Bank Zachodni WBK

Weekly economic update

17 – 23 June 2013

Last week saw quite dynamic changes of moods in the world financial markets. First days passed under the sign of sell-off in the emerging markets, which triggered a surge in Polish bond yields and IRS rates, while the zloty quickly shrug off the NBP's intervention, heading back to 4.30 versus euro. Apart from worries about possible tapering of Fed's QE3, this was caused by disappointment with Bank of Japan's decision and concerns related to hearing in the German Constitutional Court regarding the ECB mandate. Clear improvement of moods in the second half of the week was caused by better by forecast data from the US and euro zone, joined by rising investors' belief that the recent concerns about Fed's tapering were probably premature and overdone.

Similarly as in the last two weeks, in the upcoming days expectations about the Fed monetary policy may be crucial for the markets. After article in the Wall Street Journal, which suggested that the US central bank may want to calm the markets, the investors will be awaiting the post-meeting Fed statement and earlier testimony of Ben Bernanke before the US Congress. Domestic market will pay attention to a series of data releases, which, in our view, will be in general weaker than expected and may again reinforce expectations about NBP interest rate cut in July. At the end of past week the FRA market began to price-in cuts more aggressively again, despite recent relatively hawkish comments of MPC members.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 June)					
14:00	**PL**	**Exports**	**Apr**	**€m**	**12 550**	**12 710**	**12 764**
14:00	**PL**	**Imports**	**Apr**	**€m**	**12 594**	**12 600**	**13 037**
14:00	**PL**	**Current account**	**Apr**	**€m**	**-153**	**20**	**-200**
		TUESDAY (18 June)					
11:00	DE	ZEW index	Jun	pts	38.0	-	36.4
14:00	**PL**	**Wages in corporate sector**	**May**	**%YoY**	**2.6**	**2.7**	**3.0**
14:00	**PL**	**Employment in corporate sector**	**May**	**%YoY**	**-1.0**	**-1.0**	**-1.0**
14:30	US	Core CPI	May	%MoM	0.2	-	0.1
14:30	US	House starts	May	k	950	-	853
14:30	US	Building permits	May	k	978	-	1005
		WEDNESDAY (19 June)					
11:00	**PL**	**Bond switch auction**					
14:00	**PL**	**Industrial output**	**May**	**%YoY**	**-1.9**	**-2.1**	**2.7**
14:00	**PL**	**Construction and assembly output**	**May**	**%YoY**	**-21.7**	**-23.3**	**-23.1**
14:00	**PL**	**PPI**	**May**	**%YoY**	**-2.5**	**-2.2**	**-2.0**
20:00	US	Fed decision		%	0.0-0.25	-	0.0-0.25
		THURSDAY (20 June)					
3:45	CN	Flash PMI – manufacturing	Jun	pts	49.4	-	49.2
9:28	DE	Flash PMI – manufacturing	Jun	pts	49.9	-	49.4
9:58	EZ	Flash PMI – manufacturing	Jun	pts	48.5	-	48.3
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	340	-	334
16:00	US	Home sales	May	m	5.0	-	4.97
16:00	US	Philly Fed index	Jun	pts	-1.0	-	-5.2
		FRIDAY (21 June)					
		No important data releases					

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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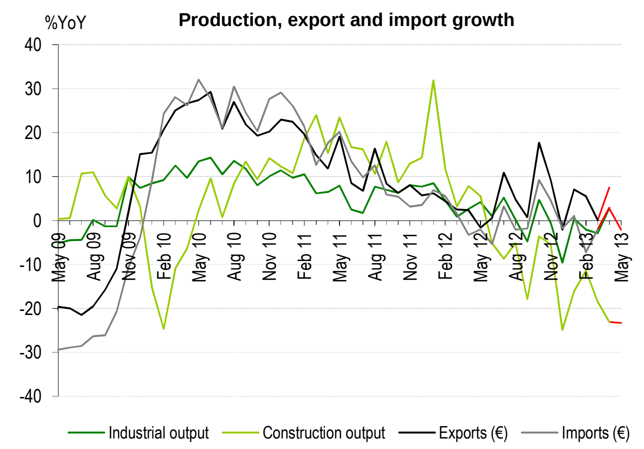
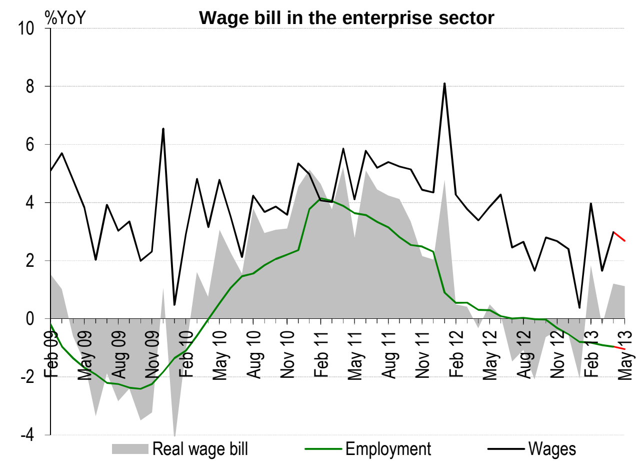
What's hot this week – Weak domestic data and Fed meeting

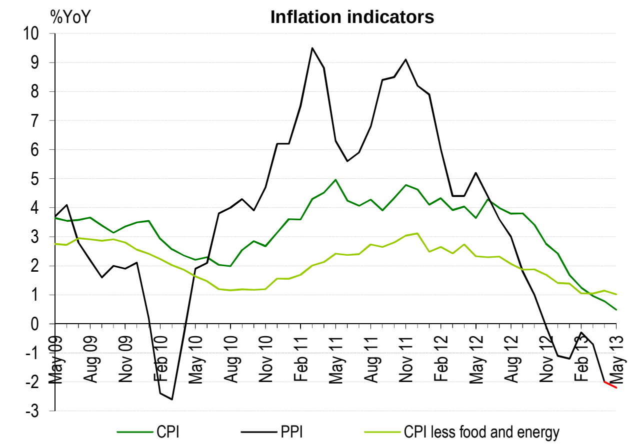


- Most domestic macro figures due for release this week will be quite pessimistic, supporting expectations for an interest rate cut in July.
- Data on balance of payments may be an exemption, as they should show a visible improvement in growth rate of exports in April. CSO data released a few days ago suggest a considerable upward risk for our forecast of foreign trade.
- We are expecting a marked deterioration of industrial output growth, among others due to the fact that the working days effect will have an adverse impact, in contrast to positive impact in April. Deepening of output drop in construction and assembly should be halted by a significant improvement of weather conditions.
- Data from the labour market will be still showing weakness, with no signals of improvement.



- This week the markets will focus on the US Fed meeting. Worries that the US central bank will finish its QE3 programme or will raise interest rates earlier than it announced previously were the main market drivers and culprit of market mood deterioration in the previous weeks. This was not Fed's intention, so there are rumours that the US central bank will try to calm markets at the upcoming meeting.
- Europe will also pay attention to flash PMI readings for manufacturing in the euro zone and in Germany. Last month the indicator for Europe's biggest economy was close to 50pts. If the gauge exceeds this mark, this will suggest that the Germany is slowly returning back on track of growth.
- Minutes for the June's Monetary Policy Meeting will help judge chances for another interest rate cut in July.

Last week in the economy – Inflation rate near the bottom



- CPI fell in May to 0.5%YoY, in line with our forecast and below market expectations. Weak domestic demand was the most important factor behind a drop. However, it was also reinforced by cuts in fuel prices and lower tariffs introduced by phone and TV operators. We expect another drop in June, and in H2 it should start a gradual pickup, however still remaining well below the NBP target. The data are supportive for our expectations of MPC's interest rate cut by 25bps in July (probably the last one in the cycle).
- Core inflation excluding food and energy prices fell in May to 1.0%YoY. Other gauges of core inflation also declined.
- Growth of M3 money supply amounted to 6.5%YoY. Figures showed a second in a row decline of households' deposits and a considerable pickup in companies' deposits. Rise in loans was mainly due to weaker zloty.

Quote of the week – Monetary easing cycle coming to an end

Elżbieta Chojna-Duch, MPC member, 13.06, PAP

July's rate cut is possible, but not sure (…) we can leave door open for the upcoming months.

Andrzej Bratkowski, MPC member, 12.06, Reuters

Monetary easing cycle is coming to an end (…) in my view we can still think about cut to 2.25-2.50%.

Anna Zielińska-Głębocka, MPC member, 10.06, PAP

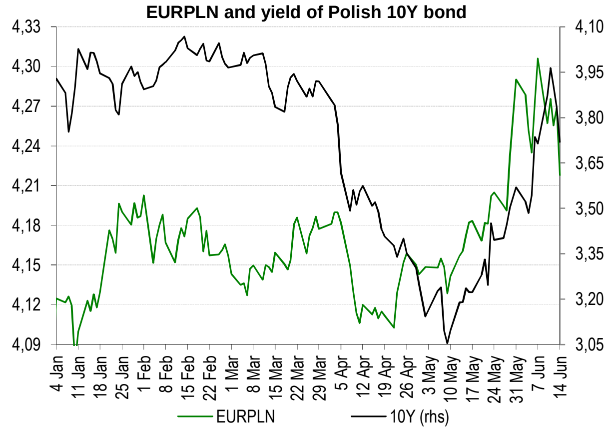
July is the right time to implement some adjustment in interest rate.

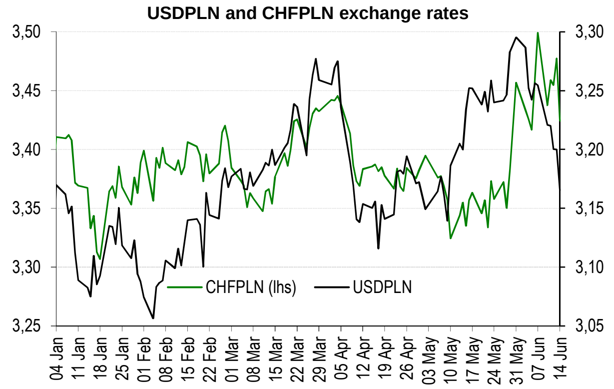
Adam Glapiński, MPC member, 10.06, PAP

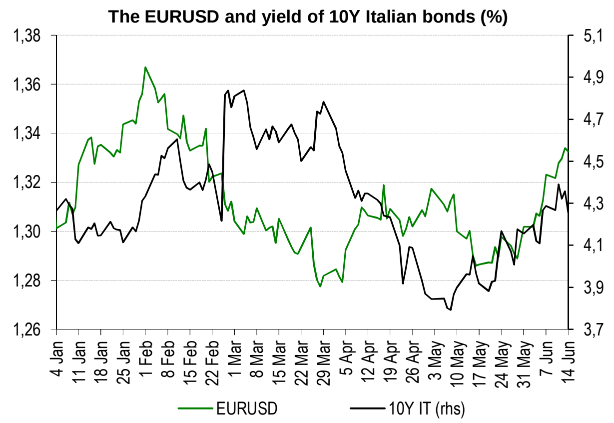
In my view the monetary policy easing in Poland has ended (…) Further cuts will provide no additional impulse for the economy. They will only raise risk of capital outflows.

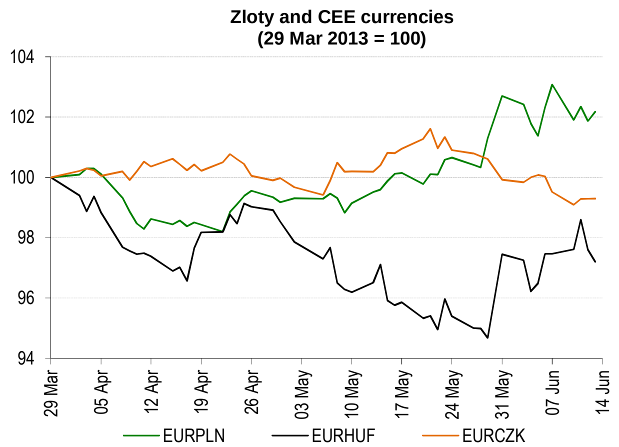
Recent comments of those MPC members, who were the main supporters of more monetary easing (Bratkowski, Chojna-Duch) have considerably cooled expectations for more cuts. Investors have even begun considering risk of no rate cut in July, which influenced money market rates. In our view we will see another cut by 25bps in July and this will conclude the easing cycle. Still, decision will probably be a close call, with likely 5:5 distribution of votes and decisive vote of the NBP President. This decision will be justified not only by weak macro data for May, but also by the new NBP projection – according to NBP board member, Andrzej Raczko, the document will show a lower GDP growth and inflation in 2013 as compared to previous edition. The Council may consider signalling its return to neutral bias, which was recently suggested by Marek Belka at the post-meeting conference in June.

Foreign exchange market – Will FOMC calm markets and give impulse for market rebound?









Zloty rebounds …

▪ The beginning of last week brought another wave of the zloty weakening as a consequence of further T-bonds sell-off. Influence of NBP's intervention was only short-lived, however one should notice that volatility of the zloty declined. The EURPLN increase towards 4.29 (only temporary) coincided with climb of 10Y benchmark yield above 4%. The end of Tuesday's session has brought some rebound, continued in next days. Due to some global mood improvement the EURPLN declined towards 4.20 during Friday's session. It might come from some rumours saying that Fed may soon deny market speculations of plans of withdrawing from the QE3.

▪ Using advantage of market sentiment improvement, the zloty gained the most against the US dollar (by ca 3% in weekly terms). It partly resulted from the euro strengthening (the EURUSD increased towards 1.34). The zloty appreciated a bit less against the CHF and GBP (in weekly terms it was 2% each).

▪ Taking into account technical analysis, on the EURPLN chart we see the head and shoulders pattern. It suggests that the support level at 4.20 is very important for the EURPLN. We believe that breaking this level will open the door for further decline towards 4.17 or even lower. Friday's session showed that worries about fast limitation of QE (or even exit) abated. Notwithstanding, it seems to be still the main risk factors for financial markets. Therefore, the June's FOMC meeting will be crucial for investors' mood. We believe that if Fed calms down fears, it will be positive for the domestic currency. We think that domestic data might be shadowed by core markets. But further strengthening on bond market (across the board) should support the zloty.

… euro gradually stronger …

▪ Euro gained gradually last week, but resistance level at 1.34 effectively stopped the upward move of the EURUSD. Consequently, the rate declined to 1.33 (result of better than expected the US macro data, in which retail sales).

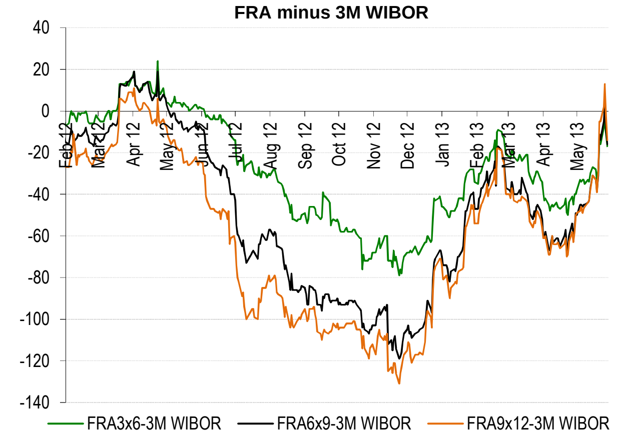
▪ Despite that worries about further action of Fed abated, it is still the main risk factor, which will bring a lot of nerves and volatility on the market. Therefore, investors focus on FOMC meeting and earlier Ben Bernarke's speech. If Fed tries to calm fears about tapering a monetary stimulus program, it will positively affect the market sentiment and we do not exclude more visible euro strengthening and the EURUSD breaking the resistance level at 1.34.

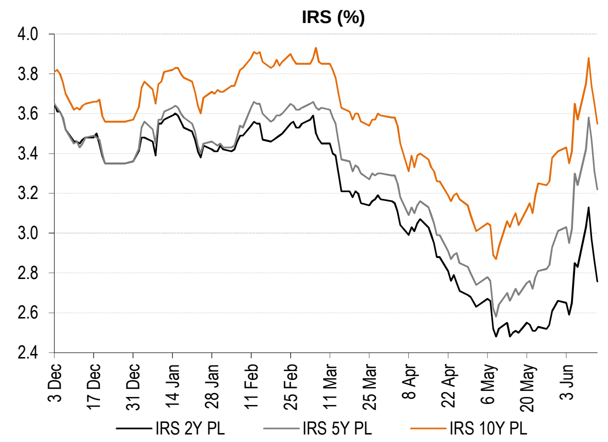
… and other CEE currencies

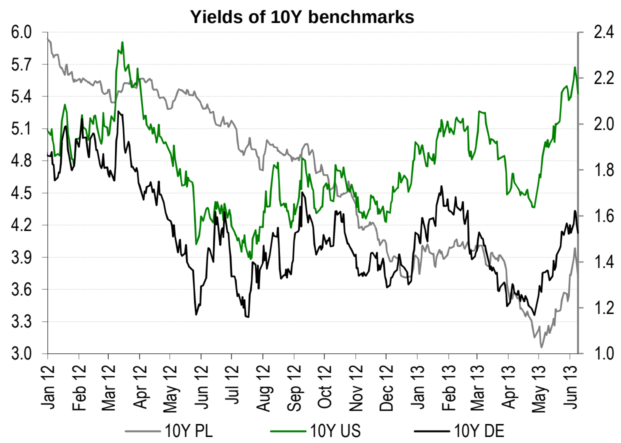
▪ The forint and the Czech koruna, similarly as the zloty, were also gaining. Hungarian currency appreciated by most (see chart beside), supported by comments of Prime Minister Orban, which stated that the economic recovery will be more considerable than predicted earlier. On the other hand, political turmoil in the Czech Republic (corruption scandal in the government) halted the strengthening of the koruna. The EURCZK exchange rate again headed north towards 26.

▪ This week the markets will focus on core markets, especially on the FOMC meeting. Political situation in the Czech Republic will be negatively pressuring the koruna, while EURHUF main test support at 290 again.

Interest rate market – Fed and Polish data may drag IRS down







Shy increase of WIBOR

- The upward correction developing in case of the IRS rates and bond yields in response to global trends as well as MPC rhetoric had visible impact on WIBOR and FRA rates. 6M and 9M cost of money on the interbank market was rising for three consecutive sessions during the past week, by 1bp per day. In case of other rates changes were less visible – 12M and 3M WIBOR increased less, 1M remained stable. Due to further increase of FRAs, rates 6x9 and 9x12 were temporarily slightly above 3M WIBOR (for the first time since May 2012). At the end of the week due to – among others – data on CPI a quite visible correction was recorded on the FRA market (by ca. 10bps).
- If in July the MPC cuts NBP rates by 25bps (which is our base scenario), then for current level of WIBOR rates the spread vs. the NBP rate will be at 35bps for 1M and 20-25bps for 3-12M rates. Since 2008 the average positive spread for 1M is at 18bps, 45bps for 3M and 60-70bps to 6-12M rates. Since 2011 average positive spread is at 15bps, 30bps and 38-44bps, respectively. If the MPC actually ends the easing cycle next month (what we expect to happen), then there will be a room for an adjustment in case of 1M WIBOR and rather limited room for decline of longer-term rates.

High volatility of bonds and IRS

- After the 5Y and 10Y rates reached highest levels since mid-March and 2Y one since the beginning of April (3.58%, 3.88% and 3.13%, respectively) in the second half of the week sudden correction was recorded (by ca. 25bps for 2-10Y rates). Also on the bond market dynamic changes were observed, but the scale differed for the short and long term rates. Consequently, 2-10 spread increased on weekly basis from 88bps to 112bps, highest level since early 2012.
- Bond switching auction is scheduled this week. Due to clear recovery observed at the end of the week – particularly on the long end of the curve – we think the Ministry of Finance may decide to issue 10Y bond. OK0713 and DS1013 bonds are likely to be bought back. We do not expect offering any short term debt by the Ministry.

Fed and Polish data may drag IRS and bond yields down

- This week Wednesday seems to be crucial day for global – and thus for the domestic – market. Investors will likely seek in the statement and press conference for any clue for what the Fed intends to do with the QE3. That day Polish data on industrial output is also due to be released.
- By means of monetary policy stimulation Fed wanted to lower long-term interest rates and make US consumers feel more wealthy (amid rising prices of stocks). We think that recent developments (S&P500's decline by temporarily even over 5% from record high since last decade of May and the increase of yields of the US 10Y bonds from 1.62% to 2.29% observed since the beginning of May) will encourage the Fed to issue rather calming statement to the market (that there are no plans to trim/end QE3). Together with domestic data – that in our opinion will be below market consensus – this should have a positive impact on Polish debt and drag IRS rates further down.