Bank Zachodni WBK

Weekly economic update

10 – 16 June 2013

Actions of the central banks (MPC), disappointments about lack of their decisive actions (ECB) and expectations about further steps, which can be taken by them (US Fed) were the main drivers of global and domestic market during last two weeks. The much better-than-expected data on consumer confidence in the USA (which fuelled worries that the Fed may limit QE3 soon) together will lower liquidity of domestic market at the end of May, triggered a rapid sell-off of Polish debt and a depreciation of the zloty. At the beginning of June the MPC cut interest rates again by 25bps (to 2.75%), which came as no surprise given recent macroeconomic data and earlier comments of the MPC members. At the same time, it was suggested by the MPC that the easing cycle is coming to an end, which amplified the ongoing sell-off of domestic bonds. Additionally, words of governor Marek Belka, who said that depreciation of the zloty is not a problem and can support exports, were putting a pressure on the PLN. On the other hand, the ECB disappointed, as it decided it is too early to use additional non-standard measures, even though it analysed possibility of utilizing many tools able to support the euro zone economic situation. Due to accumulation of these circumstances, 2-, 5- and 10Y IRS and yields of bond benchmarks climbed by 30-50bps in course of two weeks, while EURPLN reached temporarily almost 4.33. On Friday afternoon the zloty strengthened rapidly after information that the NBP is intervening on the FX market. Taking into account recent words of Marek Belka and condition of economy (stagnating growth, minimal inflation) these interventions seem hardly understandable.

The upcoming days will be depending on new important macro releases in the USA, and these will be concentrated mainly at the end of the week. It seems that their impact on FX and interest rate market will be more considerable that impact of May CPI. Investors' expectations about prospects of monetary stimulus of the ECB and Fed (providing cheap liquidity) were the main drivers of global and domestic markets over the previous weeks and this dependency will probably remain in place in the upcoming days. The NBP governor said at the press conference after last MPC meeting that the Council is aware of the fact that inflation may decline further, so a reading in line with downward trend may cause only a moderate and temporary rebound after recent rises of IRS and bond yields.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (10 June)					
9:00	CZ	CPI	May	%YoY	1.6	-	1.7
10:30	EZ	Sentix index	Jun	pts	-10.3	-	-15.6
		TUESDAY (11 June)					
9:00	HU	CPI	May	%YoY	1.9	-	1.7
		WEDNESDAY (12 June)					
11:00	EZ	Industrial output	Jun	%MoM	-0.2	-	1.0
		THURSDAY (13 June)					
14:00	**PL**	**CPI**	**May**	**%YoY**	**0.7**	**0.5**	**0.8**
14:30	US	Initial jobless claims	week	k	-	-	
14:30	US	Retail sales ex autos	May	%MoM	0.3	-	-0.2
		FRIDAY (14 June)					
11:00	EZ	HICP	May	%YoY	1.4	-	1.4
14:00	**PL**	**Money supply**	**May**	**%YoY**	**6.5**	**6.5**	**7.2**
14:00	**PL**	**Core inflation**	**May**	**%YoY**	**1.2**	**0.9**	**1.1**
15:15	US	Industrial output	May	%MoM	0.2	-	-0.5
15:15	US	Capacity utilization rate	May	%	77.9	-	77.8
15:55	US	Flash Michigan	Jun	pts	84.5	-	84.5

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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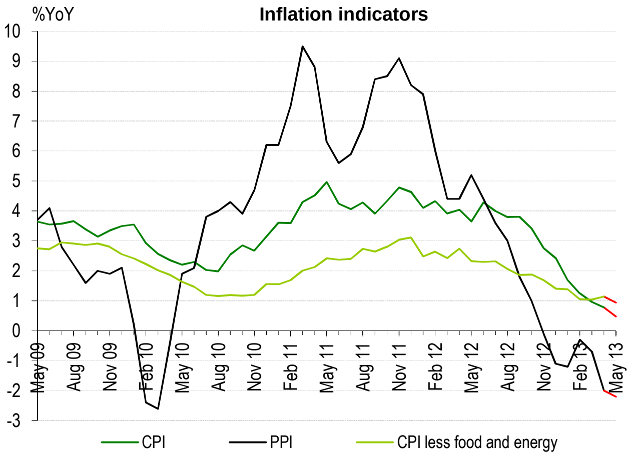
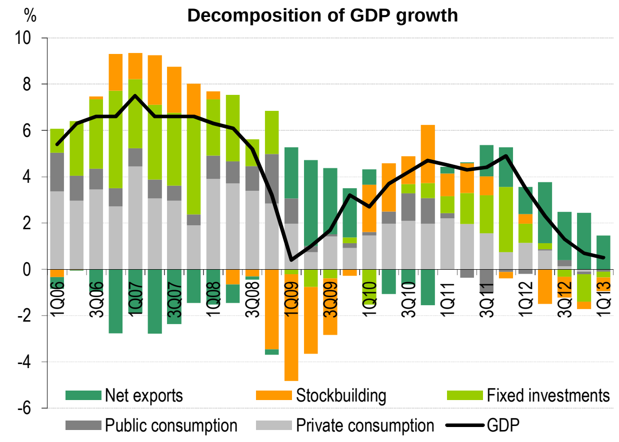
What's hot this week – Further decline of inflation

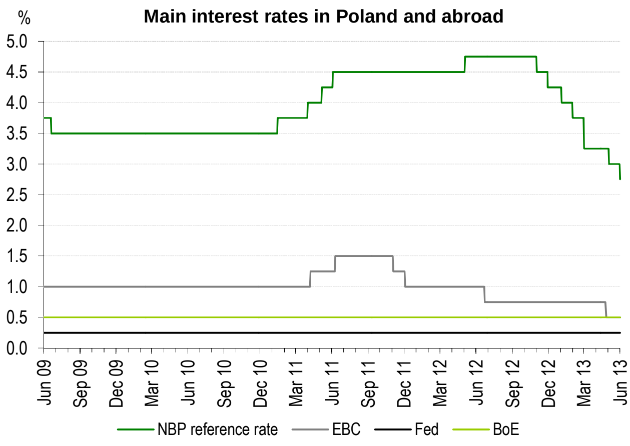


- We are expecting further declines of CPI (to 0.5%YoY) and core inflation (to 0.9%YoY) in May. In our view, decrease of both gauges will be caused, among others, by promotions on the mobile phone market. It is worth noting that our forecasts of both these indicators lie significantly below market expectations. Realization of these predictions may be supportive for the debt market, but strength of this impulse will probably be muted given last MPC statement. We are expecting that the CPI inflation will reach bottom in June, and then it will be rising gradually, mainly due to low base effect from 2H2012. At the end of the year we may approach 1.5%. Core inflation should follow a similar trend.
- In our view the pace of M3 money supply growth decelerated in May to 6.5%YoY. We are expecting growth rate of loans to remain on low levels.

Last week in the economy – Weak GDP growth in Q1, cut of interest rates



- GDP growth in 1Q2013 amounted to 0.5%YoY. Continuing weakness of the domestic demand was the main source of slow economic growth, as it plunged by 0.9%YoY (the fourth quarter in a row of negative annual growth). Individual consumption stagnated at 0%YoY, while investments contracted by 2%YoY. Net exports are currently the sole engine of growth (contribution of +1.4pp in Q1).
- PMI index for Polish manufacturing climbed in May to 48.0pts, returning to levels from March and breaking the two-month long downward trend. This is supporting our stance that in the coming quarters the pace of GDP growth should not decline further. Improvement in economic activity in Q2 2013 might be only marginal and it seems we are still running at the bottom of business cycle. However, in the second half of 2013 we foresee more visible GDP acceleration.



- The Monetary Policy Council cut interest rates again, bringing the reference rate to new all-time low at 2.75%.
- As it could have been expected, the Council noted in the statement that the upcoming data are indicating lower-than-expected economic growth in Q1 and stronger-than-expected decline of inflation. If we supplement this information with the fact that recent monthly data are suggesting low economic activity also in Q2, the cut was certain. However, as the Council (but only them) acknowledge uncertainty about scale and timing of expected economic recovery in the euro zone, and this may adversely affect economic activity in Poland, they left the door for further cuts open.

Quote of the week – We are approaching an adequate level of rates

MPC, post-meeting statement (last sentence), 05.06, NBP

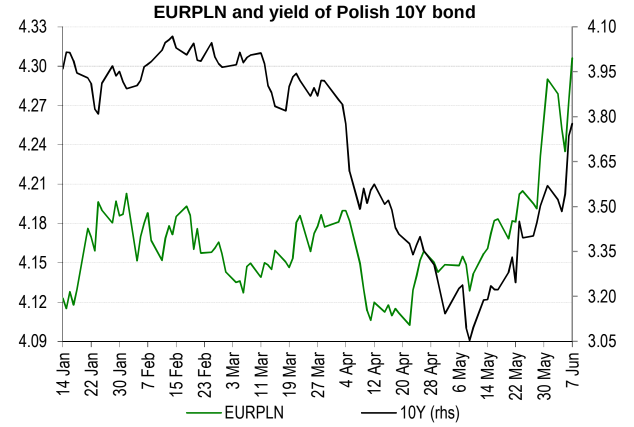
The Council assesses that monetary policy easing conducted since November 2012 supports economic recovery and limits the risk of inflation running below the NBP target in the medium term.

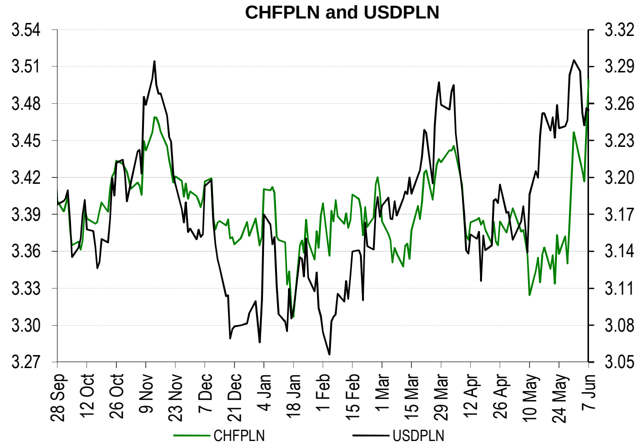
Marek Belka, press conference after MPC meeting, 05.06, Reuters

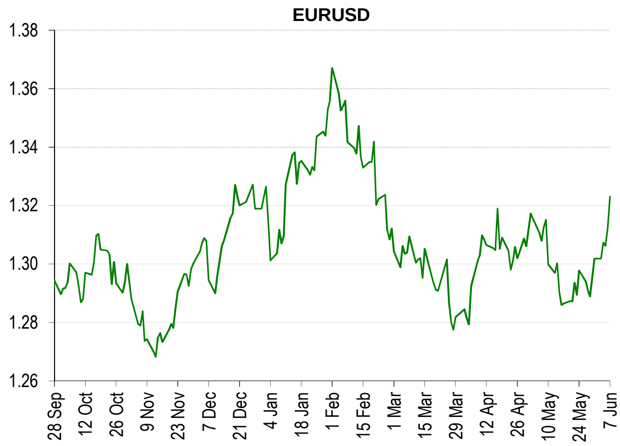
Statement that this is an end of easing cycle is too far-fetched. Surely, change in the statement is suggesting that we are approaching level of interest rates, which we can describe as adequate, given current economic situation (…) We should stick to conventional policy and I understand this as a policy of positive real interest rates. By real interest rates I mean difference between reference rate and expected inflation – we pay attention mostly to inflation expected by analysts.

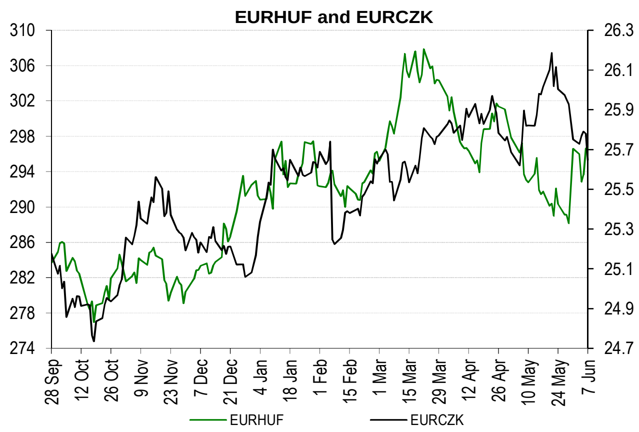
The last sentence of the communiqué may be suggesting that the MPC are adopting a neutral bias. However, the governor Belka said directly that such an interpretation would be too far-fetched. Still, the last paragraph of the statement is suggesting that we are close to the end of the cycle, and this is in line with our scenario. As the governor said during the press-conference, the Council preferred to wait for results of new GDP and inflation projections, as they will help to set the economic picture for the upcoming quarters in a better order and then it would be possible to send an unambiguous signal for the markets. Belka stressed that we are approaching level of interest rates, which can be described (according to most MPC members) as adequate. In our opinion new inflation and GDP projections will give room for one more rate cut by 25bps and this will be the end of the easing cycle. Such a scenario will be supported by next macro data.

Foreign exchange market – Fate of the zloty in hands of US data









Sudden depreciation of the zloty

- The zloty lost quite significantly during the last two weeks vs. main currencies. The weakening was initiated by the US data (among others, much better-than-expected consumer confidence) that fuelled worries the Fed will soon limit the QE3. This, along with low liquidity on the Polish FX market (due to long weekend in late May) pushed the EURPLN to nearly 4.30. In the first week of June this momentum was fuelled further (exchange rate reached nearly 4.33) after the MPC meeting (NBP governor said zloty's depreciation is not a problem, as it may help exports) and disappointment of lack of willingness of the ECB to take more action now. At the end of the week the NBP unexpectedly emerged on the market and started buying the zloty and this dragged the EURPLN fast down from 4.30 to 4.26.
- Despite rising EURUSD, the USDPLN climbed as well and reached 3.31 (the highest level since September 2012). The CHFPLN surged from 3.35 to 3.52 (Swiss franc was most expensive since mid-July 2012) and GBPPLN from 4.90 to 5.10 (highest since the beginning of the year).
- Visible increase of volatility of the zloty's exchange rates was due to the central banks. This week next vital US data are due for release and will be probably interpreted by investors as an indicator what the Fed may do with the QE3 (particularly given the fact that US payrolls did not give any clear picture). Higher worries over thinner inflow of capital on the global market may continue to weigh on the zloty. On the other hand, recent depreciation was quite rapid, so this gives hope that these worries are already priced in. Additionally, intervention of the NBP may cool expectations for continuation of zloty's depreciation.
- From technical analysis point of view, next resistance levels for the EURPLN are at ca. 4.35 and 4.38. Support levels are at 4.27 and 4.22.

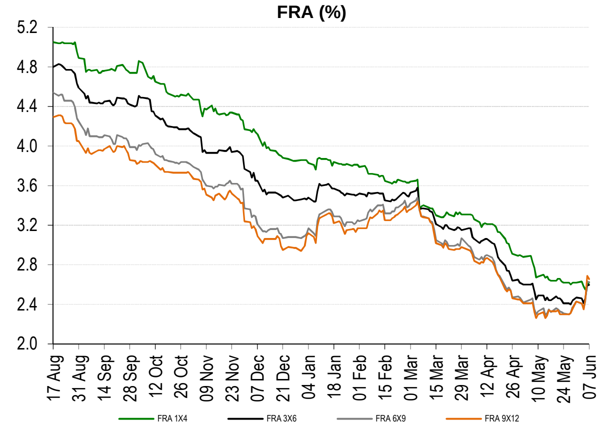
Clear euro's appreciation vs. the dollar

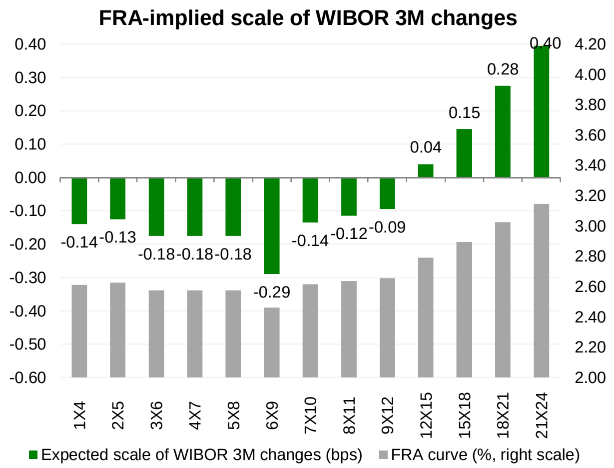
- The better-than-expected PMI for manufacturing in Germany and the euro zone, much weaker ISM for the US and lack of ECB's suggestion on possibility of prompt reduction of the deposit rate below 0% pushed the EURUSD temporarily to 1.33, highest level since last week of February 2013. Data from the US labour market were roughly in line with consensus and triggered some profit taking at the end of the week.
- This week next crucial US data are due for release and interpretation of how it will influence Fed's plans on QE3 may have key impact on the market.

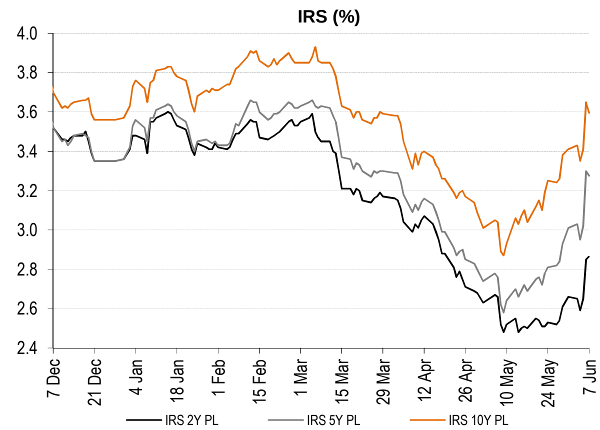
High volatility of forint and koruna

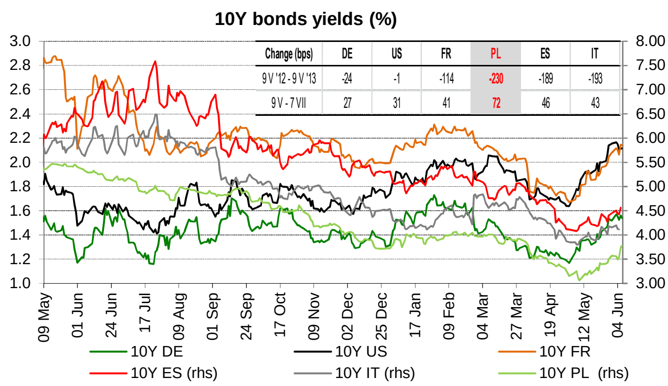
- During the last week of May forint and koruna depreciated together with the zloty. The EURHUF surged from 285 to ca. 300 and the EURCZK tested vital resistance at ca. 26.1. When in the following days the zloty and forint remained under pressure, the Czech koruna pared nearly whole losses. The Czech GDP data for 1Q, somewhat weaker than initially estimated, only temporarily hit koruna and did not prevent EURCZK from coming back to ca. 25.5.
- As a consequence of sudden changes, the CZKPLN reached over 0.168, highest level since September 2012.
- This week, next to domestic inflation, data on pace of price growth in Czech Rep. dnd Hungary will be also released. However, this should not trigger major changes.

Interest rate market – Possible rebound after CPI data









Change (bps)	DE	US	FR	PL	ES	IT
9 V '12 - 9 V '13	-24	-1	-114	-230	-189	-193
9 V - 7 VII	27	31	41	72	46	43

Decreasing scale of rate reduction priced-in by FRAs

▪ WIBOR rates of 3M maturity and above remained quite stable last week, while 1M rate kept falling. June's MPC decision to cut rates by 25bps was fully priced-in, thus WIBOR's reaction was insignificant, except for drop of 1M rate.

▪ FRA market saw much more volatility, as it was affected by changes in IRS and bond markets. After significant rise in FRAs at the end of May, there was a slight rebound just before the June's MPC decision. However, the Council's suggestion that the end of easing cycle is nearing triggered a notable rise in FRA rates along the curve. In two-week horizon the FRA rates rose by 18-39bps, with biggest move in FRA 9x12.

▪ June's MPC statement encouraged the market to withdraw from expectations for more significant interest rate reductions (see the chart on the left). Interest rate cut at the July's meeting is still on cards, but FRA market is currently pricing-in a gradual rise in WIBOR rates more than one year horizon (even though NBP official rate may stay unchanged in this period). This week the inflation data for May will be released. Our forecast (0.5%YoY) is below market consensus (0.7%YoY) and its materialisation may give impulse for rebound on the money market. Moreover, next macro data releases will be weak, also supporting the market.

T-bonds significantly weaker, IRS rates shift up

▪ The end of May and the beginning of June brought further significant sell-off on the Polish debt market. The front end of the curve was relatively immune to swings in global mood till the June's MPC meeting, while after the Council's statement, suggesting the closing end of easing cycle, yield of 2Y also increased. In bi-weekly terms yields increased by 35-46bps, in which the highest growth was noted in 5Y sector.

▪ IRS market was more sensitive to global mood. In the period between 24 May and 7 June IRS rates increased by 22bps (for 1Y IRS) - 50bps (for 5Y). What is more, IRS curve has steepened, with 2-10Y spread increasing to 80bps, the highest level since July 2010. This tendency might be continued.

▪ Auction results of PS0718 and WZ0119 were relatively positive, taking into account market conditions. Poland's Ministry of Finance sold T-bonds worth PLN4.6bn in total, slightly below the maximum level of offer, i.e. PLN5bn. However, demand for 5Y T-bond PS0718 was relatively solid (above PLN7bn). What is more, auction yield of PS0718 at 3.303% was a bit lower than the level on secondary market. After Thursday's auction the gross borrowing requirements are financed in 83%.

Domestic and foreign data crucial

▪ The weakening of domestic debt recorded in recent weeks was driven mainly by external factors – worries that the Fed will tamper or even terminate earlier QE3. This was the first visible correction on the bond market this year (yields of 10Y benchmark surged by nearly 70bps from record low established in May after a decline by 230bps during the year 2013). Middle and long end of the curve remain sensitive to situation on the global market. Continuation of outflow of capital may push yields further up.

▪ May's data on CPI may be crucial for short end of the curve. Data may initiate a correction after recent weakening. Next data from real economy may be also weak.

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