a new easing cycle, and May's cut was only a correction of earlier decisions, caused by a considerable decline of inflation. Even though the Council is in easing bias, probability of a cut is equal to probability than rates will remain on hold. The Council suggested strongly that from now on it will focus on medium-term inflation outlook, while data from the real economy will be less important for future monetary policy decisions.

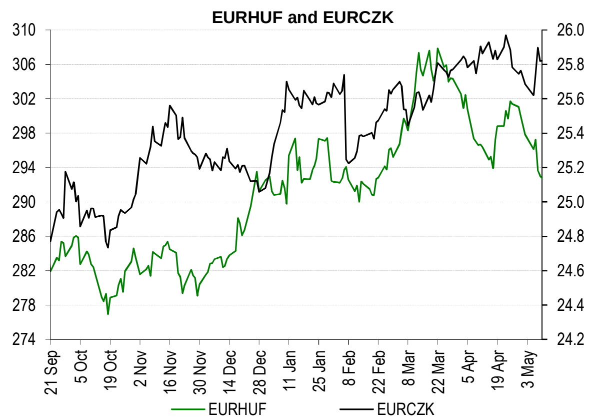
In our view, the May's move is probably still not the end of easing cycle and until July rates may be cut by further 25-50bps. This will be supported by upcoming economic data (falling inflation, no significant economic recover). Still, we think that scale of cuts currently priced-in by the markets (100bps) is clearly exaggerated.

Foreign exchange market – Data from Poland and abroad crucial for the zloty









Zloty under impact of the ECB and MPC

▪ The zloty gained slightly versus the euro during the past two weeks. After a temporary increase to 4.18 during Polish market holidays in early May the domestic currency recovered in the following days. The zloty was supported by the suggestion from the ECB on its technical readiness to cut deposit rate below 0%. Consequently, the EURPLN dropped just below 4.12 for a while.

▪ The USDPLN hovered in the range of 3.13-3.20. It ended this 2-week period roughly unchanged.

▪ The zloty gained slightly versus the euro and the dollar after the MPC decision due to strengthening of the domestic debt. During the upcoming week many domestic and foreign data is due to be released that may influence Polish bonds and consequently also the zloty.

▪ Just like in case of the EURUSD – we elaborate on this in the next paragraph – also in case of the EURPLN, despite some higher volatility, no major changes occurred. Regarding the situation from last months, the exchange rate still stays in the range of 4.05-4.20. During last few days this range narrowed to 4.12-4.17 and we expect the upper band will not be broken in May. This is also vital level for this week.

EURUSD close to vital support

▪ The euro was losing gradually versus the dollar. The single currency was under pressure from the ECB's readiness to cut deposit rate below 0%. The exchange rate plunged from 1.324 to 1.30 also due to some correction on the stock exchanges.

▪ Despite recent decline, since mid-April the EURUSD stays in the horizontal trend of 1.295-1.325.

▪ This week many vital data from the US and the euro zone will be released. It is worth to notice, that despite recent plunge of the manufacturing PMI (in March and April) data from Germany on industrial orders and output proved much better than expected. This fuels hopes that next hard data may also show more optimistic picture than sentiment indexes.

▪ From the technical analysis point of view, the EURUSD is testing aggressively 200-day simple moving average. It has already once – in late April – prevented from more visible depreciation of the single currency. Next support is 1.294.

Forint gains, koruna pressured by risk of interventions

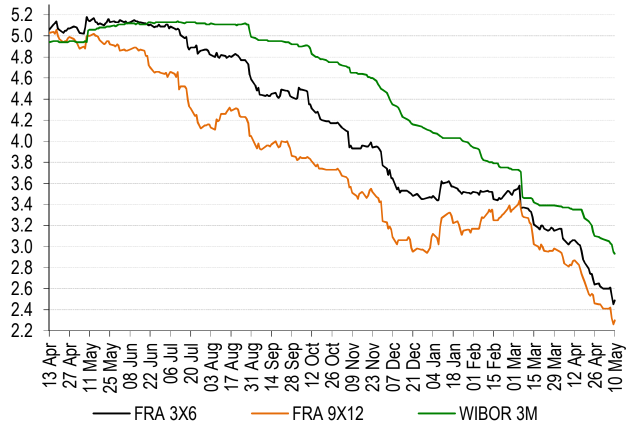
▪ The forint gained ca. 3.3% vs. the euro during the past two weeks. The biggest positive impact was provided by only a 25bps rate cut by the Hungarian central bank (investors worried that more nonstandard measures may be implemented to support the economy) and decent data from Germany.

▪ The Czech koruna was gaining only during the first week of May. The EURCZK declined from 25.9 from 25.5. Still, in the following days the currency depreciated as expectations for intervention of Czech central bank strengthened (after weak macro data and comments of CNB's governor). The EURCZK rebounded to 25.9

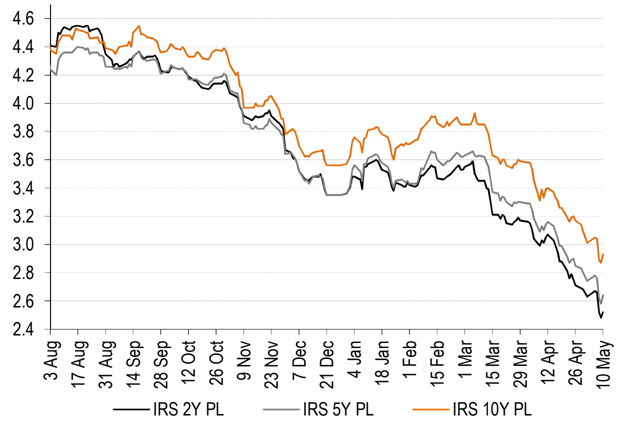
▪ This week flash GDP numbers for 1Q are due to be released in Czech Republic and in Hungary. Weaker than expected data may fuel expectations for more actions of this countries' central banks and hit the koruna and forint.

Interest rate market – CPI may put downward pressure on IRS

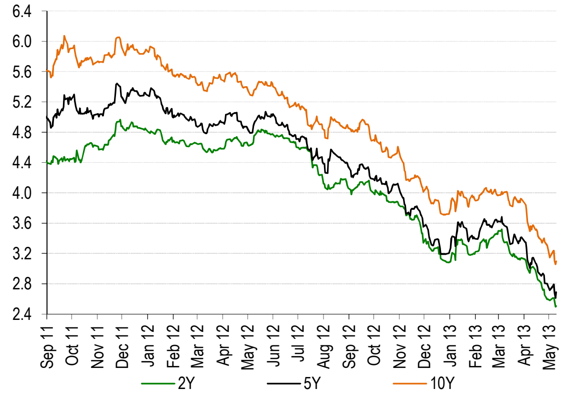
Money market interest rates (%)



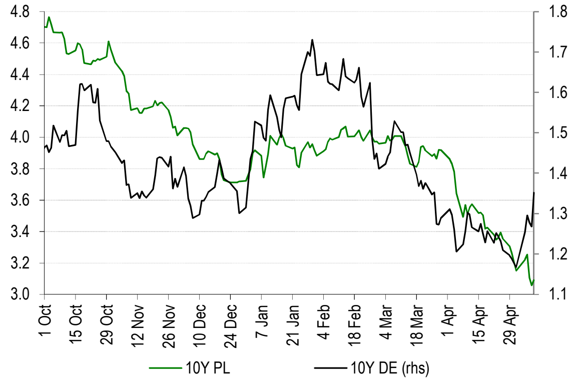
IRS (%)



Yields of Polish benchmarks



Yields of Polish and German 10Y Bonds



Only 1M WIBOR above 3%

- Persisting expectations for more easing of monetary policy by the MPC and the May's rate cut dragged WIBOR rates further down. As a result, during the past two weeks 1-12M rates plunged by 15-17bps. Currently, only the shortest of these is above 3% (3.07%).
- Since late August 2012 interbank cost of cash declined from 180bps for 1M rate up to 220bps for longer rates. In this period the NBP rate was cut by 175bps. Thus the WIBOR rates have price-in additional 50bps rate cut. FRA market expects WIBOR to decline by additional 50bps on top of that in next 6-9 months and this is overdone in our opinion.

New records of IRS and bond yields

- IRS moved down by 19-30bps during the last two weeks, biggest move occurred on long end of the curve. Of course, all rates reached fresh record low levels (2.48% for 2Y, 2.58% for 5Y and 2.87% for 10Y).
- Similar changes – both regarding the scale of move and the shape of the curve – were recorded on the bond market.
- The Ministry of Finance sold new 5Y bond PS0718 for PLN6.5bn, above the upper band of planned supply at PLN5.5bn amid demand at PLN9.0bn. Yield was at 2.55%, nearly the same level as 5Y benchmark, PS0418. According to our estimates, after this auction the Ministry has covered 77% this year's borrowing needs.

CPI and foreign data vital for IRS and bonds

- Despite that in our opinion the NBP governor was trying to cool down market expectations for rate cuts during the press conference, no correction of the plunge of yields occurred on the market. At the end of the week IRS and bond yields increased as core market weakened.
- Data on inflation – the release is scheduled for Wednesday – may support the domestic debt. Developments during the MPC press conference show that market still expects more rate cuts. Decline of annual inflation below 1% for the first time since June 2006 (and quite visible decline compared to March data) may put downward pressure on IRS and bond yields.
- Rich set of foreign data is also due to be released. Long end of the curve follows developments on the core markets. Last data from Europe (mainly from Europe) fuelled hopes for more data showing an improvement in global economy.
- A week after a successful auction of 5Y bond the Ministry of Finance will offer debt from the long end of the curve (WZ0119/DS1023/WZ0124/WS0428 – choice will be determined by market situation). At the end of March, foreign investors held 61% of DS1023 so far issued on the market and their activity should be expected at the nearest auction.

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