

WEEKLY ECONOMIC UPDATE

31 March – 6 April 2014

Last week brought a further improvement of global market sentiments. This was due to expectations that government of China will decide for further actions supporting the Chinese economy (after weaker macro data), but also due to information from Ukraine (agreement about loan with IMF, approval of anti-crisis bill by the Ukrainian parliament). These factors fuelled a further strengthening of emerging markets' currencies, including the zloty. On the other hand, we saw some more dovish signals from the ECB representatives, which fuelled market expectations for more monetary easing in the euro zone. As a result, EURUSD declined, while bonds of euro zone peripheries were gaining, similarly as the Polish debt.

This week investors will focus mostly on the ECB meeting. The euro zone's central bank will be considering whether to take more actions aiming at lowering the deflationary risk. In our view, the ECB will wait not take such a decision yet and will maintain its dovish rhetoric. Materialization of such a scenario would mean a profit-taking after recent strengthening of the dollar or German debt. Strength of this rebound will be determined by the USA data. Ukraine will remain in centre of attention.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (31 March)							
11:00	EZ	Flash HICP	Mar	%YoY	0.6	-	0.8
14:00	PL	Current account	Q4	€m	-2013	-2013	-2072
14:00	PL	Inflation expectations	Mar	%YoY	-		0.6
TUESDAY (1 April)							
3:45	CN	PMI – manufacturing	Mar	pts	48.1	-	48.5
9:00	PL	PMI – manufacturing	Mar	pts	55.5	54.8	55.9
9:00	CZ	Final GDP	Q4	%YoY	1.3	-	0.3
9:53	DE	PMI – manufacturing	Mar	pts	53.8	-	54.8
9:58	EZ	PMI – manufacturing	Mar	pts	53.0	-	53.2
16:00	US	ISM – manufacturing	Mar	pts	54.0	-	53.2
WEDNESDAY (2 April)							
14:15	US	ADP report	Mar	k	190	-	139
16:00	US	Industrial orders	Feb	%MoM	0.8	-	-0.7
THURSDAY (3 April)							
9:53	DE	PMI – services	Mar	pts	54.0	-	
9:58	EZ	PMI – services	Mar	pts	52.4	-	52.6
11:00	PL	Bond auction					
13:45	EZ	ECB decision		%	0.25	-	0.25
14:30	US	Initial jobless claims	week	k	-	-	
FRIDAY (4 April)							
12:00	DE	Industrial orders	Feb	%MoM	0.3	-	1.0
14:30	US	Non-farm payrolls	Mar	k	190	-	175
14:30	US	Unemployment rate	Mar	%	6.6	-	6.7

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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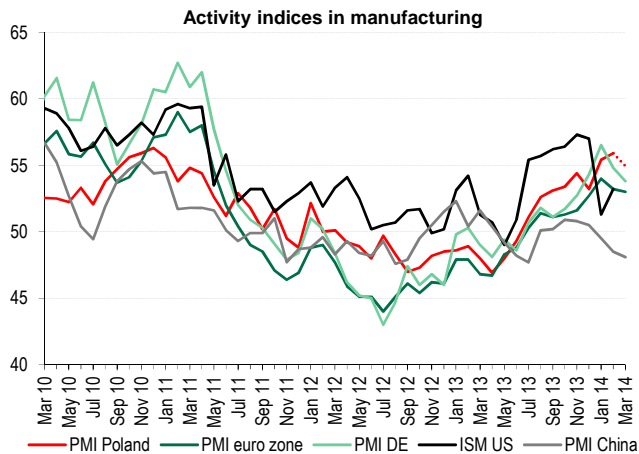
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What's hot this week – Activity in industry and quarterly balance of payments

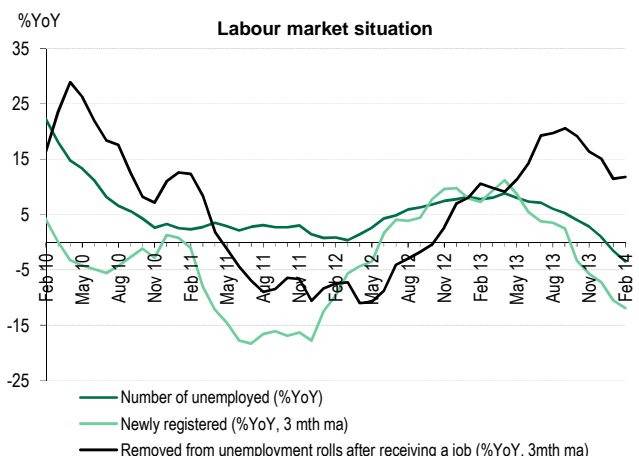
▪ After a series of impressive gains in previous months, March's PMI will probably show some downward correction following analogous move in the euro zone and Germany. Still, the index will remain in zone consistent with solid expansion in manufacturing, which suggests a decent reading of March's industrial output. Please note that seasonally adjusted CSO's business climate index climbed in March to the highest level since December 2010, while subindex of industrial output climbed substantially and reached the second highest level since April 2008.

▪ Monthly balance of payments data suggest that in 4Q2013 the current account deficit was close to previous quarter (ca. €2bn) but pace of growth of exports and imports was a bit lower (3.7%YoY and 1.2%YoY, respectively). However, the quarterly release may bring some revision of the data, as usual.

Last week in the economy – Labour market revival is supporting consumption

▪ February brought an acceleration of retail sales growth to 7%YoY, the highest level since May 2012. This was partially due to high sales of personal cars registered as trucks and low statistical base. However, according to our estimates, retail sales excluding cars and fuels also accelerated – to 4.2%YoY (the highest growth rate since August 2012).

▪ High growth rate of sales and, in general, of consumer demand is underpinned by recovery of the labour market, which results in faster growth of personal income and improving consumer confidence. Recent data are in line with our scenario of economic recovery, driven not only by net exports, but also by consumption and investment. These figures support our scenario of GDP growth in Q1 by slightly above 3% and by 3.5%YoY in the entire 2014.



▪ Decline in registered unemployment rate was deeper than expected. In February unemployment rate reached 13.9% versus 14% in January 2014 and 14.4% in February 2013. The number of unemployed persons amounted to 2255.9k and was lower by 4.8k than in the previous month and by 80.8k as compared the same period of 2013.

▪ The number of unemployed people fell in monthly terms, and such a development is untypical for this month (last time we saw it in 2008) and is suggesting that recovery on the Polish labour market is gaining steam. In upcoming months we expect the registered unemployment rate to continue downward trend. It will come from not only further economic recovery, but also from increase in seasonal works.

Quote of the week – Influence of situation in Ukraine will not be dramatic

Wojciech Kowalczyk, deputy finance minister, 27 March, Reuters

Crisis in Ukraine and potential trade disruptions can only slightly affect the economic growth, they can slow down its acceleration, but not halt it. In the first quarter we are expecting a GDP growth of ca. 3%, in the second half of the year we may see rising investment, also due to inflow of new funds from the EU.

Mateusz Szczurek, finance minister, 26 March, Reuters

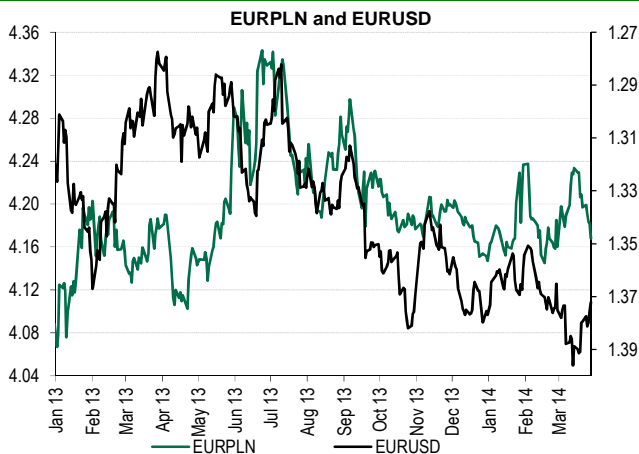
GDP growth may prove much higher than assumed in the budget bill, above 3%.

Marek Belka, NBP president, 24 March, TVP Info

Polish economy, so far, and as regards the currency, did not feel this. However, we know there may be some problems, or are already, with exports to Russia or Ukraine (...) (Situation in Ukraine and Russia) may have an impact, it is visible, but it will not be dramatic.

According to representatives of the Finance Ministry and the NBP president the situation in Ukraine should not weigh on economic growth in Poland too much. We support the opinion that impact on Polish economy should be limited, at least as long as tensions between Russia and the West do not undermine the fragile recovery in the euro zone (e.g. due to escalation of economic sanctions, trade limits or disruptions in supplies of gas and oil). As for the time being, the negative scenario does not seem most probable, yet we should be conscious of the fact that future developments of the situation may be unpredictable (taking into account the concentration of Russian forces close to Ukrainian border).

Foreign exchange market – Zloty benefits from euro's weakness, Ukraine still crucial



Zloty gains vs. the weak euro...

▪ The past week was already second in a row when the zloty gained vs. the euro. The domestic currency was supported by Polish data, news from Ukraine and expectations for further monetary policy easing by the ECB. Taking a broader glance on the Polish FX market we see that recent six weeks in case of EURPLN are very similar to mid-January/mid-February period. After three weeks of an upward move of EURPLN recorded at that time (triggered by high risk aversion in the emerging markets), next two weeks saw a move down from 4.26 to 4.14.

▪ We suppose that some part of the zloty's appreciation versus the euro is due to weakness of the single currency observed in the global market (see next paragraph). Despite some positive news from Ukraine (among others, on the IMF loan for this country and structural reforms voted by Ukrainian parliament), we think it is too early to erase this issue from the list of risk factors given rising activity of Russian army just beyond the Ukraine's border.

▪ Although there are chances of zloty appreciating to 4.14 per euro, we do not expect this move – if it materializes – to be persistent given the situation beyond our eastern border. This week the ECB decision may be crucial. If the central bank again shows its readiness to act only verbally, then the single currency may recover at least part of losses suffered in recent weeks vs. the zloty and other currencies.

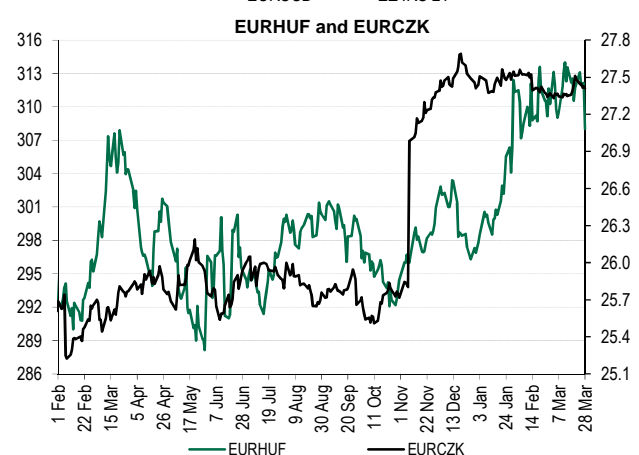
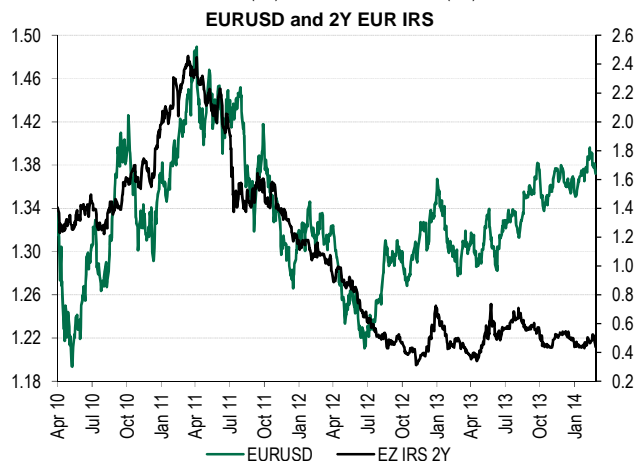
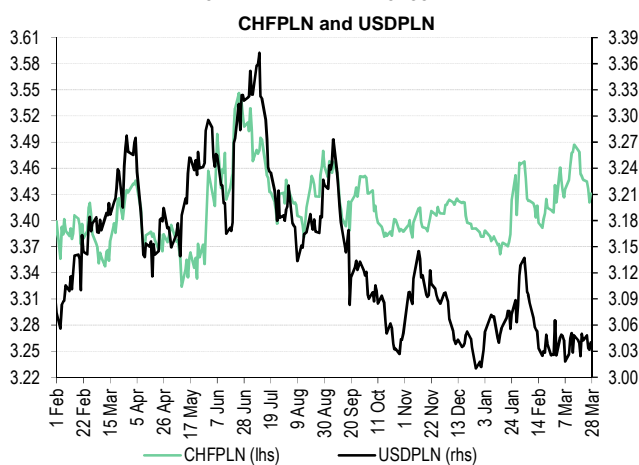
... that depreciates before the ECB decision

▪ Euro's weakening recorded in recent weeks on the global market indicates that ECB officials, who have been repeating the ECB's readiness to take further actions in order to defend the euro zone against deflation, have reached their goal – EURUSD plunged for already second week in a row (from 1.39 to nearly 1.37 in recent days). Since the market sentiment has improved in mid-March (when there was no severe tensions in response to outcome of the Crimea referendum), the single currency depreciated vs. nearly all EM currencies (except the Ukraine hryvnia or the Argentine peso) and vs. the majority of core currencies (Canadian, New Zealand or Australian dollar, the pound or yen). The US dollar was additionally supported by statement after the FOMC meeting, followed by comments of the Committee's members, and decent US macro releases.

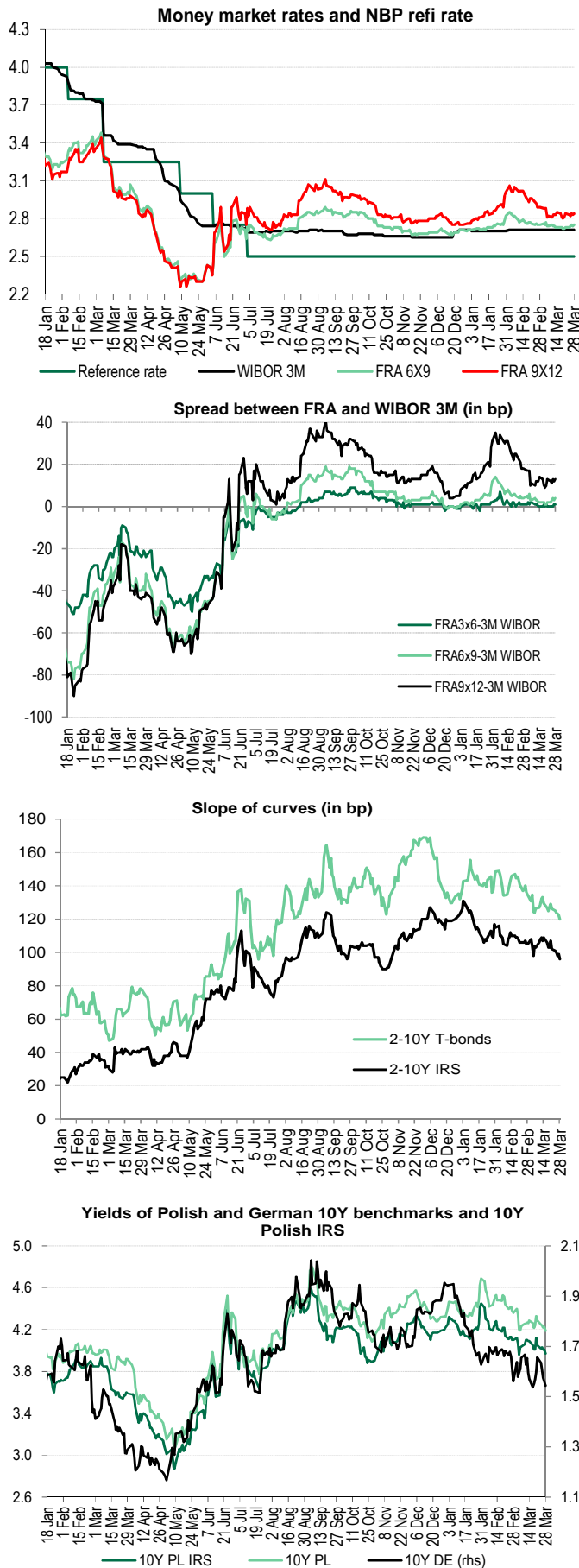
▪ Recent remarks of the ECB officials, particularly of the Bundesbank head (who did not rule out QE as a tool that may be used), as well as readiness to take further actions repeated in the statements from the meetings strengthened expectations, that the central bank will finally stop talking and starts doing. After last plunge of EURUSD, further easing of the monetary policy is already priced in to some extent, so only any extraordinary steps may trigger further depreciation of the euro. If the ECB does not extend beyond verbal interventions, then the single currency may start to recover after recent losses.

No breaking changes of the koruna and the forint

▪ EURCZK remained stable while forint gained slightly versus the euro, similarly to the zloty. The Czech central bank kept interest rates unchanged, in line with expectations. The bank reiterated that it plans to keep EURCZK above 27.0 at least until start of 2015. Miroslav Singer, central bank president said that should there be a need to ease monetary policy further, the bank would be more prone to extend its horizon of keeping EURCZK above 27 than to raise this floor. Statement from the meeting said there is some downward risk for inflation forecasts. The S&P decision to raise Hungary's credit outlook to stable from negative did not trigger any considerable changes in the region.



Interest rate market – Domestic debt strengthened thanks to global mood improvement



Stable expectations on future NBP's rate path

▪ Last week did not bring any significant changes in money market rates. WIBOR rates have remained stable, supporting by comments from MPC's members, who suggest that period of stable rates may be extended further at least till the year-end. Better than expected retail sales data, however, caused increase in FRA rates by 1-3bp in weekly terms. Notwithstanding, investors' expectations of the timing of the first hike remain stable. Market is pricing-in rates increase by 25bp in one year period.

▪ This week money market rates should remain stable due to lack of important domestic macro data releases. We think that publication of the March's PMI for manufacturing may influence FRA market in short-run. However, we expect valuation of FRA12x15 to stabilise around 3%.

Continuation of strengthening on bond and IRS markets

▪ Improvement on the global markets, combined, with strengthening zloty are the main factors, which caused strengthening of bonds and IRS last week. This tendency was temporarily halted by data on retail sales, which proved better than expected. Most considerable declines of yields were noted during Friday's session. Yield of 10Y, after breaking support at 4.20% declined temporarily towards 4.17%, only slightly above this year's minimum at 4.13%.

▪ Declines of yields and IRS were observed mainly in the middle and at the longer ends of curves, while the shorter end remained relatively stable. Due to these changes, 2-10Y spread narrowed to 120bp for bonds (the lowest level since August 2013) and to 96bp for IRS (the lowest level since October 2013).

▪ Improvement of global moods were also supported a narrowing of asset swap spreads (difference between bond yields and IRS rates for the same tenors), especially for 5 and 10Y sectors. Asset swap spread for 5Y narrowed to 16bp, 10Y to ca. 20bp (as compared to 20bp and 23bp one week earlier).

Auction and ECB meeting in the centre of attention

▪ Auction of T-bonds is the most important debt market event this week (03.04). Earlier (31.03) the Ministry of Finance will reveal details about issue plans for the second quarter with special focus on auctions in April. In our view, in April-June period the T-bond supply may reach PLN25-35bn as compared to sales at PLN38.3 in Q1 (total on regular and switch auctions). We are expecting a higher supply in April – as an effect of buyback of PS0414 (ca. PLN16bn) and coupon payments on April's PS and WS series (PLN5.6bn in total). A considerable part of these means will go to foreign investors (after cancellation of OFE portfolios non-residents were holding ca. 60% of PS0414 issue), so their demand will decide whether the auction is successful.

▪ Last week showed that domestic bond yields took cue from the core markets. Thus, the result of Thursday's ECB meeting may affect the domestic market. Dovish comments of the ECB representatives (including the Bundesbank president Jens Weidmann who thinks that negative deposit rates would be good solution to weaken the euro) awoke hopes for additional steps supporting the European economy. In our view, monetary policy parameters will remain unchanged and such a decision may encourage profit-taking both on core and domestic debt markets.

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