Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

13 – 19 January 2014

Moods in the financial markets remained last week under influence of central banks' rhetoric, despite better than forecast data from the USA and Germany. In line with expectations, the MPC, ECB and BoE kept monetary policy parameters unchanged. However, clear commitment of the ECB to act further if needed has supported the debt markets (mainly at the short end of curves). On the other hand, minutes of the December's Fed meeting showed that majority of the FOMC members supported continuation of gradual reduction of the bond buying program, which gave impulse for strengthening of the US currency. The EURUSD fell below 1.36 before the release of December's US non-farm payrolls data. However, the latter proved to be much weaker than expected, which weakened dollar at the end of the week.

This week we will see important data in Poland and abroad. Investors' attention will focus on inflation numbers. We predict a rise in CPI and core inflation, however inflationary pressure is still so low that the move should not have significant negative impact on the debt market. After disappointing US employment data, the next releases from this country and a series of FOMC members' speeches planned for this week will have particular meaning for the market.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 January)					
		No important data releases					
		TUESDAY (14 January)					
11:00	EZ	Industrial output	Nov	%MoM	1.5	-	-1.1
14:00	**PL**	**Money supply**	**Dec**	**%YoY**	**5.8**	**6.1**	**5.7**
14:30	US	Retail sales ex autos	Dec	%MoM	0.4	-	0.4
		WEDNESDAY (15 January)					
9:00	HU	CPI	Dec	%YoY	0.4	-	0.9
14:00	**PL**	**CPI**	**Dec**	**%YoY**	**0.7**	**0.8**	**0.6**
20:00	US	Fed Beige Book					
		THURSDAY (16 January)					
11:00	EZ	HICP	Dec	%YoY	0.8	-	0.9
14:00	**PL**	**Core inflation**	**Dec**	**%YoY**	**1.2**	**1.3**	**1.1**
14:30	US	Initial jobless claims	week	k	325	-	330
14:30	US	CPI	Dec	%MoM	0.3	-	0.0
16:00	US	Philly Fed index	Jan	pts	8.7	-	6.4
		FRIDAY (17 January)					
14:00	**PL**	**Current account**	**Nov**	**€m**	**-1092**	**-1200**	**-466**
14:00	**PL**	**Exports**	**Nov**	**€m**	**13 658**	**13 576**	**14 622**
14:00	**PL**	**Imports**	**Nov**	**€m**	**13 790**	**13 836**	**14 569**
14:30	US	House starts	Dec	k	990	-	1091
14:30	US	Building permits	Dec	k	1010	-	1007
15:15	US	Industrial output	Dec	%MoM	0.3	-	1.1
15:55	US	Flash Michigan	Jan	pts	83.2	-	82.5

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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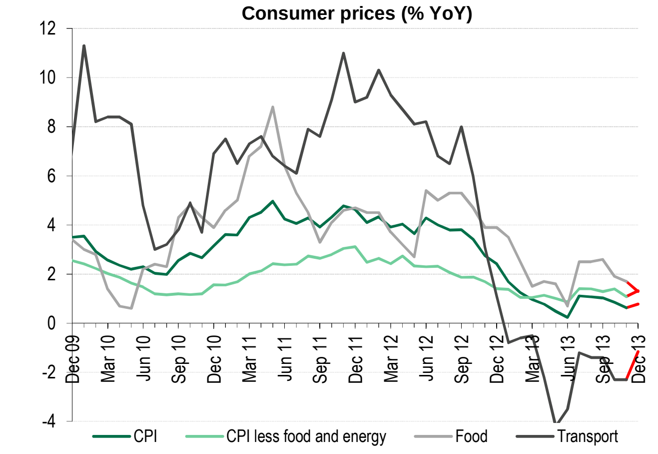
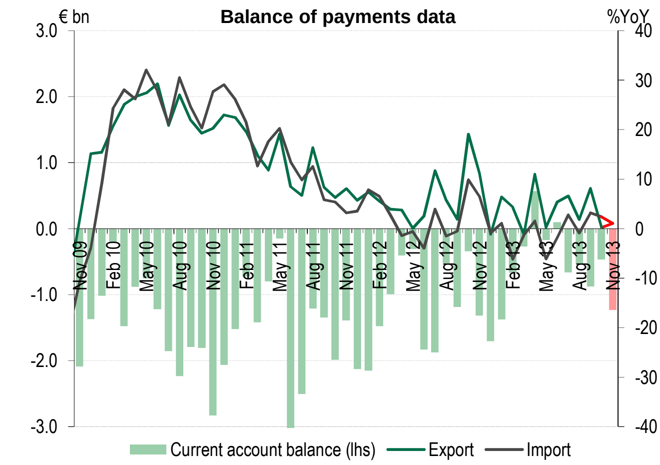
What's hot this week – Slightly lower inflation, current account deficit

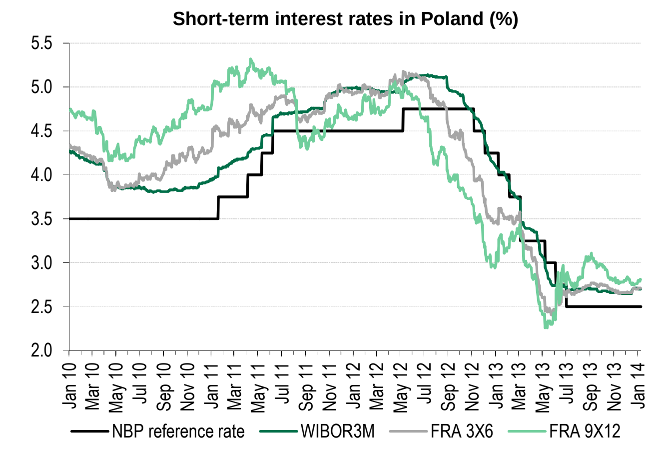


- We are expecting that in December CPI inflation increased to 0.8%YoY from 0.6%YoY in November. Rise of CPI indicator is mainly to be blamed on higher fuel prices. Our forecast is slightly above market consensus (0.7%YoY). As regards core inflation excluding food and energy prices, we are estimating it reached 1.3%YoY vs. 1.1%YoY in November and we are slightly above consensus also in this case (1.2%YoY). Reading of inflation gauges in December will not affect outlook for domestic monetary policy.
- In our view inflation will be climbing in the upcoming months, to ca. 2%YoY at the year-end.
- CPI path may be strongly affected by food market situation. As for the time being, it is a strong disinflationary factor (in 2H2013 global index food prices calculated by FAO and adjusted by PLN exchange rate was falling by 6-8%YoY), but this situation may reverse under impact of variable weather conditions.



- We estimate that November's current account data will show the highest deficit since January 2013. According to our estimates, this was due to low surplus in current transfer balance (due to weak inflow of funds from the European Union) and seasonal deficit in trade of goods (we are estimating that import was higher than export for the first time since March 2013). We are expecting that in the upcoming months exports will be higher than imports again on the back of economic revival abroad and only moderate acceleration of domestic demand.
- We are expecting a slight acceleration of M3 growth rate in December. We are forecasting that growth rate of deposit rate decelerated somewhat, while loan growth accelerated slightly, probably mainly in sectors of consumer loans and investment loans for companies.

Last week in the economy – No surprises in monetary policy



- The Monetary Policy Council kept interest rates unchanged. The most important part of the MPC's statement was also left intact. The Council maintained the opinion that the NBP interest rates should remain on hold at least until the end of first half of 2014. In the MPC's view, reduction of interest rates in the first half of last year and keeping them at low level in subsequent quarters will support revival of domestic economy, gradual return of inflation towards the target, and stabilisation in financial markets. In the statement the Council noticed a continuation of gradual economic recovery (suggested by business climate indicators, growth of industrial output and retail sales, and some rebound in construction), which to a limited extent translates into improvement in the labour market situation (high unemployment is curbing wage and demand pressures in the economy), while inflationary pressure stays low.

Quote of the week – There are no risks which can change monetary policy

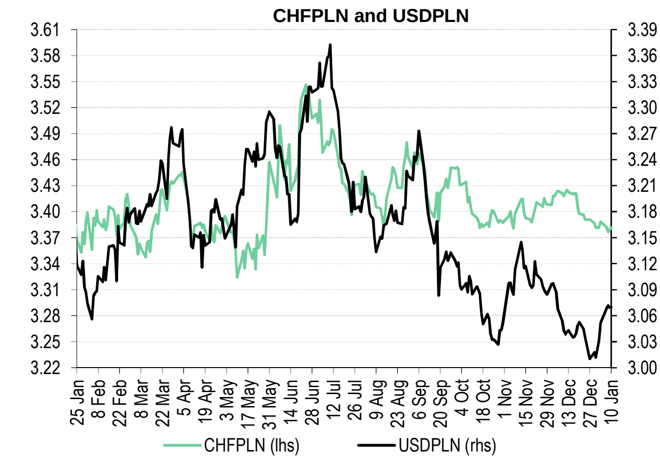
Marek Belka, NBP Governor, 08.01, NBP conference
I see no risks that can potentially change the monetary policy. In two months we will see the new NBP projection and this will help us to talk about the most probable inflation and GDP paths with a bit more confidence. We think that economy might surprise to the upside.

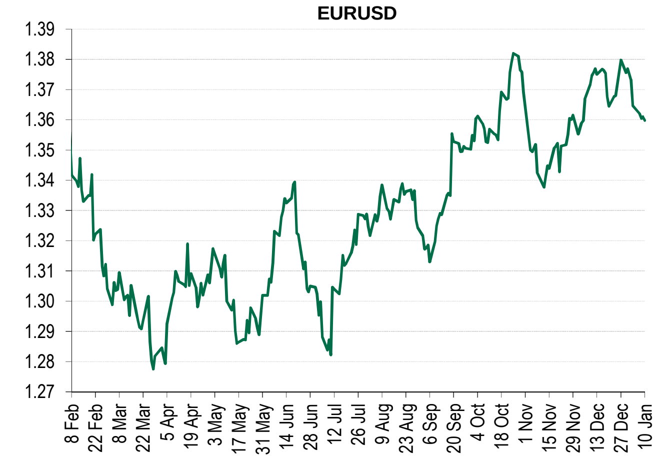
Andrzej Kaźmierczak, MBP member, 08.01, NBP conference
We still have a negative output gap, so there are no inflationary risks as regards internal situation; as regards external factors (…) there are no threats as well.

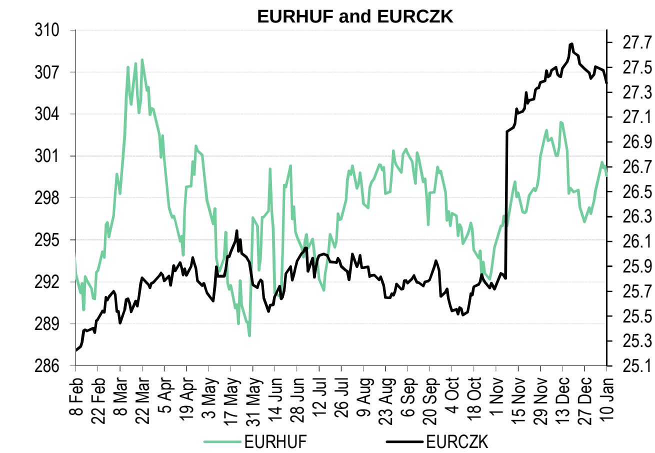
Jerzy Hausner, MBP member, 08.01, NBP conference
I see no risks as well and I suggest all interviews to be rescheduled for H2, as I will say nothing new until this time.

It seems that the March meeting of the MPC will be clearly more interesting that the last one, as we will see update of inflation and GDP projection. New projection will help to assess how long will interest rates remain unchanged. We maintain our forecast that the first hike will be implemented in autumn, but we see the risk of extension of stable-rate period. This will depend on expected inflation path and possible further changes in the MPC composition, should NBP act be amended. This was the first MPC meeting with Jerzy Osiatyński, the new Council member. It is hard to judge the impact of his presence on the discussion However, comments of Osiatyński presented recently suggest that after his access to the MPC, it may be harder to gather the majority for hiking interest rates.

Foreign exchange market – US data and FOMC members' speeches in the spotlight







Zloty paring losses from early 2014

- We have been heralding for some time already that some bigger move may be recorded in case of EURPLN. During the Christmas/ year-end period we have actually experienced higher volatility on the market, and the exchange rate was testing 4.14 quite aggressively. Start of QE3 tapering did not have a negative impact on the zloty , an impulse for (temporary) drop below 4.14 came from the capital market (rising stock prices fuelled by FOMC rhetoric indicating that decision on limiting QE3 was based on expectations for further recovery of the US economy) and BGK state bank activity on the market at the year-end.
- According to Bloomberg, in 2013 the zloty was third strongest currency vs. the euro, dollar, Swiss franc and British pound compared with performance of currencies from emerging markets. However, at the turn of 2013/2014, EURPLN, USDPLN, CHFPLN and GBPPLN increased more than in case of, for example, Turkish lira, Russian ruble or many LatAm currencies. The zloty (and to some extent also Czech koruna and Hungarian forint) has been pressured by weaker than expected December's manufacturing PMI that showed a decline in our region. Additionally, Warsaw stock exchange is clearly underperforming compared to situation in the Western Europe and this might have also weighed on the domestic currency.
- December's US nonfarm payrolls have clearly disappointed and lead to visible appreciation of the zloty at the end of the past week (EURPLN plunged to 4.16 and USDPLN to nearly 3.04). This week many FOMC members will give public speeches and after the recent disappointing US data investors will try to judge how this reading influenced their opinion on further QE3 tapering. Some negative pressure on the zloty may be put by domestic balance of payments (we expect deeper deficit than market consensus).

High volatility of EURUSD

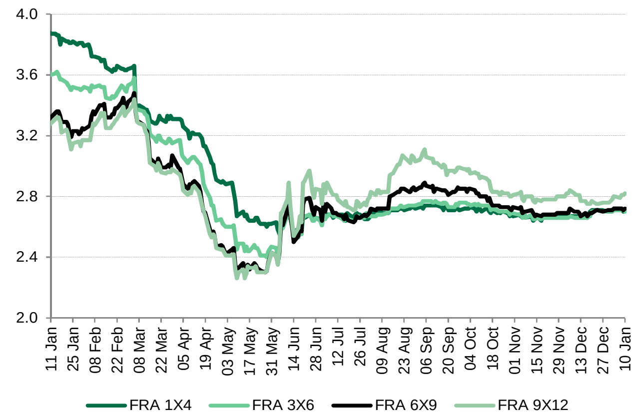
- Lower liquidity at the year-end resulted in some higher volatility of EURUSD – the exchange rate broke temporarily peak from end-October (1.383) and reached nearly 1.39. Early 2014 saw stronger dollar – the euro was pressured by data from the euro area (showing uneven recovery) and positive news from the USA. Rhetoric of the ECB – stronger declaration on readiness to act – also supported the downward move to 1.355. A trigger for a rebound came from the much weaker than expected US labour market data – at the end of the past week the exchange rate was above 1.365.
- This week a set of vital US data is due to be released and some FOMC members will give public speeches. It seems then, that expectations regarding further decisions on QE3 may have major impact on EURUSD in the coming week. Crucial levels for EURUSD are at 1.355 and 1.38, respectively.

Forint and koruna similar to the zloty

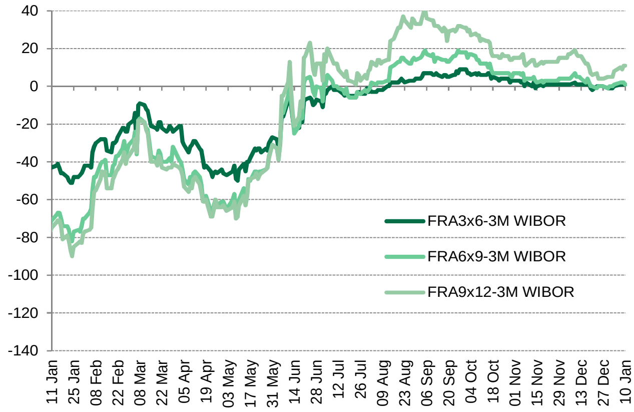
- Just like in case of the zloty, Czech koruna and Hungarian forint came under pressure at the beginning of the year. An upward move of EURCZK was rather limited, but EURHUF rebounded from 296 to slightly above 301. Both currencies managed to recover thanks to decent macro data and a rebound of inflation (in case of koruna) and successful bond auction and suggestion the easing cycle may be getting to an end (factors vital for the forint).
- Forint gained after the weak US nonfarm payrolls. In the following week, next to global market sentiment the data on Hungarian CPI may be important. It may help to judge when the monetary policy easing cycle in Hungary may end.

Interest rate market – Slightly higher CPI should not hurt bonds

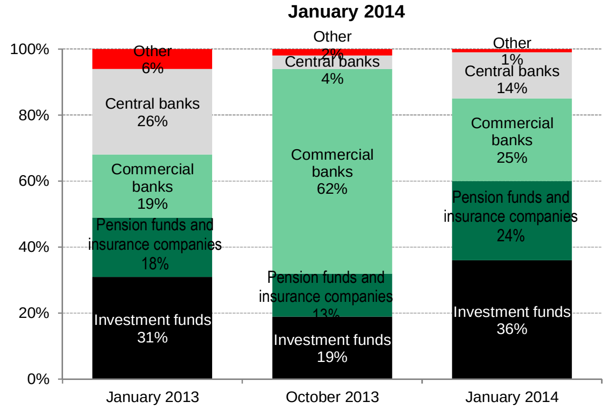
FRA (%)



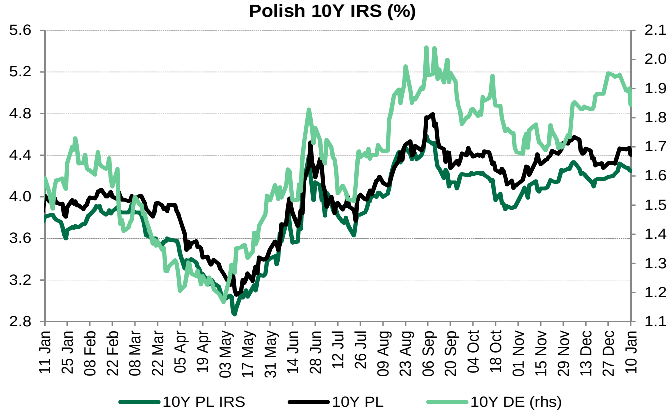
Spread between FRA and WIBOR 3M (in bp)



Institutional distribution eurobonds issued in 2013 and in January 2014



Yields of Polish and German 10Y Bonds and Polish 10Y IRS (%)



Stable beginning of a new year

- Turn of the year brought increase in WIBOR 1M to 2.62% and WIBOR 3M to 2.71% (the highest levels since the end of August 2013), while other WIBOR rates were more or less stable. As in previous weeks FRA rates were more sensitive to released macroeconomic data. Better than expected figures (mainly lower CPI inflation) caused decline in FRA rates. As a consequence spread between FRA and WIBOR 3M narrowed significantly.
- The money market was relatively stable at the beginning of the new year. While WIBOR rates did not change significantly, FRA rates, in particular for longer tenors (9 months and longer) increased gradually. Notwithstanding, market expectations on the first rate hike did not change significantly –market is still pricing-in the start of monetary tightening in 4Q 2014.
- Strong MPC's declaration that official rates will remain unchanged at least till the end of June 2014 (repeated also in January's statement) supports our basic scenario, assuming relatively stable WIBOR rates in coming weeks. Still FRA market will be more changeable. Expected growth in the headline CPI (to 0.8%YoY) might support upward trend in FRA rates (in particular for longer tenors).

Higher volatility on T-bonds and IRS markets

- Turn of the year brought profit taking on both T-bond and IRS markets. Upward trend of yields/rates strengthened in the first days of 2014, in which yield of 10Y increased towards 4.50%, while 10Y IRS reached the level of slightly above 4.30%. Favourable auction results of domestic T-bonds and dovish rhetoric of the ECB supported the front end and mid of curves. At the same time 10Y sector was under pressure of global factors as well as higher supply from domestic investors. As a consequence yield curve become more steep, with 2-10Y spread widening towards 160bp, following global tendencies (yield of 10Y UST increased to 3.05%, while yield of 10Y Bunds to 1.90%). But only weaker than expected the US non-farm payrolls caused yield decrease in this sector. As regards IRS, we noted some rebound in 10Y rate after sharp increase in the first days of 2014. It resulted in curve flattening on the one side and asset swap spread widening in 10Y sector on the other one.
- Start of the year brought higher activity of Finance Ministry as the debt issuer. The ministry placed 10Y bonds worth €2bn in total and bonds PS0718 and WZ0124 worth PLN5.2bn. Both auctions saw high demand. Let us note that 10Y euro-denominated bond was placed with 3.032% yield, the lowest level in history. After these actions, this year's borrowing needs are covered almost in 40%. Such a high realization makes it probable that borrowing needs will be covered in 60% at the end of March.

Inflation should not weigh on bonds

- This week domestic investors will focus on inflation data (CPI, core inflation). The still low inflationary pressure should be supportive for stabilization on the shorter ends of curves.
- Middle and longer end of curves will remain under impact of global factors, mainly expectations on Fed policy. Changes in OFE will negatively affect the longer end in the upcoming days/weeks. Thus, we are expecting that curves will remain steep.

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.