Bank Zachodni WBK

Bi-Weekly economic update

27 May – 9 June 2013

A set of economic data that was released last week, did not give reasons to be optimistic regarding the stance of Polish economy at the start of second quarter, at the same time confirming complete lack of inflationary pressure. Recent comments of MPC members suggest that last publications will probably convince them to trim interest rates again by 25bps at the next meeting on 5th June. MPC's statement will probably leave door open for further adjustment.

On the other hand, flash European PMIs and German Ifo recorded clear rebound in May and we expect to see a similar move in Polish PMI. CSO's business climate survey also shows a clear improvement of moods in all economic sectors in May, as well as a rise in consumer confidence. This all suggests that hopes for economic recovery in the second half of the year may be indeed justified.

The biggest impact on financial market last week had concerns that the Fed may start tapering its QE3 programme in the next few meetings. Next US data releases in nearest weeks will be interpreted in this context. In the euro area, investors will focus on the ECB meeting and the release of country-specific policy recommendations by the European Commission.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		TUESDAY (28 May)					
15:00	US	S&P/Case-Shiller home price index	Mar	%MoM	0.9	-	1.2
16:00	US	Consumer confidence index	May	pts	70.0	-	68.1
		WEDNESDAY (29 May)					
10:00	**PL**	**GDP**	**Q1**	**%YoY**	**0.5**	**0.4**	**0.7**
		THURSDAY (30 May)					
	PL	**Market holiday**					
14:30	US	Initial jobless claims	week	k	341	-	340
14:30	US	Preliminary GDP	Q1	%QoQ	2.5	-	0.4
		FRIDAY (31 May)					
11:00	EZ	Flash HICP	May	%YoY	1.4	-	1.2
14:00	**PL**	**Inflation expectations**	**May**	**%YoY**	**-**	**-**	**1.1**
14:30	US	Personal income	Apr	%MoM	0.2	-	0.2
14:30	US	Consumer spending	Apr	%MoM	0.1	-	0.2
15:55	US	Flash Michigan	May	pts	83.7	-	83.7
		MONDAY (3 June)					
9:00	**PL**	**PMI – manufacturing**	**May**	**pts**	**-**	**48.6**	**46.9**
9:53	DE	PMI – manufacturing	May	pts	49.0	-	48.1
9:58	EZ	PMI – manufacturing	May	pts	47.8	-	46.7
16:00	US	ISM – manufacturing	May	pts	-	-	50.7
		WEDNESDAY (5 June)					
	PL	**MPC decision**			**-**	**2.75**	**3.00**
9:53	DE	PMI – services	May	pts	-	-	49.6
9:58	EZ	PMI – services	May	pts	-	-	47.0
14:15	US	ADP report	May	k	-	-	119
		THURSDAY (6 June)					
13:00	GB	BoE decision		%	0.50	-	0.50
13:45	EZ	ECB decision		%	-	-	0.50
		FRIDAY (7 June)					
14:30	US	Non-farm payrolls	May	k	-	-	165
14:30	US	Unemployment rate	May	%	-	-	7.5

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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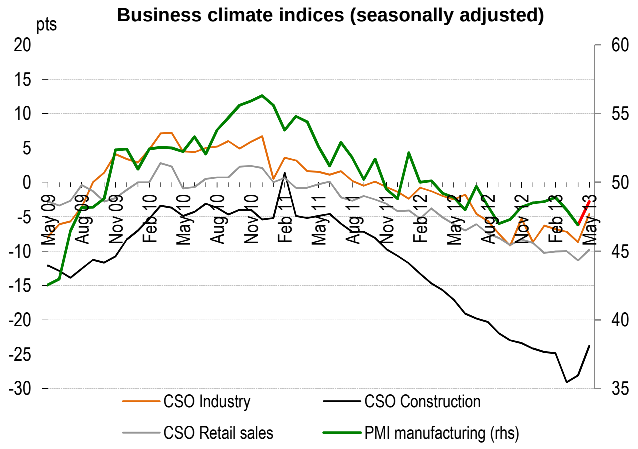
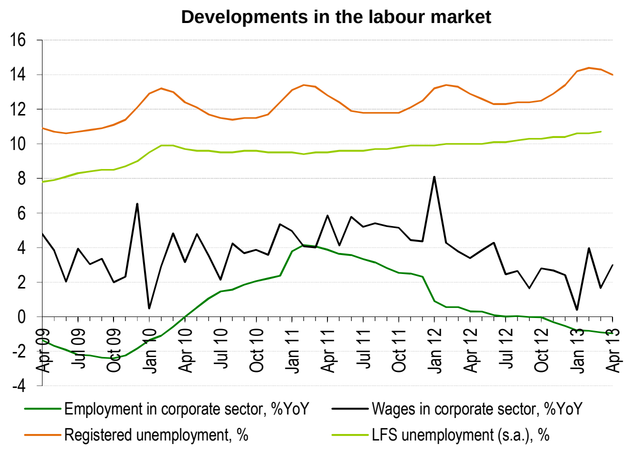
What's hot this week – PMI will rise, NBP rates will fall

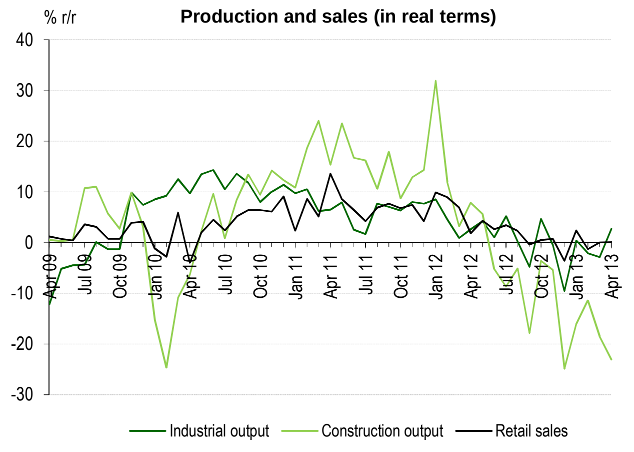


- Data on GDP in Q1 will probably confirm weak condition of domestic demand (stagnating consumption and declining fixed investments) and will show positive net exports. However, these data are not expected to move the market, provided that there is no major revision of headline GDP as compared to "experimental" CSO's estimate from mid-May.
- Domestic PMI will probably show a rebound in May and an improvement of outlook for industry. This is supported not only by increasing PMI indexes for Germany and the euro zone, but also by visible jump of CSO business climate gauges (seasonally adjusted index of output forecasts has turned positive for the first time since June 2012!).
- Still, first week of June will be under influence of MPC decision. We are expecting a cut by 25bps, in reaction to recent data suggesting lack of economic recovery and inflationary threats.

Last week in the economy – Weak labour market, no breakthrough in industry



- In April wage growth in corporate sector accelerated to 3%YoY from 1.6%YoY one month earlier. Rebound in wage growth was probably mainly due to higher number of working days.
- Employment in corporate sector fell in April by 1%YoY. Number of jobs declined by 53k in comparison to April 2012 and this was the sixth consecutive drop. It is worth noting that April 2012 saw an increase of workplaces by 16.7k on annual basis.
- In April the registered unemployment rate fell to 14.0%. This is a typical seasonal development, but this time this effect was weaker than in previous years and this is shown by the decline of employment in construction – for the first time in April in more than 10 years. Situation of the labour market is still deteriorating and we are expecting a continuation of negative tendencies in the upcoming months.



- Industrial output expanded in April by 2.7%YoY, after two months of contraction. However, number of working days was higher than one year ago, while in two previous months the situation was opposite. That is why these – seemingly positive – data do not indicate any actual improvement in Polish manufacturing.
- Construction sector recorded sharp deterioration, as production fell by 23.1%YoY, by most since December It cannot be excluded that weather conditions contributed to this result – the first days of the month were still snowy. Nevertheless, poor construction data did not give reason to be optimistic about investment growth in the second quarter.
- Retail sales contracted in May by 0.2%YoY. Results of sales were undermined, among others, by effect of earlier Easter. Still some other categories recorded an improvement.

Quote of the week – There is still room for monetary policy easing

Elżbieta Chojna-Duch, MPC member, 24 May, PAP

Lack of inflationary pressure and data on retail sales should be supportive for the decision to cut rates in June (…) We should wait with decision on probable deeper cuts until July's projection.

Andrzej Bratkowski, MPC member, 23 May, TVN CNBC

Another cut by 50bps is fully justified (…). We should go down to 2.0-2.5% quickly, as we are late with cuts.

Anna Zielińska-Głębocka, MPC member, 22 May, PAP

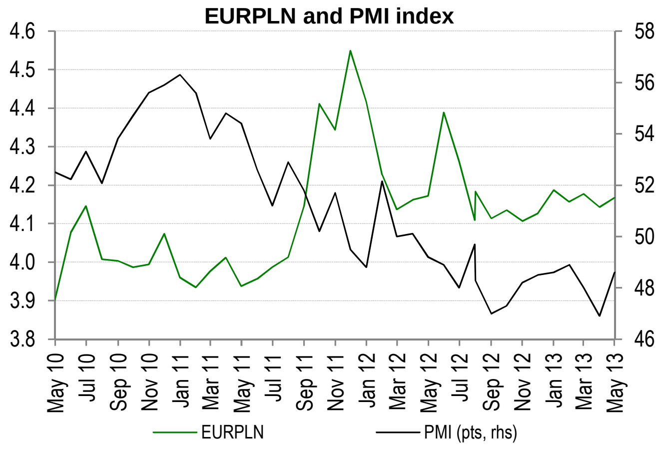
I think that there is still room for monetary policy easing, but this has to be done soon and then wait, stabilize interest rates.

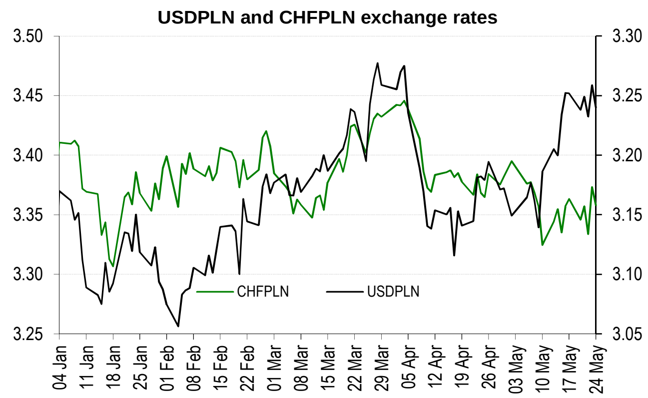
Jerzy Hausner, MPC member, 20 May, Reuters

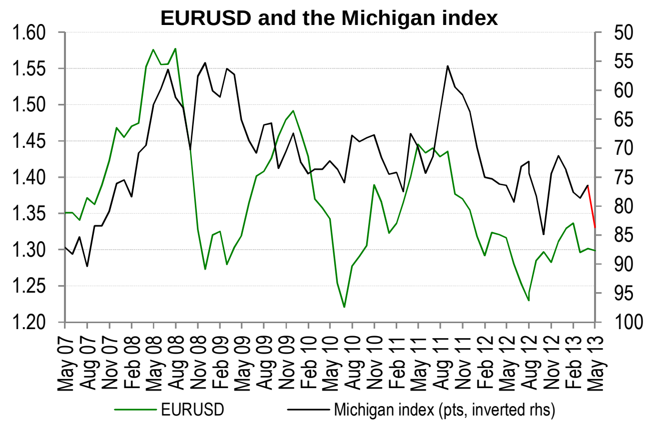
Council should take into consideration that current projections are indicating that even if inflation picks up (…), then it will not reach target soon and this is another argument in favour of cuts.

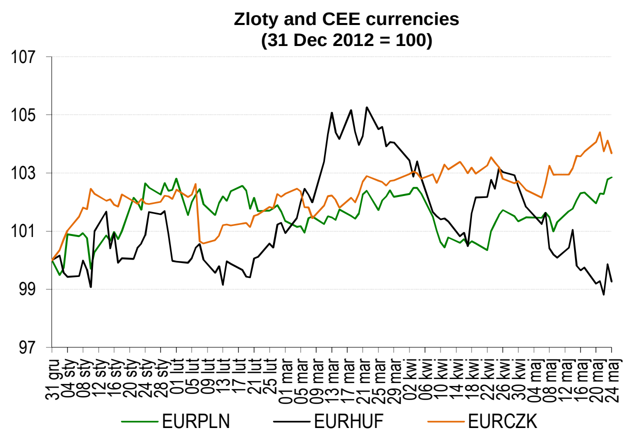
Minutes of the May MPC meeting showed that 10-members panel is deeply divided: majority of members supported a cut by 25bps, some preferred 50bps, some thought that it is too early to cut and some that easing cycle should come to an end. Recent comments of MPC members are showing that a strong number of them sees need for further monetary policy easing. We are assuming that the NBP governor Marek Belka also belongs to this camp, and this makes the interest rate cut in June almost certain. Motion for a 50bps cut will probably be filed in (Bratkowski), but we do not think that it will gather majority. Another cut by 25bps is possible in July, and this move will probably end the easing cycle. After summer break (no decisive meeting in August) some signals of economic recovery and of rebounding inflation will become visible, and they will prevent the MPC from further moves.

Foreign exchange market – Zloty under influence of signals from abroad









The EURPLN above 4.20

▪ Last week brought visible zloty depreciation against the euro. It came from investors' mood deterioration due to weaker than expected PMI reading for China and Fed's governor statement together with FOMC minutes, which caused worries about of lowering scale of purchasing securities or even earlier exit decrease in Fed's purchasing Fed's exit from QE3. As a consequence the EURPLN broke resistance level at 4.20 and increased (temporary) to 4.211 (the highest level since the end of January).

▪ Exchange rates against other currencies (CHF, GBP, USD) were more volatile. Investors' sentiment deterioration caused increase in rates, however they ended the week at lower level in comparison with the previous one. In weekly terms the zloty strengthened the most against the British pound sterling (1.1%).

▪ In the coming two weeks the zloty has remained under influence of external environments (the US data releases, the ECB meeting). Consumer confidence data from the US and non-farm payrolls might might be interpreted with reference to the last statements of the Fed's governor. Increase in convictions that Fed will quite fast decide to limit QE3 should negatively affect risky assets, including the zloty. We think that if the EURPLN breaks the resistance level at 4.211 (the last maximum), it will open the doors for further increase towards 4.26. However, upward move of the EURPLN might be limited by the upcoming macroeconomic data from domestic economy (we expect the height of the PMI index) and possible signals from RPP, limiting hopes for further monetary easing.

Data from Germany supported the euro

▪ Worries about possibility that QE3 will be limited already this year and weak data from China triggered a significant strengthening of the US dollar. The EURUSD exchange rate slid to 1.284. At this level some corrective increases took place, supported by incoming better-than-expected data from the European economy (e.g. PMI indexes). At the end of the week EURUSD approached 1.30.

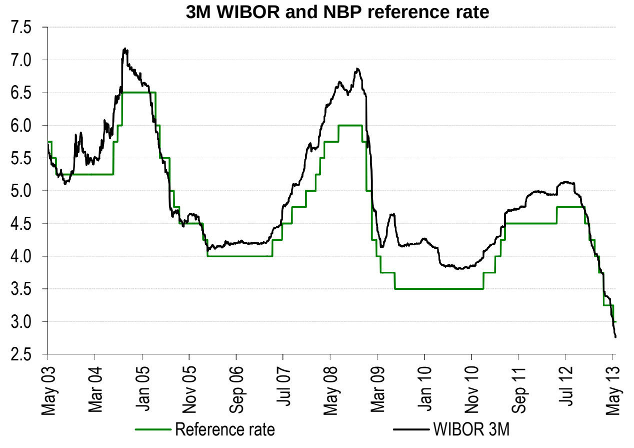
▪ Data incoming in the nearest two weeks will be interpreted in light of their impact over the future Fed action. The EURUSD pair may be influenced by results of ECB meeting and possible signals of possibility to introduce negative deposit rate and/or other non-conventional actions. The strongly better-than-expected data from the USA or suggestion of further monetary easing in the euro zone may be an impulse for renewed tests of support by EURUSD. Important levels are at 1.28 and 1.30.

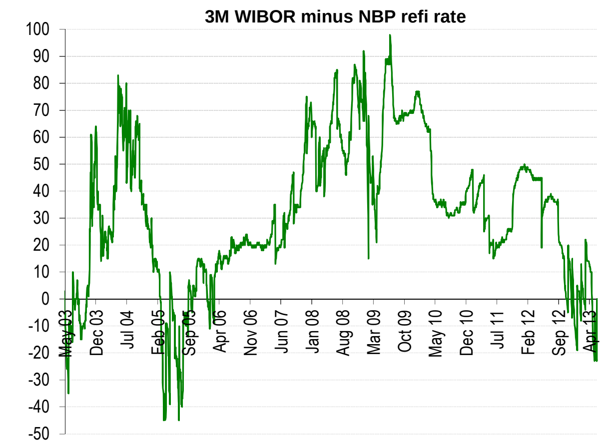
CEE currencies under pressure

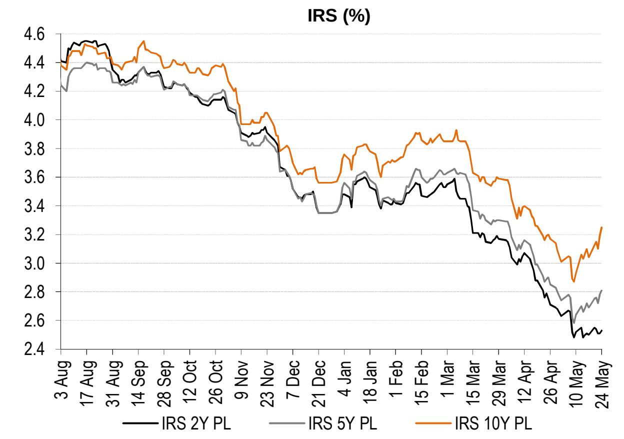
▪ CEE region currencies, similarly as the zloty, were losing due to rising risk aversion. Weekly peaks were at ca. 26.2 for the EURCZK and at ca. 292 for the EURHUF. End of the week brought a rebound, so EURCZK declined below 26 and EURHUF slid below 290.

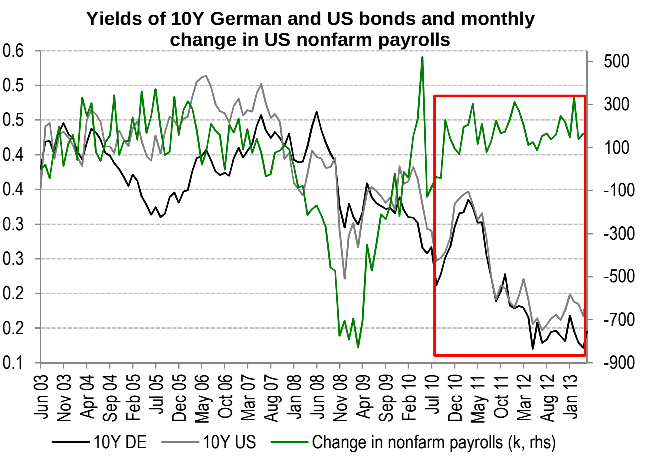
▪ In recent weeks the EURHUF exchange rate was outperforming other CEE region currencies. If unofficial information that the European Commission will lift the excessive deficit procedure for Hungary proves true, then the upcoming days/weeks may bring further strengthening of the forint.

Interest rate market – US data and the MPC decision will set a direction









WIBOR rates may continue falling

▪ Despite high volatility on the IRS and bond market, FRA remained roughly stable around levels from the past week. On the curve up to one year biggest changes occurred on the WIBOR market. 3-12M rates declined by 6-7bps while 1M one – after a stabilization lasting 7 sessions – declined finally to 3.04% from 3.05% at the end of the week.

▪ Since end August 2012 3-12M WIBOR rates declined by 230-245bps while NBP rates were trimmed by 175bps. Currently, the spread between 3M WIBOR and NBP rate is at -24bps. FRA expects further decline of 3M rate by ca. 50bps in next 6-9 months. Next rate cuts by the MPC (first by 25bps as soon as on June 5) may drag WIBOR rates further down, but the scale of their reaction may be weaker.

Clear steepening of curves

▪ Domestic and global factors had much impact on the IRS and bond market. Higher than expected data on April's wages and strong weakening of 10Y Bunds (in response to worries that the Fed may cut size of QE3 soon) pushed the 10Y IRS up by nearly 20bps (to 3.22%, highest level since mid-April). This rate has already rebounded from all-time low by 35bps. In the middle and on the long end of the curve the scale of an increase was smaller, 12bps and 2bps, respectively (5Y rate is 25bps above all-time low, 2Y rate only 4bps). 2-10 spread reached 70bps, highest since January 2011.

▪ Even more visible changes occurred during the past week on the bond market. Scale of an increase of yields reached 4bps for 2Y (just like in case of IRS, also on the short end of the bond curve comments of MPC members constrained the room for a move up), 14bps for 5Y and nearly 20bps for 10Y sector. Data on retail sales released at the end of the week (below market consensus and in line with market expectations) helped the bonds to pare some losses.

US data and decision of the MPC in the spotlight

▪ Factors that may have biggest impact on the interest rate market are US data and MPC decision.

▪ Last week Fed's governor said that monetary policy program may be trimmed if situation on the labour market improves clearly. Much of US data is due in coming days. Investors are likely to focus on these publications and they may have a visible impact on US bonds. The last chart shows that when the labour market was recovering after recent collapse, US and German bonds remained strong due to Fed's activity.

▪ If next data confirm gradual improvement in US economy then the market may continue to price in termination/cutting the QE3 and yields of US and German bonds may continue to increase. This year's correlation of Polish 10Y benchmark and 10Y IRS with German 10Y bond is 72% and 75%, respectively.

▪ For the short end of bond and IRS curve the outcome of the MPC meeting may be crucial. We expect, just like the market, next rate cut by 25bps and leaving the door open for more cuts. Thus, further steepening of the curves is likely in next weeks.

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 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl