

WEEKLY ECONOMIC UPDATE

14 – 20 April 2014

After weak start of the week (effect of events in Ukraine and Bank of Japan's rhetoric), the following days saw a significant improvement of investors' moods after the release of minutes of March FOMC meeting. More dovish than expected Fed's discussion and expectations for ECB actions were the main factors that supported demand for risky assets, including Polish debt.

This week's agenda is quite abundant with data releases. Inflation data for the euro zone will be closely watched in the context of next ECB decisions – at the April's meeting the bank did not exclude non-standard measures to counter deflation. This may be the crucial factor for the core debt markets, but also for Polish bonds. Large number of important data from the USA will be released, as well as Polish figures, which should confirm economic recovery. The Ukraine will remain as a potential risk factor for market moods.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (14 April)							
11:00	EZ	Industrial output	Feb	%MoM	0.2	-	-0.1
14:00	PL	Money supply	Mar	%YoY	4.8	4.5	5.3
14:30	US	Retail sales	Mar	%YoY	0.8	-	0.3
TUESDAY (15 April)							
11:00	DE	ZEW index	Apr	pts	50.5	-	51.3
14:00	PL	CPI	Mar	%YoY	0.7	0.7	0.7
14:30	US	CPI	Mar	%MoM	0.1	-	0.1
WEDNESDAY (16 April)							
11:00	EZ	HICP	Mar	%YoY	0.5	-	0.5
14:00	PL	Core inflation	Mar	%YoY	0.9	1.0	0.4
14:00	PL	Wages in corporate sector	Mar	%YoY	0.4	3.6	4.0
14:00	PL	Employment in corporate sector	Mar	%YoY	0.4	0.4	0.2
14:30	US	House starts	Mar	k	968	-	907
14:30	US	Building permits	Mar	k	1000	-	1014
15:15	US	Industrial output	Mar	%MoM	0.5	-	0.6
20:00	US	Fed Beige Book					
THURSDAY (17 April)							
14:00	PL	Industrial output	Mar	%YoY	6.3	5.9	5.3
14:00	PL	Construction and assembly output	Mar	%YoY	13.9	10.6	14.4
14:00	PL	PPI	Mar	%YoY	-1.2	-0.9	-1.4
14:00	PL	MPC minutes					
14:30	US	Initial jobless claims	week	k	315	-	300
16:00	US	Philly Fed index			9.5	-	9.0
FRIDAY (18 April)							
No important data releases							

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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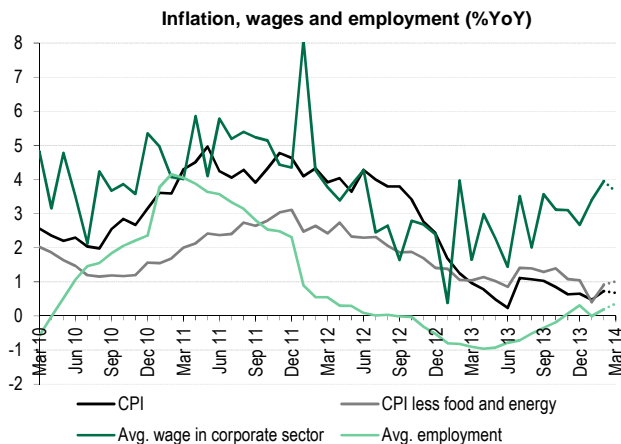
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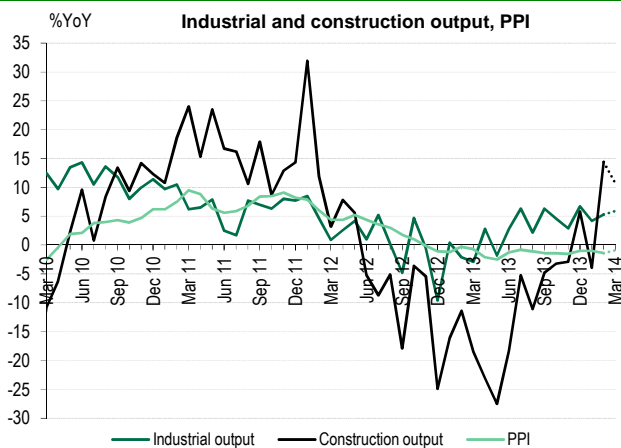
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What's hot this week – CPI inflation still low, industrial output and employment up



- Amongst numerous of macro data publications inflation figure will be one of the most important. Our forecast of inflation rate shows stabilization in March at 0.7%YoY (same as market consensus) as inflationary pressure remains weak and food and energy prices are still low (meat prices are depressed by ban on exports to Russia, and prices of fruits and vegetables are also under pressure of weaker trade with the East after significant weakening of the ruble and the hryvnia). Core inflation after excluding food and energy prices, according to our forecast, will increase to 1.0%YoY. Inflation figures should not significantly affect market expectations on monetary policy outlook.

- CPI inflation for the euro zone may be even more important than domestic reading. After April's meeting expectations that ECB will make steps to fight with deflationary risk increased significantly.

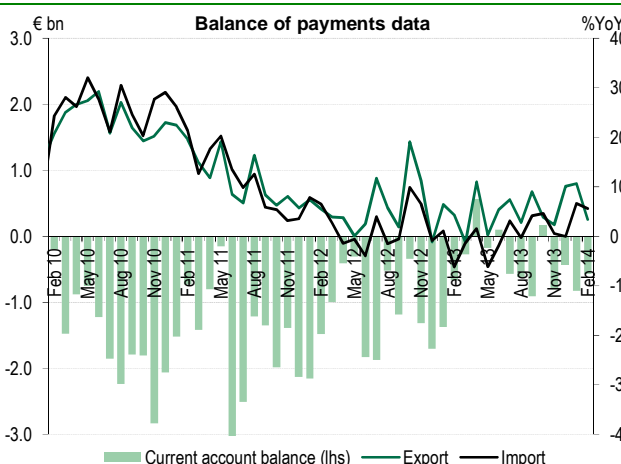


- Labour market data will confirm continuation of positive tendencies. We expect continuation in growth of employment numbers in enterprise sector and quite solid increase (but in lower pace in February) in wages. It should support further revival in private consumptions.

- Our forecast of industrial output for March is one of the most caution on the market, but it still assumes further improvement as compared with February. March PMI made us to be caution, showing lower industrial orders and production, but market pessimism would result from uncertain situation in Ukraine. On the other hand business sentiment presented by Statistical Office suggested another good month in industry.

- As regards construction sector, it will be difficult to repeat very good results from February, but weather conditions and base effect should still support growth (we would like to recall that in March 2013 it was snowing).

Last week in the economy – Predictable MPC, surprising balance of payments



- In line with expectations, in April the Monetary Policy Council kept interest rates on hold and maintained its rhetoric unchanged. It is likely that in July the Council may extend its *forward guidance* till year-end, but until then the MPC meetings will not be very exciting.

- In February current account deficit amounted to €572mn and was higher than expectations. It came from lower exports and imports data. It might have partly resulted from deteriorating situation on the East, but we should wait with going much too far with conclusions. In our opinion in the next part of this year both exports and imports growth should return to upward trend, while strengthening of demand from the West Europe and domestic side may largely offset the negative effect of Russia-Ukraine conflict. We uphold our baseline scenario of further narrowing current account deficit, which will decrease below 1% of GDP at the end of this year (after February it was only 1.1%).

Quote of the week – No changes of the statement until July

Marek Belka, NBP governor, 9 April, MPC press conference

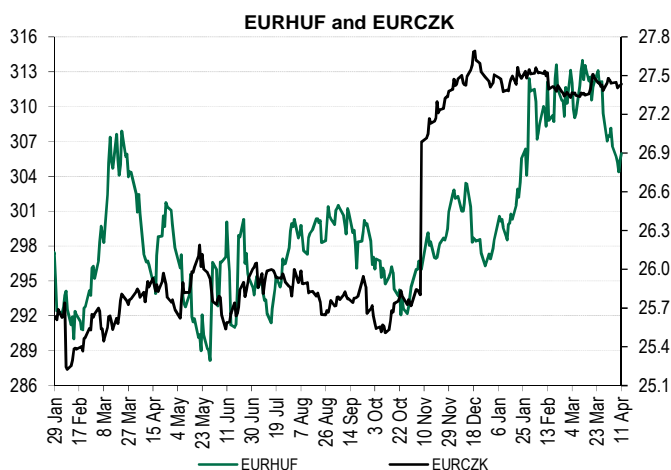
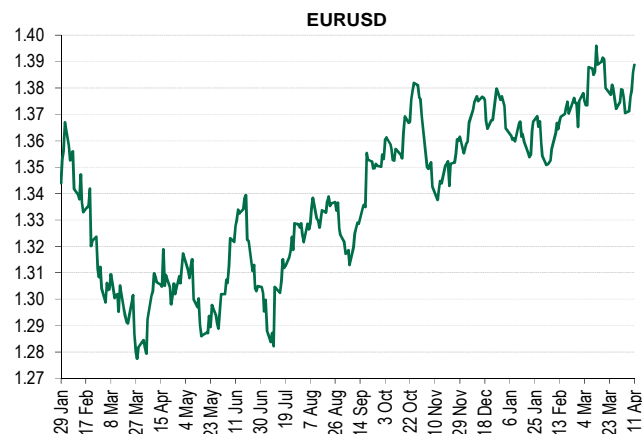
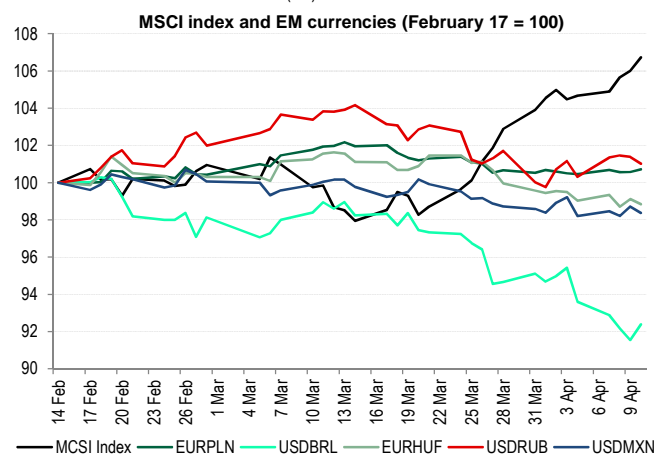
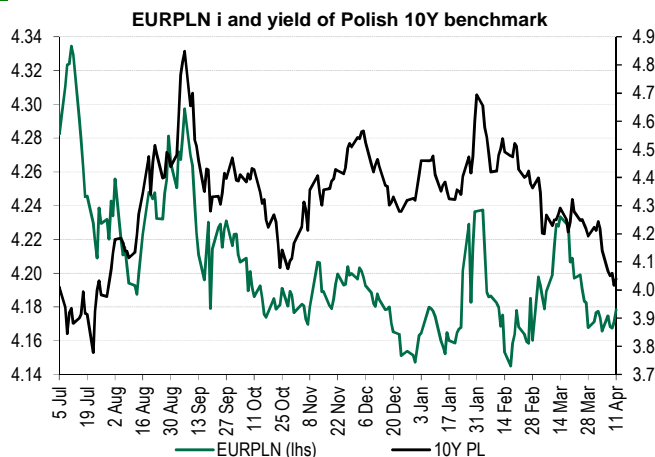
Probably in July, that is the month when new GDP and inflation projection will be presented, we will modify today's statement. Until then, if noting changes significantly, the tone of the statement is likely to remain unchanged. (...)

This (the ECB decision) may obviously change the environment for the monetary policy in our country. If the ECB starts asset buying program, that is increases the money supply, then this may lead to zloty's appreciation and will work towards lower inflation. On the other hand, the excess cash may flow into Poland and this may work in the opposite direction. (...)

Any recession in Ukraine and weak economic growth in Russia connected with possible trade sanctions, may have a downward impact on inflation and GDP growth.

Marek Belka, said during the press conference that if nothing special happens, then one should not expect any changes in the MPC tone and its bias until July (when fresh NBP projections will be available). This means that there are two rather unexciting MPC meetings ahead, which outcomes are easy to predict. At the same time, Belka reminded that numerous comments of the MPC members have recently indicated that the period of stable interest rates may be extended beyond the end of the 3Q14. This seems to be a clear suggestion, that in July the MPC may extend its forward guidance once again (probably until the end of 2014), provided that economic outlook does not change significantly. We uphold our stance that NBP's official rates will remain stable till year-end, while at the beginning of 2015 the MPC will decide to hike rates. It will be justified by strengthening of economic growth and upward revision of inflation forecasts (in our opinion inflation rate will start rising faster than predicted in recent NBP's projection).

Foreign exchange market – EURPLN still in the 4.14-4.25 range



Only slight changes of EURPLN

EURPLN stayed in the very narrow 4.16-4.18 range for the better part of the past week. At the beginning of the week, the exchange rate was close to the lower band of this range, but at the end of the week – due to some global market sentiment deterioration and weaker than expected Polish C/A data – it has tested 4.18. Stabilization in the middle of the week was on the one hand due to zloty's resilience to worrying events in Ukraine and lack of reaction to quite positive market mood and euro's significant appreciation vs. the dollar, on the other hand.

Two weeks ago we indicated, that recent weeks in the Polish FX market are very alike to situation from mid-January/mid-February period. Last developments in this market confirm our suspicions – the zloty has just recorded first weekly weakening vs. the euro after three consecutive weeks of appreciation. On the other hand, changes of EURPLN and USDPLN are rather small when compared to situation in the global market. MSCI index for emerging markets increased by nearly 7% since the situation in Ukraine has deteriorated (in mid-February). Similarly, positive changes have been recorded also in case of the LatAm currencies, that gained 5-8% vs. the euro or the dollar. At the same time, among CEE currencies best performers (next to the ruble that has recovered at fastest pace after it has depreciated most) was the forint (2.6% gain vs. the euro) and the zloty (0.5% gain vs. the dollar).

This shows that situation in the Polish market has stabilized recently – EURPLN remains in the horizontal trend in 4.14-4.25 range while Polish bonds gained significantly. Given the worrying information emerging from time to time beyond our eastern border, we think it is more likely the zloty will depreciate to ca. 4.20 per euro rather than appreciate to 4.14. At the same time, we do not anticipate EURPLN to break 4.25-4.26 soon. Expectations for more monetary policy easing by the ECB may support risky assets, including the zloty. Many US data is due to be released this week that may also influence the zloty.

Euro recovers versus the dollar

Similarly to EURPLN, EURUSD has also terminated the series of three consecutive weeks of the downward move. During the past five sessions the euro has pared nearly whole losses suffered vs. the dollar due to dovish signals from the ECB and hawkish tone of the FOMC statement. EURUSD rebounded this week from 1.386 to 1.39.

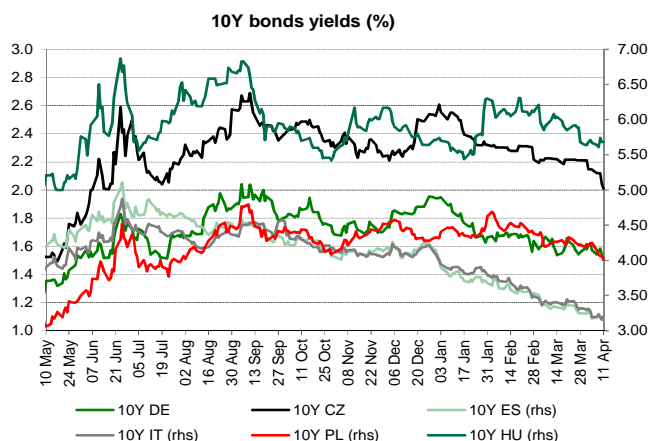
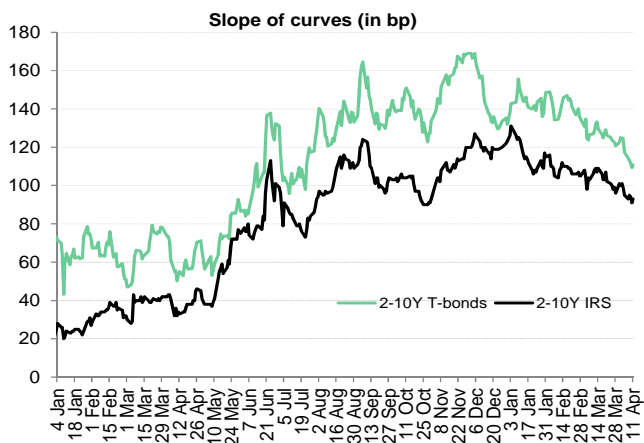
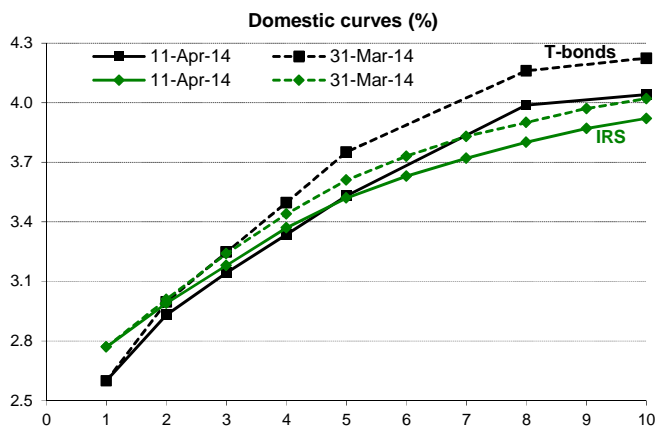
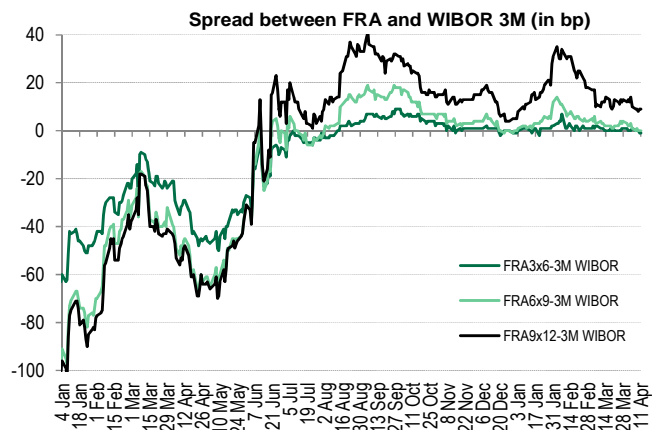
Large amount of the US macro data is due to be released in the coming week that may influence market expectations of the Fed monetary policy. Next to Beige Book, numerous FOMC members will give a speech, including Janet Yellen. Vital levels for EURUSD for coming days are 1.368 and 1.397.

Hungarian and Czech CPI still very low

The results of Hungarian parliamentary elections did not have any significant impact on the market. Forint remained stable for the better part of the week and only at the very end depreciated slightly due to global market deterioration and lower than expected CPI data that fuelled expectations for more rate cuts in Hungary.

March Czech CPI reached 0.2%YoY, and stayed at its lowest since October 2009. Depreciation of the Czech koruna since the CNB intervened in the market, had so far only temporary impact on inflation – after a December's rebound to 1.4%YoY from 0.9%YoY in October, the following months saw deep decline. Current inflation environment clearly postpones the moment when the central bank will decide that its activity in the FX market is no longer necessary. The head of the Czech

Interest rate market – Awaiting inflation data

**The MPC's rhetoric supports money market**

▪ Last week only WIBOR1M increased by 1bp, while other rates remained stable. On the FRA market situation did not change significantly as the MPC's decision was in line with expectations. The Council not only kept interest rates unchanged, but also uphold its tone of the statement, suggesting possibility of further extension of its forward guidance till year-end. Such scenario is currently discounting by the market players. Current FRAs valuation shows that the first hike may take place in one year period (temporarily the market was even pricing-in slightly longer period of stable rates).

▪ This week investors will focus on domestic macroeconomic data. In our opinion, data should confirm economic rebound without inflationary pressure (CPI below 1%YoY, PPI below 0%YoY). These data together with the MPC rhetoric should stabilise WIBOR and FRA rates near current levels. However, further decline in FRAs is likely in short run as IRS and T-bonds will continue their strengthening.

Domestic debt is growing in strength

▪ Last week domestic T-bonds and IRS gained substantially, following strengthening on core market. It came from market expectations that ECB will make further steps to fight with deflation risk and decide finally take additional measures (quantitative easing, negative interest rates) in upcoming months. As in previous weeks the most decline in yields and IRS rates was observed on the mid and long end of curves, while changes on the front end were muted. Consequently, curves flattened – spread 2-10Y narrowed to 111bp for T-bonds and to 93bp for IRS.

▪ T-bonds yields fell more significantly as compared with IRS rates decline. It may result from higher activity of domestic investors on debt market. Consequently, asset swap spread narrowed more substantially for 5Y and 10Y sectors (to 0bp and 13bp, respectively vs 14bp and 20bp at the end of March).

▪ Domestic bonds are recently proving quite immune to fluctuations of moods abroad (mainly due to unstable situation in Ukraine). Recent drops of yields of Polish debt caused a significant tightening of spread versus German counterparts. In the 10Y segment the spread fell below 250bp (lowest since early January).

Watch out for inflation data

▪ This week inflation data will be key for investors, in particular those from the euro zone, as the market will watch them in the context of future ECB decisions. We think that even a confirmation of flash HICP reading for the euro area may strengthen the market view that the ECB in nearest months may implement non-standard measures in monetary policy. This may generate impulse for further drop of yields and IRS rates. Thus, we may see Polish 10Y bond yield testing again 4% level.

▪ Publications of Polish data may be overshadowed by the releases abroad. However, we think that domestic inflation (which is likely to stay at 0.7%YoY) should stabilise the short end of the yield curve close to current levels.

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