Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

9 – 15 December 2013

The ECB's rhetoric was less dovish that the market expected. The statement and the message from the press conference suggested that after the surprising interest rate cut in November the ECB feels no pressure to implement further actions soon. The better-than-expected data from the US economy (faster than expected GDP growth in Q3, higher employment growth in non-farm sector in November) amplified expectations that already this month the FOMC may announce a beginning starting QE3 tapering. Despite better reading from the US labour market, the reaction of financial markets was very limited. After a temporary weakening, the euro, but also the zloty, rebounded and trimmed earlier losses. Debt market reaction was also weak, yields of 10Y Bund and US Treasury climbed by a few basis points. The domestic debt market also reacted only moderately.

The upcoming week will be not rich in US data releases, European data will be more important, including a solid portion of new information from the Polish economy. We are expecting that data on inflation will show a stabilization of CPI at low level, which can strengthen expectations that interest rates will stabilize at current level longer for a longer time. Lower current account deficit (as compared with earlier months) and all-time high exports can support the zloty prior to the weekend. One week prior to the last FOMC meeting this year, three members are speaking. Only one of them is a voter currently (Bullard), but investors will surely be eager to listen to all the comments, helping to assess if QE3 can be limited in December.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (9 December)					
8:00	DE	Exports	Oct	%MoM	-0.5	-	1.6
9:00	CZ	Industrial output	Oct	%YoY	2.0	-	7.1
9:00	CZ	CPI	Oct	%YoY	1.1	-	0.9
12:00	DE	Industrial output	Oct	%MoM	0.8	-	-0.9
		TUESDAY (10 December)					
		No important data releases					
		WEDNESDAY (11 December)					
9:00	HU	CPI	Nov	%YoY	0.7	-	0.9
		THURSDAY (12 December)					
11:00	EZ	Industrial output	Oct	%MoM	0.3	-	-0.5
14:30	US	Initial jobless claims	week	k	320	-	298
14:30	US	Retail sales ex autos	Nov	%MoM	0.2	-	0.2
		FRIDAY (13 December)					
14:00	**PL**	**CPI**	**Nov**	**%YoY**	**0.9**	**0.8**	**0.8**
14:00	**PL**	**Exports**	**Oct**	**€m**	**14 868**	**15 109**	**13 896**
14:00	**PL**	**Imports**	**Oct**	**€m**	**14 318**	**14 485**	**13 223**
14:00	**PL**	**Current account**	**Oct**	**€m**	**-586**	**-194**	**-1024**
14:00	**PL**	**Money supply**	**Nov**	**%YoY**	**6.2**	**6.0**	**5.9**

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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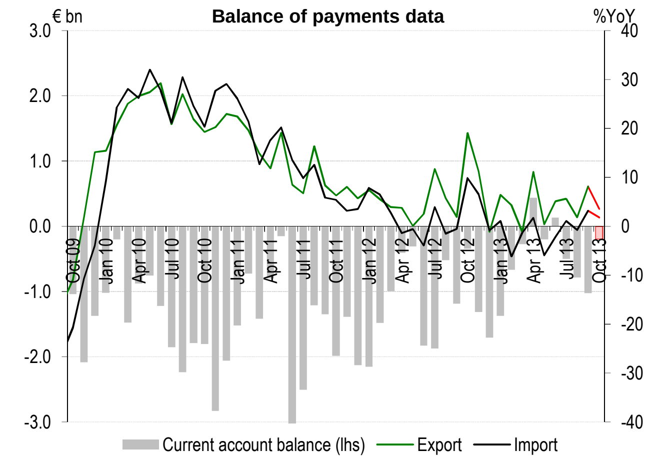
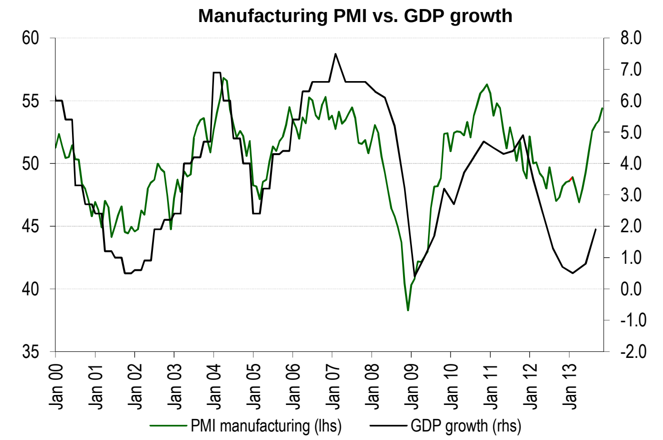
What's hot this week – Stable inflation, improvement in C/A balance

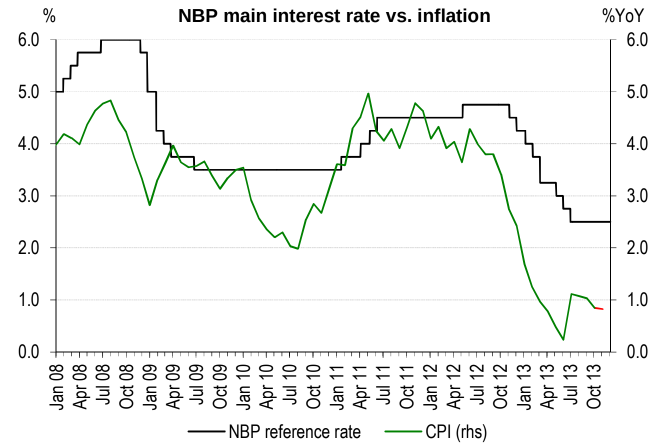


- According to our forecast in November inflation CPI stayed on a low level at 0.8%YoY due to among others still low food prices and decrease in fuel prices. The market consensus is slightly higher, therefore CPI release might slightly support debt market. However, the effect might be only short-lived as the very low reading of the headline CPI index results to a large extent from food and fuel prices. This would be reflected in the core inflation publication. We predict core inflation after excluding food and energy prices to increase to 1.5%YoY.
- Our forecast of current account gap in October is significantly lower than in previous months. The current account deficit narrowing came from not only surplus in trade (exports reached a new record high, exceeding €15bn!), but also surplus in current transfers (effect of the EU fund inflows) and seasonal rebound in income and services. These data should be very positive for the zloty quotations.

Last week in the economy – Nothing new from MPC, PMI confirms recovery of domestic demand



- The Polish manufacturing PMI surprised positively again, reaching 54.4 in November, the highest level since April 2011. Trends observed in previous months have been continued – further increase in new orders triggered production rise, which consequently resulted in improvement in labour market. Interestingly, new export orders recorded a correction (although the pace of growth was still at the second highest level in the last 2.5 years). Further acceleration of orders inflow was possible thanks to improvement in domestic demand.
- In our view these data (similarly as GDP growth figures for Q3) confirmed that the structure of economic growth is gradually changing in line with our predictions – domestic demand is gaining importance as a driver of economic recovery. We predict a continuation of these trends in subsequent quarters.



- The MPC's meeting did not surprise – the interest rates remained unchanged in December, and the Council repeated the suggestion that they will remain on hold in the first half of 2014.
- We still think that the closer we get to the middle of 2014, the bigger will be the question mark when to start monetary policy tightening. Not so long ago, some MPC members have seen no signs of economic recovery, while currently only incurable pessimists do not see an acceleration of GDP growth. Furthermore, there are rising odds that the recovery will be fuelled increasingly by domestic demand amid improvement of labour market conditions (reflected in recent GDP and PMI data).
- Still we expect official interest rate to be raised in the second half of 2014. We predict two hikes by 25bp each, with the first one in autumn.

Quote of the week – MPC agrees that rates should remain stable at least until mid-2014

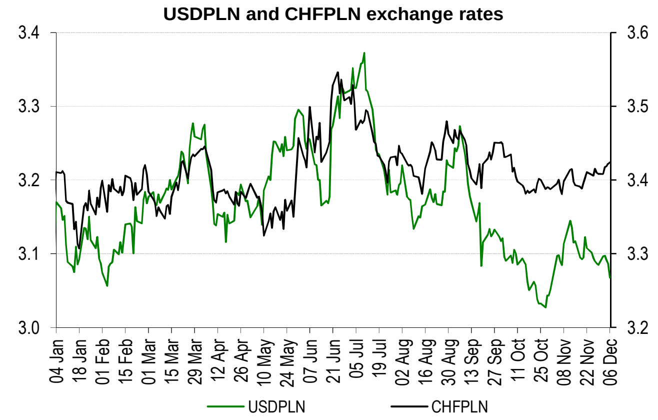
Marek Belka, NBP president, 4.12, MPC press conference

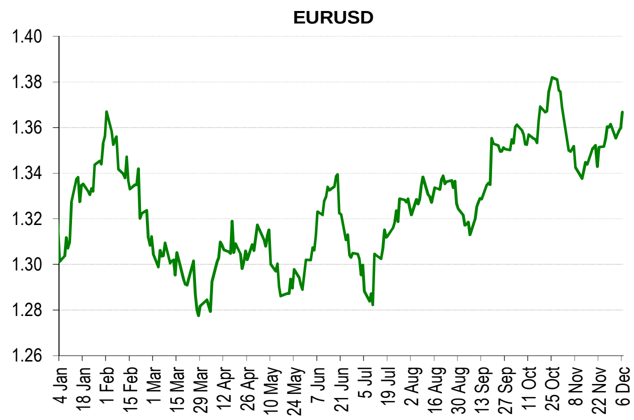
Over the month there was nothing, which could have weakened our assessment that rates should remain stable until mid-2014 (…) The whole MPC agrees that rates should not change at least until mid-2014.

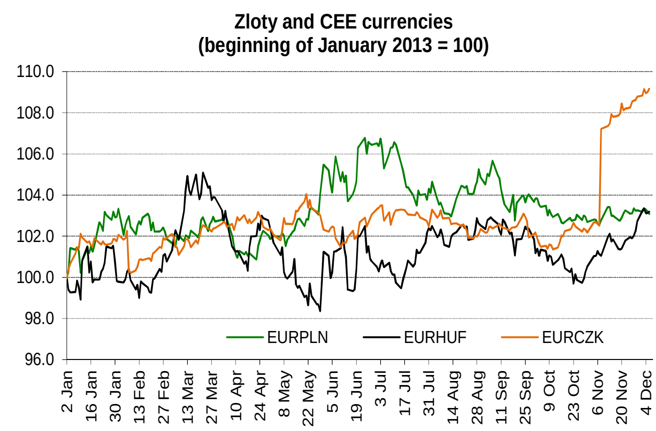
We are paying attention to a row of factors, especially at domestic demand, but also (…) labour market. I am not sure if we are ready and if we actually need to present a set of (…) indicators (…) or thresholds, making us change rates.

After the MPC meeting in November the NBP president Marek Belka suggested that the Council may decide to address, which economic symptoms could change their perception. However, after last meeting Belka said he was not sure if the MPC is ready for that and if it is actually able to resent in public a list of metrics (thresholds), which would be important for future changes in rates. Let us remind that we saw a similar pattern in case of President's comment on forward guidance – Belka stated at press conference in October that it is not very useful in Poland, meanwhile the MPC extended its forward guidance in November and stated in *Inflation Report* that such a policy is quite effective in Poland.

Foreign exchange market – This week exchange rates under influence of CPI data







ECB strengthened, while data from the US (temporary) weakened zloty…

- Last week Polish zloty gradually appreciated against the euro. The EURPLN declined during the ECB's press conference, when its governor Mario Draghi has reiterated that official rates will remain stable or even lower if needed. Consequently, the EURPLN fell temporary to 4.183, closer to the lower band of narrowing trading range, but did not break it.
- Zloty also gained in relation to the US dollar (by 0.6% in weekly terms) and British pound (by 0.4%). The USDPLN declined towards 3.06 due to the dollar's depreciation. Against Swiss franc, zloty slightly lost (by 0.5% in weekly term), with the CHFPLN increasing above 3.42, the highest level since the beginning of October.
- One should notice that the range of trading for the EURPLN has been narrowing in recent days. The exchange rate has been approaching the end of flag pattern (see chart), which suggests that more significant move might come soon. Zloty's reaction to better than expected US labour market data was temporary and limited against the euro (after increasing above 4.20, the EURPLN declined below 4.19) and relatively stable in relation to the US dollar (near 3.06). Domestic macro data (mainly balance of payments), which will be released this week should support domestic currency. Their publication might create impulse for breaking out of the flag pattern.

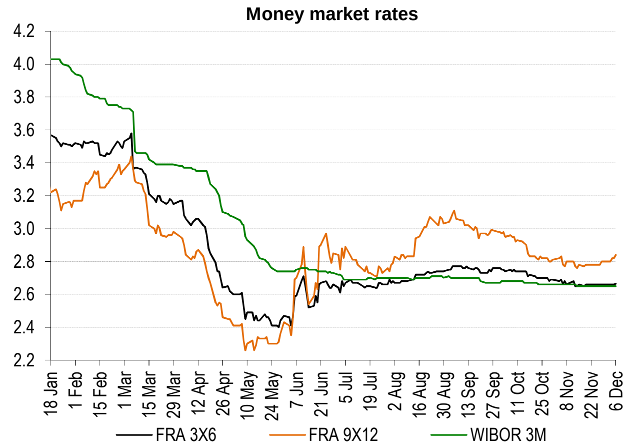
… and the single currency

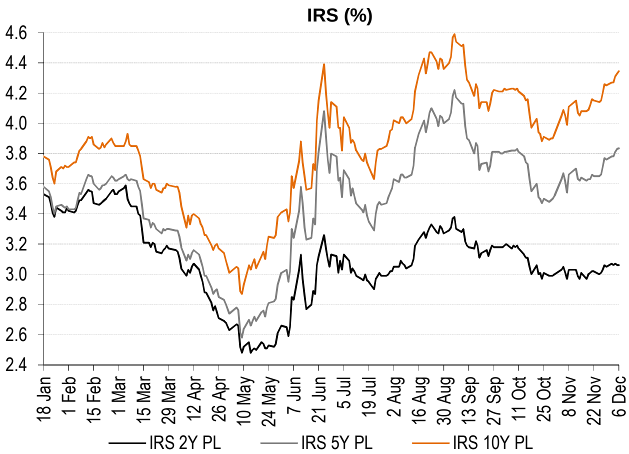
- Since the beginning of the past week the euro was under pressure vs. the dollar. This was due to better than expected data from the US (among others, second estimate of GDP). At the same time, euro zone's data showed some divergence of the pace of recovery among certain countries. The euro strengthened only after the ECB meeting – the tone of Draghi's comments proved less dovish than expected. Consequently, EURUSD surged to 1.366 and was close to this level before the US nonfarm payrolls data. The release surprised to the upside, but the plunge of the exchange rate proved only temporary and EURUSD soon rebounded to weekly peak at c.1.369.
- This week more macro data is due to be released. Recent publications indicate that US economy is outperforming the euro zone. Consequently, currently the market sees 50% of probability that QE3 tapering will start in December. In our opinion, Q1-14 is more likely and thus we expect the exchange rate to stabilize around 1.36 in coming days.

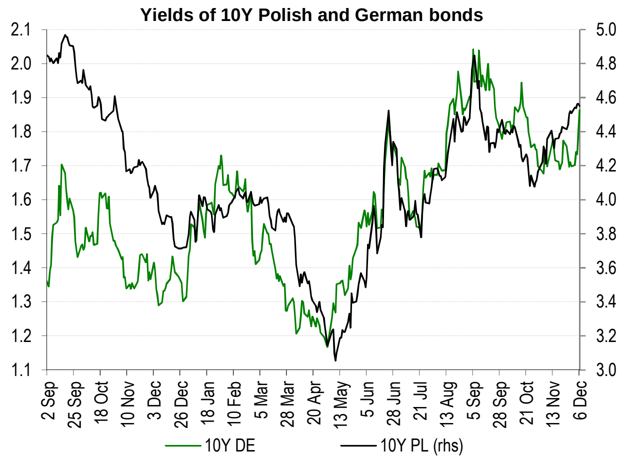
CEE3 currencies under pressure of inflationary data

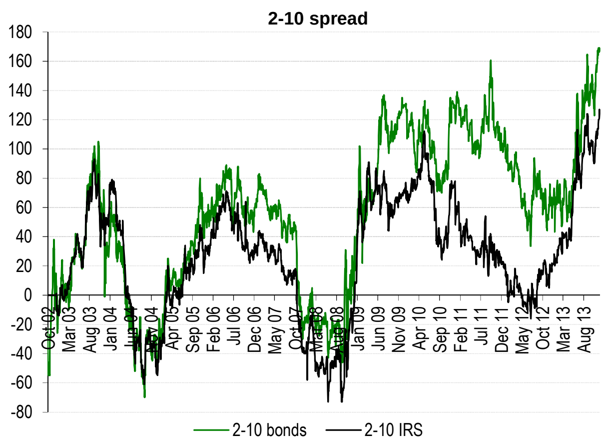
- Beginning of December was marked by weakness of other CEE3 currencies. March of EURHUF towards 304 was due to expectations for a further monetary policy easing by the Hungarian central bank. The Hungarian currency was also negatively affected by uncertainty about further actions regarding assistance for FX-denominated mortgage loans. The Czech koruna is also under pressure due to uncertainty about further actions of the central bank. The weaker-than-expected macro data (like retail sales) are also adding volatility to EURCZK.
- This week investors will focus on inflation data. The Czech Republic and Hungary are threatened by deflation - annual CPI in October in both countries reached the lowest levels in several years. This trend can be continued in the upcoming months, which can encourage central banks to ease further (another interest rates cut in Hungary - which is our baseline forecast - or a possibility of Czech interventions). Rise of such a risk can maintain EURCZK and EURHUF at elevated levels.

Interest rate market – Chance for narrowing of 2-10 spreads









Stabilisation on the money market

- It was another stable week on the money market. WIBOR6M fell by 1bp, while other rates in 1-12M sector did not change in weekly terms. FRA market pricing of future MPC decisions also did not change. The market expects a slight increases in WIBOR rates and a not-full interest rate hike in 9 months' time.
- We are expecting, similarly as the market, that data on November's inflation, due for release this week, will be in line with the scenario presented in the MPC statements – gradual GDP growth among limited inflationary pressure. Thus, we think that the upcoming week will show stable money market again.

Rises under impact of robust data from the USA

- Robust data from the USA, released at the beginning of the week caused a rise of Polish IRS and bond yields. On the other hand, let us note that scale of move on the domestic FI market was less considerable than on the core markets (yield of 10Y German yield climbed by 14bp over two days). Only in reaction to better-than-expected data from the US labour market a more considerable move was observed in Poland, following weakening on the core markets. In weekly terms, IRS rates went up by 1bp for 2Y, 8bp for 5Y and 10bp for 10Y. Scale of moves on the debt market was less considerable (increase by 4bp at the middle and the longer end, 8bp for 2Y), but trade volume was low throughout the week.
- The Ministry of Finance presented quite surprising offer of bonds for a switch auction: PS0416 and WZ0119. Biggest domestic holders are private pension funds (OFE) with PLN5.3bn (22.4% of amount outstanding, data at the end of October). In case of WZ0119, OFE held nearly PLN1.2bn of this security at the end of October (nearly 58% amount outstanding). It seems that the outlook of transfer of bonds from OFE to state pension fund (ZUS) may already now encourage the Ministry to support liquidity on the market, and these are main reasons to offer those securities on Thursday. Still, the auction was not very successful. The Ministry of Finance sold PS0416 bond for ca. PLN2bn and WZ0119 for PLN603m. Even exceptionally high coupon of PS bond (5%) did not attract bigger demand. Deputy finance minister, Wojciech Kowalczyk, said that after this auction next year's borrowing needs are covered in more than 20%.

Domestic inflation will stabilise the shorter end

- This week we will not see many important macroeconomic data, but the market may still stay under influence of better-than-expected US data on non-farm payrolls. Since the last days of October yields of 5 and 10Y bonds and IRS are moving in upward trends. After a week of upward surprises in the US numbers, worries that QE3 will be tapered in December are limiting a potential for further correction. On the other hand, reaction of Polish and Germany FI market to the positive release was dynamic, yet short-lived.
- Short end may be stabilized by data on Polish inflation, as they will be in line with scenario serving as a base for MPC's declaration that rates will be stable until mid-2014.
- Chart beside shows that domestic curves steepened strongly over the last weeks, and this is a trend visible also on the global markets. If data do not disappoint, then some recovery may be recorded on the long ends of the curves and then 2-10 spreads would narrow for IRS and bonds.

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 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.