Bank Zachodni WBK

Bi-Weekly economic update

28 October – 10 November 2013

The wave of optimism, which appeared on the financial markets after the release of weaker-than-expected US labour market data, proved short-lived – in the following days moods stabilised. However, this publication amplified hopes that the Fed will begin QE3 tapering in 2014 at the earliest. These hopes were supporting not only the single European currency, but also debt markets (including the domestic one). Yields of Polish 10Y bond fell below 4.10%, while USDPLN followed EURUSD and slid temporarily below 3.02. Domestic debt was also supported by dovish comments of the MPC members. They were indicating no certainty about the persistence of observed economic recovery abroad and in Poland, which could be an argument for stable rates, longer than only until the year-end.

As regards the upcoming two weeks, we will see a deeper assessment of current and future macro situation by the central banks. Continuation of the dovish rhetoric by the Fed (which will support hopes that QE3 tapering will begin in 2014) and by the ECB will be probably supportive for positive market moods. There are also numerous data releases, which will be interpreted in context of future central bank actions. In Poland, the NBP will show its new projections of inflation and GDP (in our view, both will be higher than in the previous report) and this will help the MPC to signal (or not) how long will interest rates remain unchanged. In our view, it will be more reasonable for the MPC to say that central bank's policy will depend on inflation and growth outlook, and not to bind itself with a declaration of stable rates in a particular period.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (28 October)					
14:15	US	Industrial output	Sep	%MoM	0.4	-	0.4
15:00	US	Pending home sales	Sep	%MoM	0.5	-	-1.6
		TUESDAY (29 October)					
13:30	US	Retail sales ex autos	Sep	%MoM	0.4	-	0.1
14:00	HU	Central bank decision		%	3.40	-	3.60
15:00	US	Consumer confidence index	Oct	pts	75.9	-	79.7
		WEDNESDAY (30 October)					
13:15	US	ADP report	Oct	k	150	-	166
19:00	US	Fed decision on monthly bond purchases		$bn	85	-	-
		FRIDAY (1 November)					
	PL	**Market holiday**					
2:45	CN	PMI – manufacturing	Oct	pts	50.6	-	50.2
15:00	US	ISM – manufacturing	Oct	pts	55.0	-	56.2
		MONDAY (4 November)					
9:00	**PL**	**PMI – manufacturing**	**Oct**	**pts**	**-**	**53.3**	**53.1**
9:53/9:58	DE/EZ	PMI – manufacturing	Oct	pts	51.5/51.3	-	-
		WEDNESDAY (6 November)					
	PL	**MPC decision**		**%**	**2.50**	**2.50**	**2.50**
9:53/9:58	DE/EZ	PMI – services	Oct	pts	52.3/50.9	-	-
12:00	DE	Industrial orders	Sep	%MoM	-	-	-0.3
		THURSDAY (7 November)					
13:00	CZ	Central bank decision		%	0.05	-	0.05
13:45	EZ	ECB decision		%	0.50	-	0.50
14:30	US	Advance GDP	Q3	%QoQ	1.8	-	2.5
		FRIDAY (8 November)					
14:30	US	Non-farm payrolls/Unemployment rate	Oct	k/%	163/7.2	-	148/7.2

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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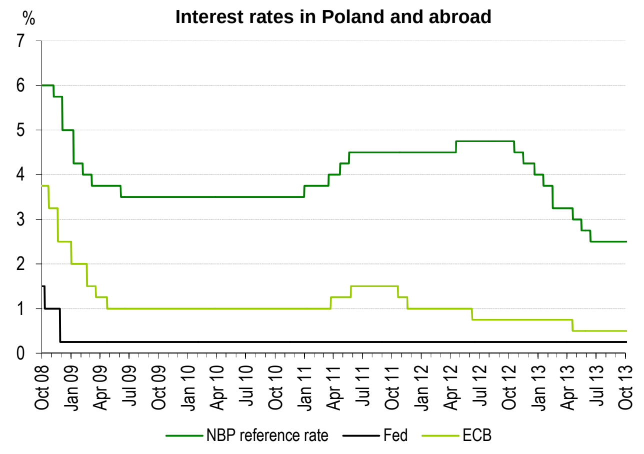
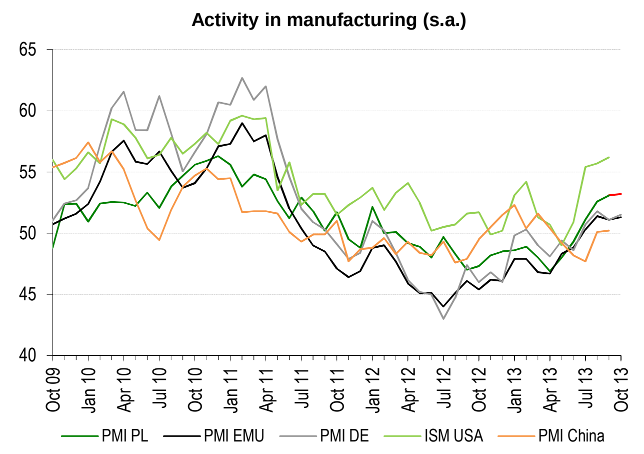
What's hot this week – Important data from the US, central bank meetings





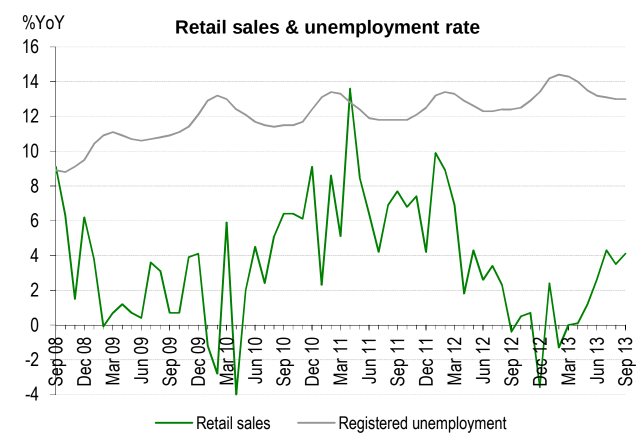
▪ The most important events of the upcoming week are: news from the USA on results of Fed meeting and reading of the labour market figures. FOMC members will be probably analysing whether to reduce the asset purchases of QE3 programme. However, we do not think they will decide for such a move at this stage, given the fact that agreement on budget is only temporary and risk due to this matter may return. FOMC will be also willing to see more economic data before it takes any decisions. Thus, non-farm payrolls will be crucial for the markets as regards assessment of probability of QE3 reduction in the upcoming months.

▪ In the nearest two weeks we will see a row of important data from the world's biggest economy. Moreover, meetings of central banks of the euro zone, the Czech Republic, Hungary and Poland are scheduled.

▪ On Wednesday 6 November the MPC will announce its decision. In our view, rates will stay on hold, similarly as earlier, but this can prove to be the first interesting meeting in the last couple of months. The Council will see results of GDP and CPI projections prepared by the NBP Economic Institute. In our view, this document can affect the Council's rhetoric and, especially, its declaration on future interest rate path.

▪ Release of Polish PMI index for manufacturing is scheduled for 4 November. Flash indices for Germany and for the euro zone posted slight gains and we think that the Polish gauge may follow suit. We are expecting some rise of PMI index, mainly under influence of improving subindices for orders and output, which will be suggesting a further improvement of domestic economic activity.

Last week in the economy – Solid retail sales, improvement on the labour market



▪ September's reading of retail sales was weaker than expected. However, the result was not bad, but rather comparable to previous two months. A clear acceleration was recorded by retail trade turnover. Growth rate reached 6.6%YoY and this was the best result since Dec 2010.

▪ Unemployment rate remained unchanged in September at 13.0%, in line with market consensus and our forecast. Number of jobseekers fell (for the seventh month in a row), by 100 persons. Annual growth rate of number of jobseekers fell to 5.3% from 6.0% in August and this was the lowest reading since June 2012. 130.6k jobseekers were removed from unemployment rolls due to taking up job and this was the best September's result since 2006. This was possible even despite the Labour Ministry's intervention is losing steam (32k unemployed were sent to subsidized jobs and trainings as compared to 54k one year before).

Quote of the week – When to take the punch bowl away?

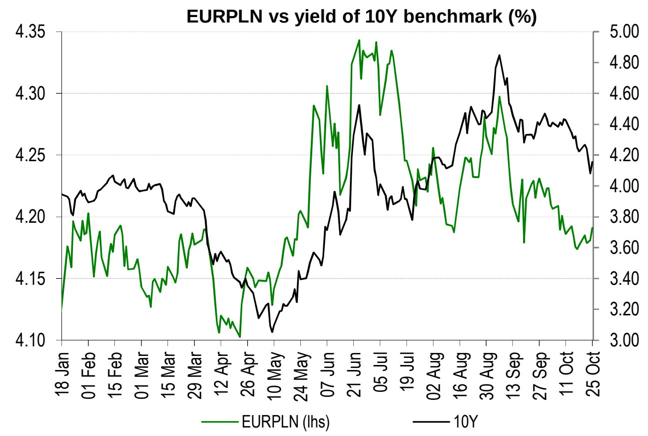
Marek Belka, NBP President, 22.10, obserwatorfinansowy.pl
Given the historical evidence, current level of interest rates in Poland is unusual and the central bank has to be particularly careful, as taking care over the economy it should not inflate distortions on the financial market at the same time (..) a good central bank knows when to take the punch bowl away as the party gets going.

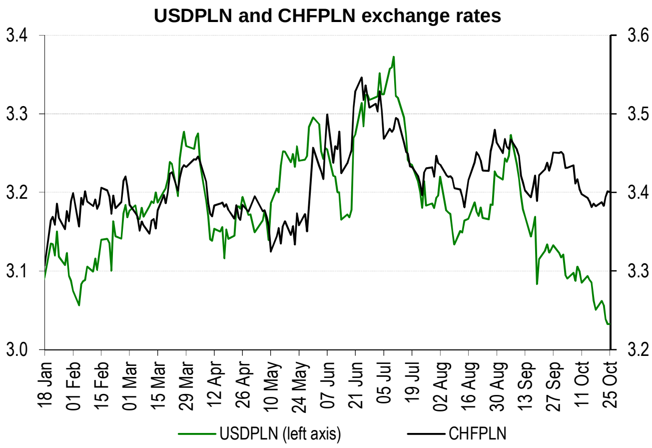
Elżbieta Chojna-Duch, MPC member, 22.10, PAP
Extension of neutral monetary bias until mid-2014 is reasonable, in my view (…) we can even think about returning to dovish bias.

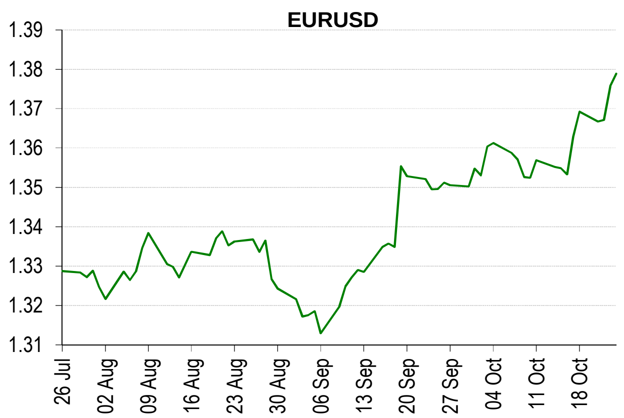
Adam Glapiński, MPC member, 24.10, PAP
It is almost certain that interest rates will remain unchanged until mid-2014 and very likely they will remain flat until end of 2014.

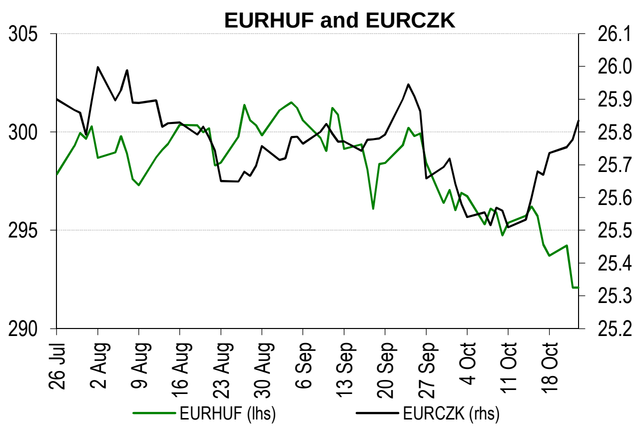
Comment of Adam Glapiński shows that he is not a typical hawk, but rather a conservative, who opposes any changes (in 2010 Glapiński was against hikes, in 2013 he was against cuts). Such an approach proved in our view to be a particularly wrong mode of a backward-looking policy. On the other hand, Elżbieta Chojna-Duch is still proposing an introduction of dovish monetary bias. In our view this is very unlikely and such an interpretation is supported by last comment of Marek Belka – current level of rates is unusual, which can cause some distortions on the financial market. That is why eventually there will come a moment, when the MPC will hike rates, i.e. as it was once said by 1951-1970 Fed governor William McChesney Martin, a good bank knows when to take the punch bowl away.

Foreign exchange market – Central banks actions crucial for the zloty









USDPLN closer and closer to 3.00

- Last week the zloty was under influence of information from global markets. As regards the news flow, the key issue was the overdue (September's) labour market data from the US. The weaker-than-expected reading strengthened expectations that Fed might delay the start of QE3 tapering until 1Q2014. Due to higher appetite for risky assets the zloty also gained, in particular against the US dollar. USDPLN fell temporarily below 3.02, the lowest level since October 2011. Next days brought some profit-taking, but the exchange rate stayed in a narrow range 3.02-3.04.
- EURPLN (despite global sentiment improvement) remained in a channel between 4.155 and 4.19, oscillating closer to the upper limit of this range. The Polish debt strengthening (see chart beside) did not help the zloty.
- During coming two weeks, besides macro data releases, investors will focus on central banks meetings. Still dovish rhetoric from both Fed and ECB and neutral monetary bias of the MPC should support a zloty strengthening or even stabilisation near current levels. Low investors' activity on the market at the end of this week (domestic financial markets will be closed) might add some volatility on the zloty. Recently, 4.19-4.20 level is an effective resistance for EURPLN. If this level is broken due to investors' sentiment deterioration, then EURPLN to increase towards 4.24, in our view. Support level is still at 4.14.

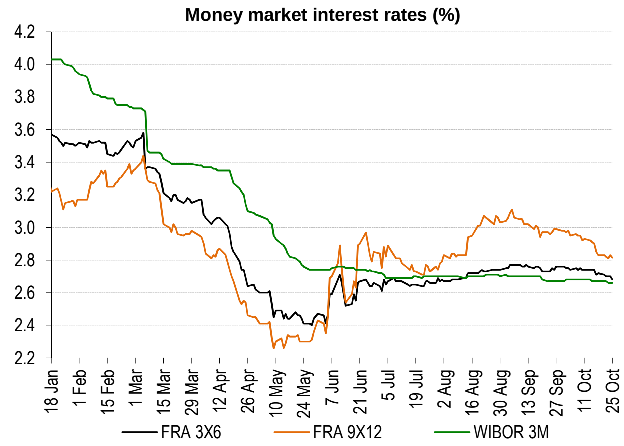
EURUSD at the highest level since November 2011

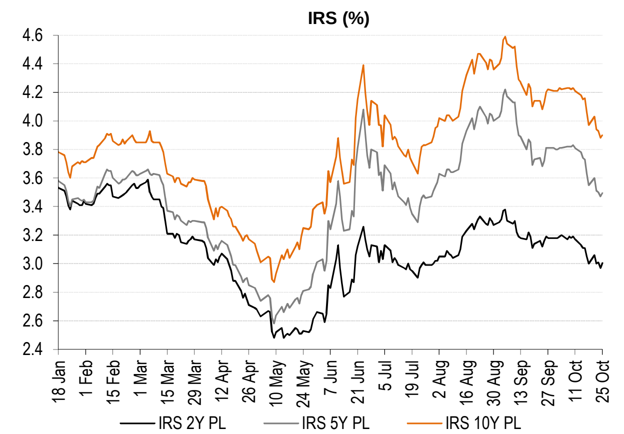
- Last week brought a visible strengthening of the European currency on the international markets. Weak data from labour market in the US, which increased probability that Fed will continue unchanged QE3 program caused EURUSD to break February's top and temporarily increase above 1.38. Macroeconomic data releases from the European economy (including flash PMI indices for manufacturing) did not bring any additional impulse to the euro strengthening. At the end of the week EURUSD was slightly below 1.38.
- Rhetoric and perspectives of future central banks' actions will be crucial for investors. Unchanged monetary policy conditions should stabilize EURUSD near current level. However, weaker-than-expected macro data releases for the US economy might increase demand for the euro, supporting further increase of EURUSD towards local maximum at 1.383.

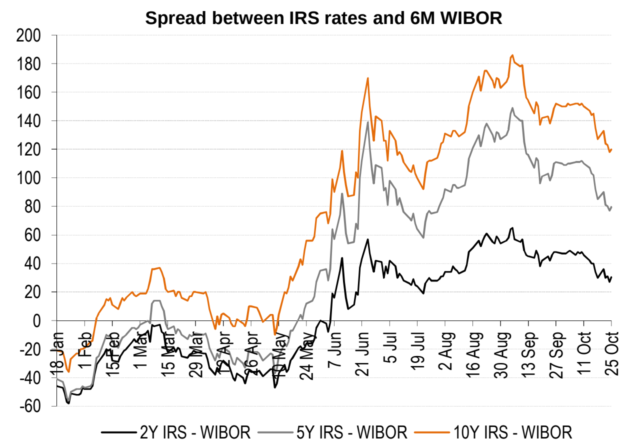
Forint and koruna await domestic events

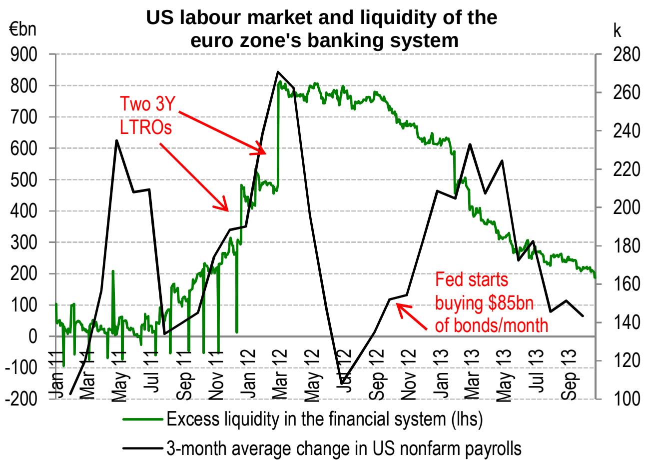
- CEE currencies remain mainly under the impact of internal issues rather than global sentiment. Every single appreciation of the Czech koruna triggers a verbal intervention of the central bank officials. This was also the case last week when, after a decline after the US data, EURCZK rebounded to 25.85. As regards the forint, the government's decision on the FX loans remains the main source of uncertainty. EURHUF stayed in 291.3-294.5 range during the past week.
- Internal factors will remain crucial for the koruna and the forint in coming weeks. Next verbal interventions of CNB's officials will maintain EURCZK on the high levels. On the Hungarian market, investors will wait for the commercial banks' propositions of solving the FX loans issue and this may inflate volatility of EURHUF.

Interest rate market – Watch for central banks









WIBOR and FRA stable, IRS down, bonds stronger

▪ On the shortest curve no major changes occurred in recent days. On weekly basis, 6-12M WIBOR rates remained stable, 1M rate increased by 1bp while 3M declined at the same scale. Despite some dovish comments of the MPC members, FRA rates changed only marginally during the past week.

▪ Clearly more visible movements were recorded on the IRS and bond curves. Much weaker than expected US nonfarm payrolls have fuelled expectations that the FOMC will postpone the moment of QE3 tapering until 2014. Strengthening on the core debt markets had a visible impact on Polish IRS – 5Y rate declined by 5bp, 10Y by 7bp, 2Y remained stable. Slightly more visible decline was recorded on the bond market where yields dropped by 7bp on the short end and 7-9 bp on the middle and on the long end.

▪ The spread between 5Y IRS and 6M WIBOR declined below 80bp, for 10Y IRS it reached 120bp and for 2Y 30 pb – in two first cases this is the lowest level since late July. 5Y and 10Y rates reached the lowest levels since late July (3.50% and 3.90%, respectively) and are now 70bp below local peak from early September. 2Y rate dropped by 40bp (to 3%).

▪ Finance Ministry sold bonds worth PLN12bn (upper limit of the border, record sales at a single auction) given demand at PLN16.5bn. Sales of IZ0823 were equal to PLN5.8bn, of OK0116 to PLN4.8bn (demand at PLN8.3bn) and of DS1023 to PLN1.4bn (demand at PLN2.4bn, yields at c. 4.30%, close to market levels). Deputy finance minister, Wojciech Kowalczyk, said that the resort has fully covered this year's borrowing needs and the upcoming auction will be pre-financing 2014 needs. He added that the Ministry plans to issue dollar-denominated bonds further in the year.

Central banks in the spotlight

▪ On the first Wednesday of November the Polish MPC will announce its decision on interest rates. For the market, far more important than leaving NBP rates unchanged, will be whether the Council expands the time span during which rates remain stable. Recent comments of its members – not only those with dovish bias in the monetary policy – have fuelled expectations for such a move. The market will wait for confirmation of this decision in the statement as the MPC will have new CPI and GDP projection at disposal at the meeting. In our opinion, new forecasts may show higher path for inflation. If the "forward guidance" is not extended (or extended more cautiously, e.g. until Q1) then this may trigger an upward correction of recent IRS decline and bonds' strengthening.

▪ Next to the MPC meeting, decisions of two biggest central banks may also influence Polish market. The Fed will make its decision on monthly scale of asset purchases one week prior to the MPC meeting, while the ECB will meet one day after the Polish monetary authority. We may say that results of actions undertaken by those two central banks have returned to the starting point. 3-month average change of the US nonfarm payrolls reached a level seen last time one year ago when the Fed decided to buy bonds worth $85bn per month. In late 2011 and in early 2012 the ECB decided to carry two 3Y refinancing operations (LTRO). During the following months, commercial banks eagerly used the option of early repayment of this loans. Consequently, currently the excess liquidity is at the level when these unprecedented actions of the ECB were implemented. Investors expect that the Fed will suggest the option of postponing QE3 tapering and the ECB will reassure it is ready to take further actions (including the LTRO) it needed.

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