Bank Zachodni WBK

Weekly economic update

20 – 26 May 2013

Last week was marked by a correction on both domestic FX and interest rate markets. This was due to, among others, macroeconomic data showing that economic growth in Q1 slowed down more than expected, while inflation declined less considerably than forecast. Information about realization of state budget in April was also worrisome, as it showed a downfall in tax receipts, being a reflection of still low economic activity at the beginning of Q2. Data on GDP growth in the euro zone and its member countries were also a disappointment, deepening worries about expected economic recovery in Europe.

This week we will see another bunch of data reflecting the state of domestic economy at the threshold of Q2. We are expecting that they will show no economic revival yet, while a possible improvement of some indicators vs last month (e.g. in case of industrial output) will be due to statistical effects (higher number of working days). Our forecasts lie below market consensuses, so their materialization may put a negative pressure on the zloty, at the same time strengthening the shorter end of yield curve. Indicators of business climate in May, to be released abroad, may prove even more important than domestic data. If there is no sign of rebound in economic activity after two months of decline, then market expectations for a recovery in H2 will have to be revised downwards again and this may translate into visible deterioration of sentiments.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 May)					
14:00	**PL**	**Wages in corporate sector**	**Apr**	**%YoY**	**2.2**	**1.5**	**1.6**
14:00	**PL**	**Employment in corporate sector**	**Apr**	**%YoY**	**-0.9**	**-0.9**	**-0.9**
		TUESDAY (21 May)					
14:00	**PL**	**Industrial output**	**Apr**	**%YoY**	**2.9**	**2.0**	**-2.9**
14:00	**PL**	**Construction and assembly output**	**Apr**	**%YoY**	**-15.4**	**-14.5**	**-18.5**
14:00	**PL**	**PPI**	**Apr**	**%YoY**	**-1.4**	**-1.6**	**-0.6**
		WEDNESDAY (22 May)					
16:00	US	Home sales	Apr	m	4.99	-	4.92
16:00	US	Speech of Ben Bernanke					
20:00	US	Minutes Fed					
		THURSDAY (23 May)					
3:45	CN	Flash PMI – manufacturing	May	pts	50.3	-	50.4
9:28	DE	Flash PMI – manufacturing	May	pts	48.4	-	48.1
9:58	EZ	Flash PMI – manufacturing	May	pts	47.0	-	46.7
10:30	GB	Preliminary GDP	Q1	%QoQ	0.3	-	-0.3
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	346	-	360
16:00	US	New home sales	Apr	k	425	-	417
		FRIDAY (24 May)					
10:00	**PL**	**Retail sales**	**Apr**	**%YoY**	**1.0**	**-0.2**	**0.1**
10:00	**PL**	**Unemployment rate**	**Apr**	**%**	**13.9**	**14.0**	**14.3**
10:00	DE	Ifo index	May	pts	104.5	-	104.4
14:30	US	Durable goods orders	Apr	%MoM	1.7	-	-5.8

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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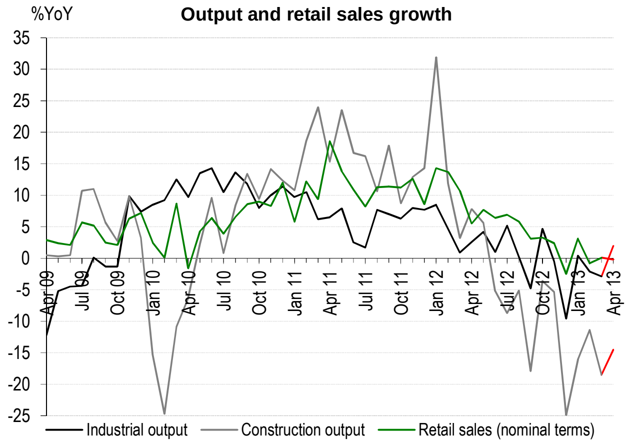
What's hot this week – New set of weak economic data



▪ We are expecting a further deterioration of labour market situation in April. In our view employment in corporate sector declined by 0.9%YoY, while wages showed a moderate growth by ca. 1.5%YoY. Registered unemployment fell in MoM terms, due to seasonal factors, but rose in YoY terms.

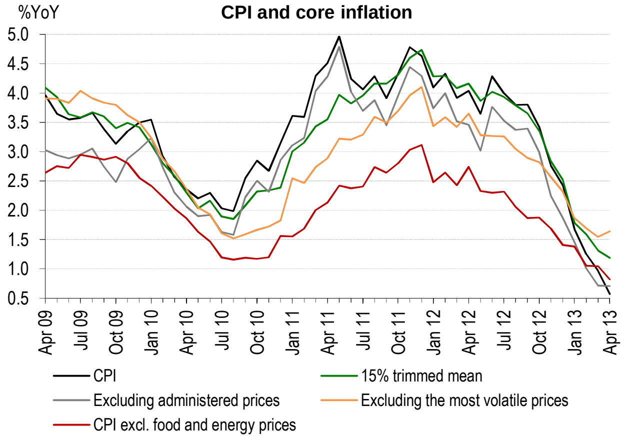
▪ We think that Polish industry was still posting weak results in April. Industrial output growth rebounded to ca. 2%YoY (we are slightly more pessimistic than the market consensus) due to impact of higher number of working days, but construction sector still stays deep in recession (ca. -15%YoY).

▪ Growth rate of retail sales amounted to -0.2%YoY in our view (market is expecting an expansion by 1.0%YoY). This was due to weakness of the consumer demand, but also due to high base effect from last year (Easter).

Last week in the economy – Slowdown of GDP growth, decline of inflation

▪ According to flash estimate, Polish GDP growth decelerated in 1Q to 0.4%YoY, lowest level since 1Q 2009. The release was clearly below expectations and showed the economic activity at the beginning of the year was actually really subdued. Breakdown of GDP is still unknown, but we guess that drag on the pace of growth was put mainly by sluggish domestic demand (while data on trade balance suggested improvement in net exports in 1Q, as shown below). This data release was experimental and will be probably revised. The publication of detailed data will take place on 29th May.

▪ In March current account deficit was higher than expected due to strong rise of imports. In whole Q1 exports advanced by 4.2%YoY, while imports contracted by 2.6%YoY. As a result trade balance of goods and services recorded a surplus of €1.5bn (as compared to -€1.0bn on year earlier).



▪ In April the CPI inflation recorded another decline, to 0.8%YoY (from 1.0%YoY). Strong price growth was recorded in clothing and footwear (effect of new collections) and recreation and culture (end of discounts on the publishing market). This pulled the core inflation excluding food and energy prices to 1.1%YoY from 1.0%YoY in March.

▪ Interestingly as much as a half of the annual increase in CPI occurred last month (in April prices increased by 0.4%MoM). This shows how significant is the effect of the statistical base from the 2H 2012. We still expect that in 2H 2013 inflation will rebound to ca. 1.5% at the end of the year. The same may happen with core CPI – it may reach a bottom below 1% in coming two months and accelerate above 1.5% in 2H 2013.

Quote of the week – Rate cut in June cannot be ruled out

Adam Glapiński, MPC member, 13 May, Reuters

I am very cautious and conservative in this situation, but I think that a rate cut in June cannot be ruled out.

Anna Zielińska-Głębocka, MPC member, 15 May, TVN CNBC

Cuts, if any, should be implemented quickly and then a stabilization should be adopted. If think there is some room for cuts. But it is not very large and we do not want to reach zero.

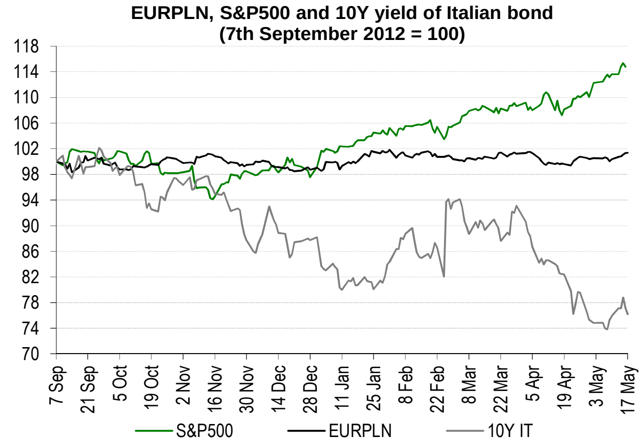
Jerzy Hausner, MPC member, 15 May, Polsat Biznes

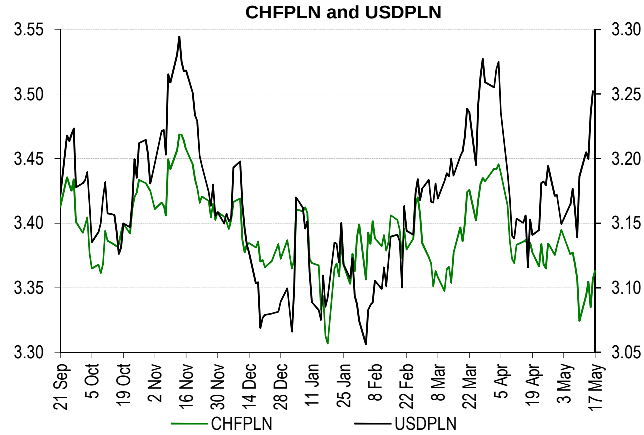
Data, which were incoming to us and were heralding a recovery in domestic business activity were flawed. Forecasts were considerably better at the time, when we should have been thinking about stronger cuts.

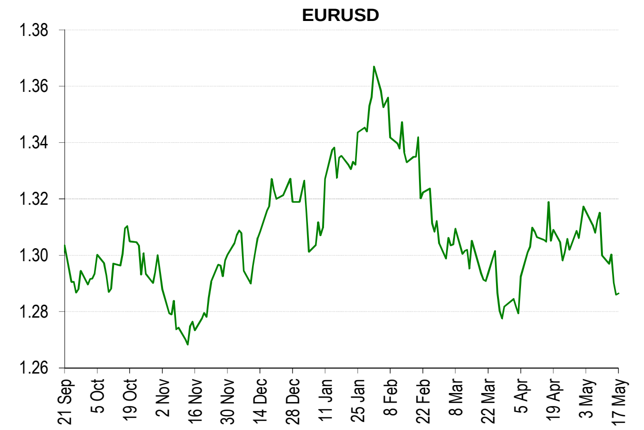
Comments of the MPC members are suggesting that the Council will seriously consider rate cut in June, due to weak economic growth and inflation running below target (2.5%). Still, a room for cuts is not large. Similar comments were expressed by Anna Zielińska-Głębocka, Elżbieta Chojna-Duch and Jerzy Hausner. These words support our forecast that rates will be cut by a total 50bps in June and July. Cut was not ruled out also by more hawkish Adam Glapiński, while Jan Winiecki stated that further cuts are unjustified and they would mean implementing a "policy of drip", meaning "a cost-free distribution of money".

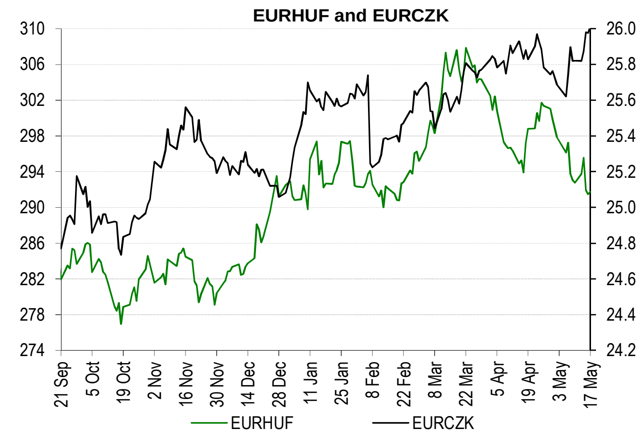
Words of Jerzy Hausner, shown beside, prove that the Council is acknowledging its mistake of starting the easing cycle too late. Hausner justifies it with flawed data. However, please recall that market analysts were talking about necessity to cuts rates even one year before the actual start of the easing cycle. And they had the same data at their disposal!

Foreign exchange market – EURPLN close to vital resistance









EURPLN close to 4.20

- Past week brought clear depreciation of the zloty versus the euro and the dollar. The EURPLN increased from 4.13 to 4.19 while the USDPLN surged from 3.18 to 3.26. Negative pressure on the zloty was put by both domestic (deeper than expected deceleration of GDP in 1Q and smaller decline of CPI) and foreign data (disappointing flash German 1Q GDP and ZEW index). Consequently, the EURPLN approached nearly 4.20, upper band of consolidation observed since the end of September 2012.
- The range trading on the EURPLN market has been observed already for three quarters, while on the foreign financial markets strong directional tendencies have been recorded at the same time. US stock indexes are establishing fresh all-time-high levels and yields on the peripheral debt market are declining. There was no clear wave of optimism in Poland regarding the pace of economic rebound – Polish PMI index clearly lagged behind strong increases recorded for example in Germany. This might have contributed to the fact that the zloty remained stable and did not benefit – as much as domestic bonds – from expectations for monetary policy easing from global central banks.
- This week many crucial domestic and foreign data are due that will hint on economic activity. Global investors are probably disappointed by lack of clear signals announcing the long-anticipated recovery (PMIs were falling in the last 2-3 months). We expect weaker than consensus data on April's industrial output and retail sales. These releases may hit the zloty but we think that strengthening of bonds (in response to these publications) will prevent the EURPLN from breaking 4.20.

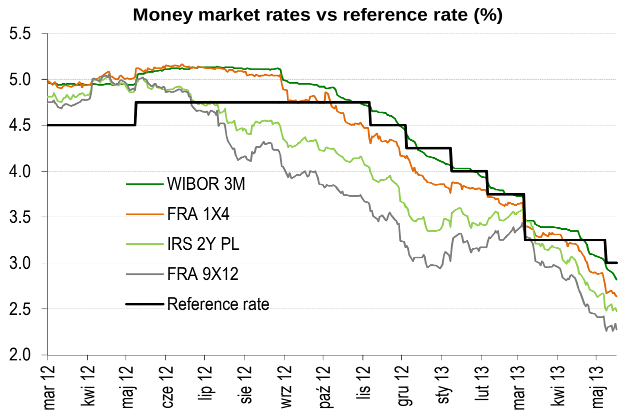
Euro under pressure second week in a row

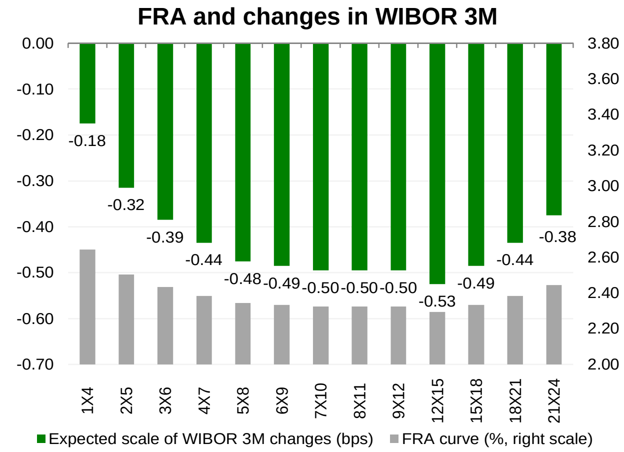
- The EURUSD broke the 200-day moving average and reached 1.28 quite quickly. The euro was hit by data from Germany (that fuelled worries that the ECB will cut deposit rate below 0%) and comments from the Fed that American central bank may trim the scale of bond purchases during summer.
- Upcoming week is likely to be very interesting given the set of euro zone's data releases (flash PMI for May) and many speeches of US central bankers including the one given by Ben Bernanke.
- The EURUSD is close to the support at 1.28, there is a line of the upward trend running just below this level and we have a local low at 1.275 (that is next vital support).

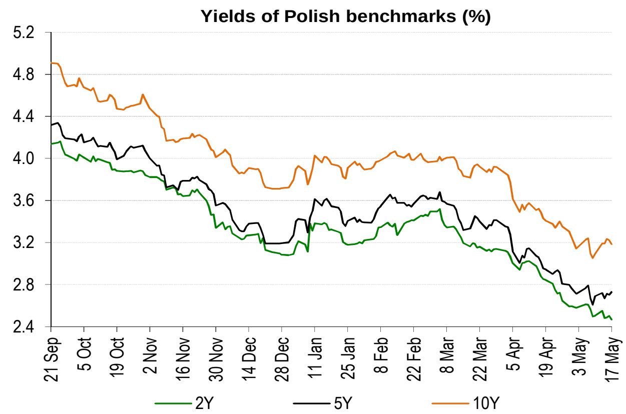
Forint and koruna driven by GDP data

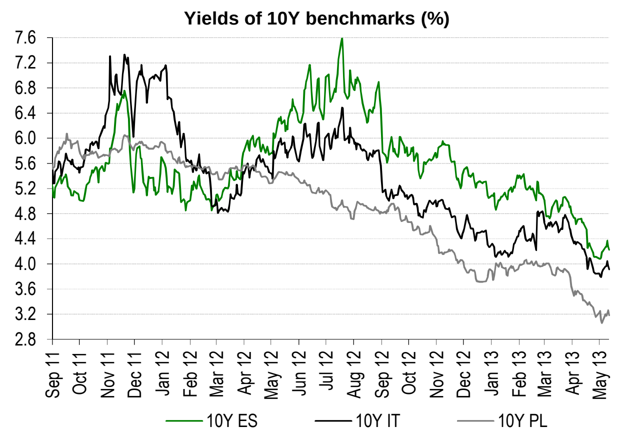
- Flash data on 1Q GDP for Hungary and Czech Republic had significant impact on forint and koruna. Estimate of pace of economic growth in Hungary clearly exceeded expectations (0.7%QoQ vs. 0.1%QoQ) and dragged the EURHUF from nearly 295 to even 290 for a while. Data for Czech Republic disappointed (-0.8%QoQ vs. -0.1%QoQ) and this triggered a surge of the EURCZK from 25.86 to 26.05.
- Forint's appreciation vs. the euro was accompanied by depreciation of the zloty vs. the single currency. Consequently, during the past week the HUFPLN reached highest level since second decade of February (slightly over PLN1.44 per 100 HUF).

Interest rate market – Data should support short end of IRS and bond curves









WIBOR lower and lower, correction on the FRA market

▪ The WIBOR rates continued declining last week. The scale of weekly drop ranged from 2bps (for 1M rate) to 13bps for 6M rate. 3M WIBOR reached 2.82%.

▪ FRA market was under the impact of domestic data. Lower than expected data on flash 1Q GDP growth halted the upward move of the FRA, but this was only a temporarily phenomenon. Above-expectations data on CPI triggered a rebound of FRA and both 6x9 and 9x12 rates were close to ca. 3.35% at the end of the week. This means market expectations of level of 3M WIBOR within next six months are stabilizing around 2.30%.

▪ This week next data from Poland is due. In our opinion they will fuel expectations for further rate cuts and thus FRA rates may decline slightly. However, the room for deeper plunged is in our opinion limited.

Curves steeper

▪ Bond yields and IRS rates increased during the past week, middle and long end of the curves were under biggest pressure while short end remained roughly stable (the effect of still strong expectations for NBP rate cuts). Consequently, the 2-10 spread widened to 72bps for bonds and nearly 60bps for IRS (highest level since early 2011).

▪ Long end of the curves remained clearly under the impact of the developments taking place on the core markets. Some recovery of Bunds constrained the potential for an increase of yield of 10Y Polish bond (it declined to ca. 3.16%). 10Y IRS did not benefit much from the improvement of situation, it stayed above 3.10% at the end of the week.

▪ The results of auction of long term bonds (DS1023, WZ0124 and WS0428) may be perceived as relatively decent given the volatile market conditions. The Ministry of Finance sold bonds for the total of PLN5.505bn (only slightly above the upper band of planned supply) at yields close to secondary market levels. After this auction the Ministry has already covered ca. 80% of this year's borrowing needs and this gives high comfort when arranging auctions later in the year.

Data shall support the debt

▪ Strong inflow of domestic data is scheduled this week, releases of retail sales and industrial output will be most important for the interest rate market. Our forecasts are below market consensus and if they materialize, this should support short- and even mid-term bonds.

▪ Long term debt will remain under the impact of core markets. Thus, data for the euro zone and the US may be crucial for the performance of domestic 10Y bond. Polish long-term benchmark, DS1023, may be also influenced by results of 10Y German bond auction (planned supply at €4bn).

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