Bank Zachodni WBK

Weekly economic update

1 – 7 July 2013

After sharp sell-off in the emerging markets, the last week of June saw some rebound. This was possible thanks to several factors, including data from the USA, part of which (incl. final Q1 GDP) was weaker than expected, raising hopes that the Fed will not hurry too much with QE3 tapering. Moods were also supported by comments of some Fed officials, who were trying to calm down markets, saying that the potential reduction of balance sheet expansion would be gradual and data-dependent. Data about Polish retail sales and unemployment were slightly better than forecast, but did not change significantly the assessment of economic situation. The government presented the review of the pension system in Poland, including proposals of changes: 1. liquidation of T-bond holdings of private pension funds (OFE), 2. voluntary participation in capital pillar of the system, 3. "augmented" voluntary participation in capital pillar (with additional contribution). The proposals may have negative impact on the bond and/or equity markets in Poland, depending on the final shape of solution and its implementation method. The decision what scenario will be implemented should be made in August.

At the start of July, as every month, we will see the release of indicators of activity in manufacturing, being important hints about pace of bottoming out in the world economy. We expect confirmation that the worst might be over for the euro zone and also in Poland an improvement of economic growth is approaching. July's MPC meeting (the last one before summer break) will end up – in our view – with decision to cut rates one more time by 25bps. This will be probably the last cut in the cycle. Some MPC members suggested recently that in the July's statement there should be a clear signal that rate cuts have come to an end. In our view, a shift to "neutral bias" would be premature, given uncertainty regarding economic outlook, however such decision cannot be excluded. In the second half of the week the focus will be on ECB meeting and US payrolls figures. The latter may be particularly important for the market, affecting investors' expectations regarding future FOMC decisions.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (1 July)					
3:45	CN	PMI – manufacturing	Jun	pts	48.3	-	49.2
9:00	**PL**	**PMI – manufacturing**	**Jun**	**pts**	**48.3**	**48.8**	**48.0**
9:53	DE	PMI – manufacturing	Jun	pts	48.7	-	48.7
9:58	EZ	PMI – manufacturing	Jun	pts	48.7	-	48.7
11:00	EZ	Flash HICP	Jun	%YoY	1.6	-	1.4
16:00	US	ISM – manufacturing	Jun	pts	50.5	-	49.0
		TUESDAY (2 July)					
16:00	US	Industrial orders	May	%MoM	2.0	-	1.0
		WEDNESDAY (3 July)					
	PL	**MPC decision**		**%**	**2.50**	**2.50**	**2.75**
9:53	DE	PMI – services	Jun	pts	51.3	-	51.3
9:58	EZ	PMI – services	Jun	pts	48.6	-	48.6
14:15	US	ADP report	Jun	k	153	-	135
14:30	US	Initial jobless claims	Week	k	346	-	346
16:00	US	ISM – services	Jun	pts	54.0	-	53.7
		THURSDAY (4 July)					
13:45	EZ	ECB decision		%	0.50	-	0.50
		FRIDAY (5 July)					
12:00	DE	Industrial orders	May	%MoM	1.2	-	-2.3
14:30	US	Non-farm payrolls	Jun	k	167	-	175
14:30	US	Unemployment rate	Jun	%	7.5	-	7.6

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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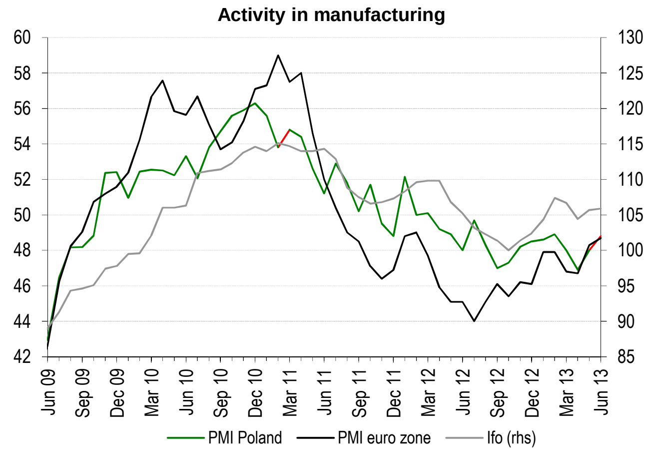
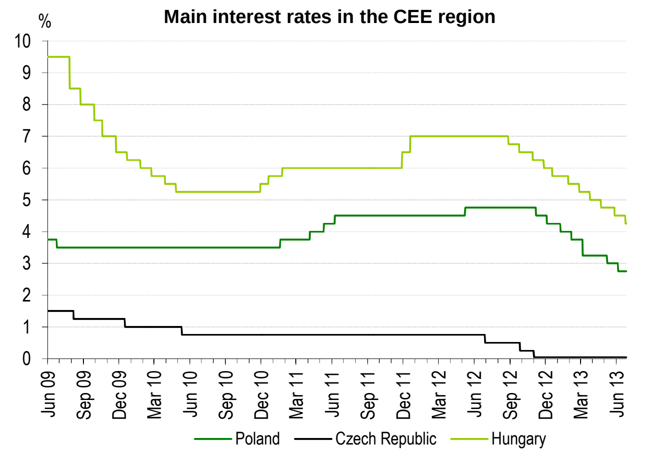
What's hot this week – PMI, MPC, ECB, ADP, etc.

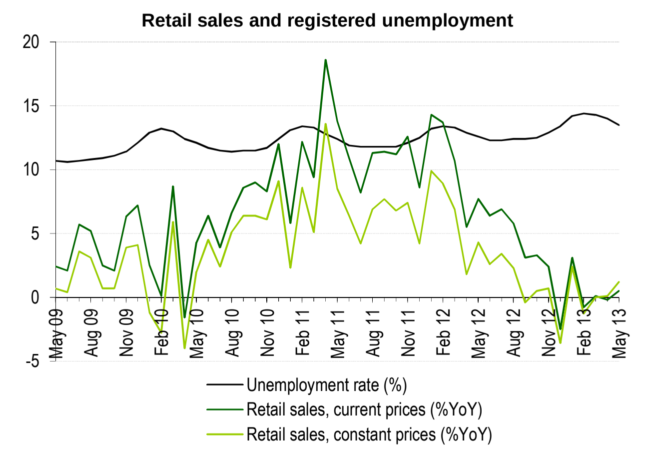


- Final readings of manufacturing PMI will be key drivers of market sentiment at the beginning of the week. Flash indicators in the euro zone posted increases in June, confirming that the worst might be over for the European economy. However, market may pay more attention to readings for China and the USA, which have disappointed recently. Especially the latter one can be important for the global risk appetite.
- We are expecting that PMI index for Polish manufacturing climbed in June for the second time in a row, to 48.8pts, following the improving moods in Europe (German PMI decreased slightly, but ZEW and Ifo picked up), heralding the expected by us economic recovery, fuelled by exports in the second half of the year. Business climate indicator for manufacturing, calculated by the CSO (seasonally adjusted) declined somewhat in June.



- Middle of the weak will be dominated by decisions of central banks. We are expecting that the Monetary Policy Council will cut interest rates again by 25bps, bringing the reference rate down to 2.50%. Such a decision will be supported by new projections of inflation and GDP. General results of these projections will be shown in the MPC statement, while the whole *Inflation Report* will be most probably released at the end of the week. Comments of the MPC members (including M.Belka and J.Hausner) were suggesting that if in July the MPC decides that rates are at adequate level, then it will signal it in the statement. In our view a declaration of "neutral bias" would be premature, given still high uncertainty about the recovery.
- No important change in the ECB's monetary policy is expected, but market may pay a lot attention to comments of M. Draghi on economic outlook.

Last week in the economy – Sales and unemployment slightly better than expected



- Retails sales expanded in May by 0.5%YoY, more than expected. Real growth of sales was even higher and amounted to 1.2%YoY, which shows a deflation in retail trade – retailers are competing mainly on prices, which suggests that the consumer demand is still weak. We maintain our forecast that consumption will gradually accelerate in the upcoming quarters, but its growth in 2013-2014 will lie well below medium-term average.
- Registered unemployment rate decreased in May to 13.5%, more than expected. Slightly lower number of jobseekers is a result, among other factors, of Labour Ministry interventions and weaker inflow of newly unemployed. At the same time, other data from the labour market are showing no improvement. On the contrary, number of jobs is declining at accelerating pace, which is shown by the LFS data.

Quote of the week – Cutting rates in autumn would be too late

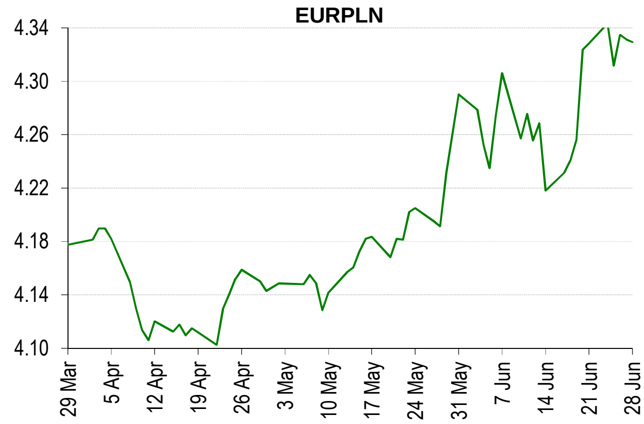
Andrzej Kaźmierczak, MPC member, 24.06, Reuters
If the zloty depreciates further, I will not imagine a cut in July

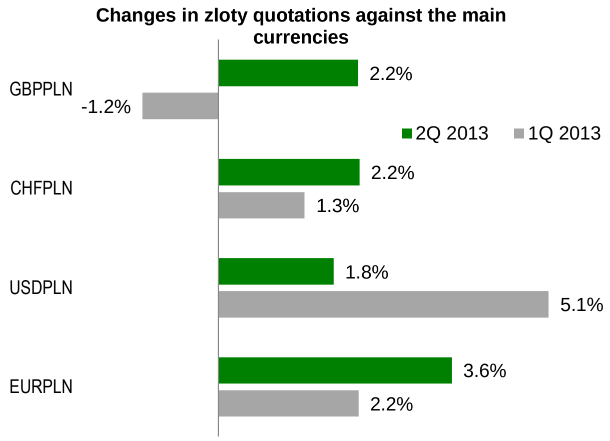
Jerzy Hausner, MPC member, 24.06, Reuters
[Depreciation of the zloty] is not a factor which can immediately affect the monetary policy, at least during the July meeting. No one said that the easing cycle will end in July, so if statement after next-month meeting does not include such declarations, the cycle may be continued in September

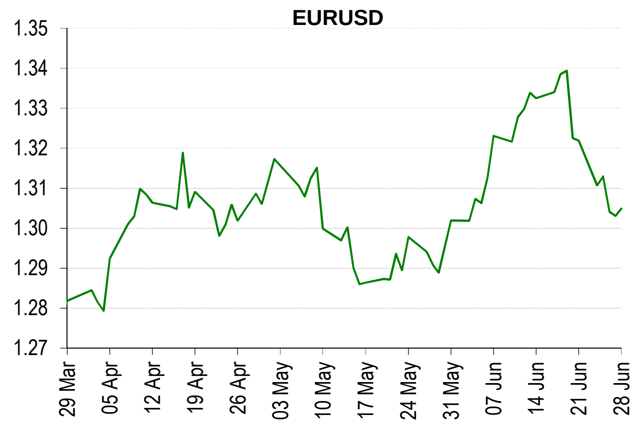
Andrzej Bratkowski, MPC member, 25.06, Reuters
I'd prefer a cut by 50bps, but there is a low chance for such a move. I believe that 25bps is enough. There are some signals of improvement, for example in trade, which is a signal that cutting rates in autumn would be too late.

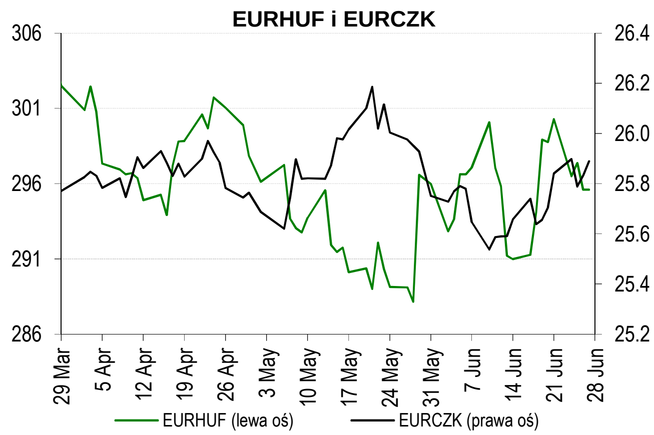
In March and May decision on rate cut was taken with 5:5 vote breakdown and decisive vote of the governor Belka. In both cases, apart from the NBP governor, the cut was supported by Andrzej Bratkowski, Elżbieta Chojna-Duch, Jerzy Hausner and Anna Zielińska-Głębocka. None of them withdrawn their support for monetary policy easing, so the last months' scenario will probably be followed also in July. It is worth noting that Andrzej Bratkowski is sceptical about cuts in autumn. If he recalls his support for easing after July, there will be probably no more cuts. Recently Bratkowski was rather consistent as regards realization of his words, so we do not think that he is speaking idly. Zloty depreciation is an important hurdle for Kaźmierczak to reduce rates. However, both Hausner and Bratkowski stated that this will not prevent them from cutting.

Foreign exchange market – Zloty to remain under pressure









Rebound after significant increase of exchange rate

▪ After a very weak beginning of the week (the EURPLN increased temporary above 4.35), next days brought some rebound on the domestic FX market. Gradual zloty appreciation came from global mood improvement. Fed's officials have tried to reduce fears over the central bank's plan to gradually reduce stimulus, softening Ben Bernanke's statement after the June FOMC sitting. Domestic macro data (retail sales, unemployment rate) and events (release of report about pension funds) had very limited impact on the zloty quotations. Still possibility of NBP intervention, and state-owned BGK's action directly on the FX market were stabilising the FX market. At the beginning of the week deputy minister of finance Wojciech Kowalczyk said that „BGK is present on the FX market from time to time when zloty weakens".

▪ One should notice that despite NBP's intervention or BGK's actions zloty at the end of Q2 2013 was weaker not only in comparison to the end of Q1 2013, but also to the end of 2012 (see chart). In the first half of 2013 zloty lost the most against the US dollar (7%), while in the second quarter against the European currency (3.6%).

▪ In coming weeks zloty will remain at the elevated level against the main currencies. Global factors (in particular future Fed's policy) will still have strong influence on the zloty, while domestic ones should stay in the shadow. The range between 4.30-4.35 for the EURPLN is still valid, however we do not exclude the exchange rate to test both bounds depending on the investors' mood. Non-farm payrolls release in the US (July 5) might set down a direction in coming weeks. On the other hand more hawkish statement from the MPC will be supportive for the zloty. One should notice that despite rate cut by the Hungarian central bank forint strengthened.

The US dollar is still favourable

▪ Last week brought some global investors' sentiment improvement. It came from calming statements from Fed's officials, but also actions of China, which supported its financial sector. However, the euro did not benefit from mood's improvement; the EURUSD was traded between 1.2985 and 1.315.

▪ This week the most important event will be labour market data in the US. Further increase in employment in non-farm sector might again renewed expectations on faster tapering by Fed, which will be supportive factor for the US dollar. Breaking the support level at 1.2985 would open the way towards 1.28.

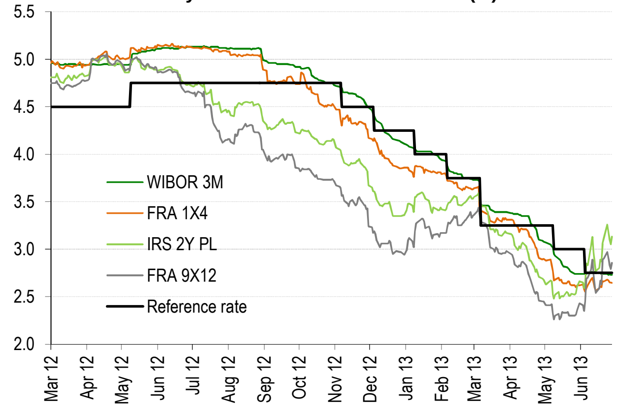
CZK did not benefit from improved global moods

▪ Central bank meetings were the most important events for the CEE currencies. Decisions were in line with expectations – central bank of Hungary cut rates by 25bps, while Czech bank kept rates at unchanged, ultra-low level. Still, higher probability of intervention on the CZK market triggered a jump of EURCZK above 26. This move was short-lived and on Friday the Czech currency continued to gain.

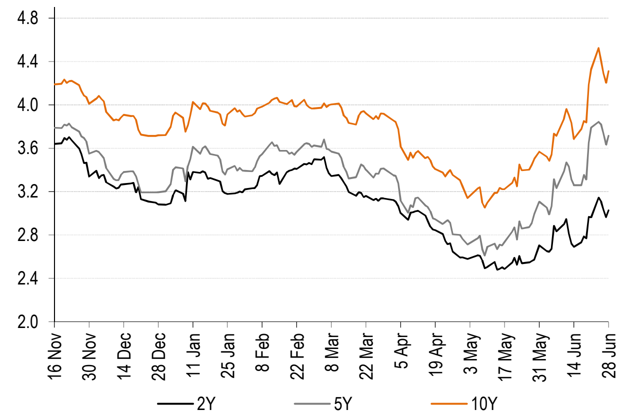
▪ CEE currencies, similarly as the zloty, are under influence of external factors, mainly future Fed policy. There may be higher volatility on the market while awaiting the Friday's US labour market data. PMI indexes for CEE economies, due for release at the beginning of the week, may affect CZK and HUF in the short term.

Interest rate market – MPC's rhetoric crucial for short end of the curve

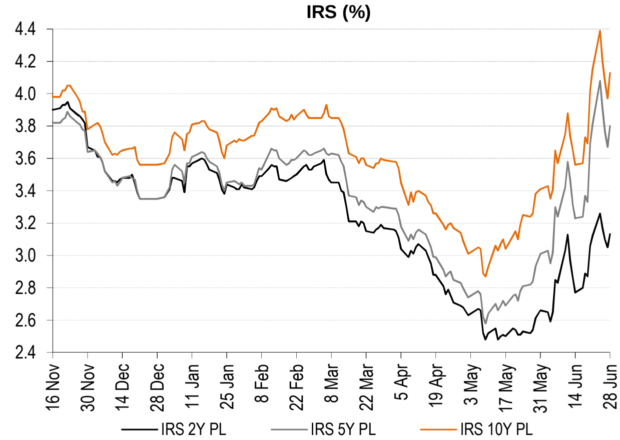
Money market rates vs reference rate (%)



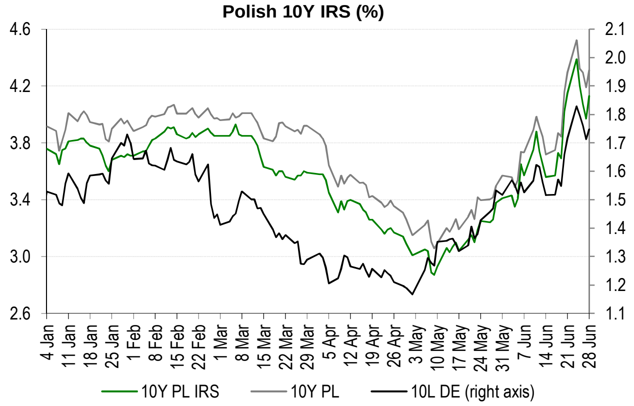
Yields of Polish benchmarks (%)



IRS (%)



Yields of 10Y Polish and German benchmarks and Polish 10Y IRS (%)



Longer WIBORs going slowly up

- Last week the situation in the money market has changed somehow. While 1M and 3M WIBORs continued declining, longer rates started increasing gradually, showing not only stability of NBP rates in the next quarters, but even possibility of their increase (due to economic revival).
- Situation in FRA market was more volatile. Improvement of global moods gave impulse for correction after recent significant rise. The biggest drop affected longer FRA rates. FRA9x12 fell to 2.79% from 2.97% at the start of the week (which then suggested pricing-in of rise in WIBOR3M by almost 25bps).
- This week market attention will focus on the MPC meeting. Interest rate cut by 25bps will give impulse for further drop of WIBOR rates up to 3M. However, the scope for decline of 3M rate is already limited.

Improvement in bond and IRS market

- After weak opening on Monday (10Y yield close to 4,6%), the following days brought improvement on the bond and IRS market, which was driven mainly by core markets. This was the result of a perception of lowering risk that Fed could swiftly begin tapering. The most significant move in yields was observed in the middle and long-end of the curve. This led to spread tightening and curve flattening – 2-10Y to 128 bps in case of bonds (from 138 bps at the beginning of the week) and to 100 bps for IRS curve (from 113 bps). Support for the market came also from the Ministry of Finance, as the deputy minister Wojciech Kowalczyk said that in current market environment they could withdraw from offering papers on auctions in July-August period.
- In line with this announcement, the ministry significantly lowered the supply of bonds in the third quarter (as compared to sell of PLN33.4bn. in Q2). In both July and August no auctions are planned, though if market stabilises or/and demand appears, the ministry might conditionally offer some papers. In September the switch auction is planned with bonds maturing in the period October 2013 – January 2014 to be bought back. This very flexible approach of the ministry of finance is possible mainly due to the fact that this year's financing needs are covered already in 88%. What is more, this ratio will soon increase further to ca. 94%, as in the third quarter the ministry plans to receive ca. €2bn from international financial institutions. Additionally, auction in international markets are possible.
- The Ministry of Finance also published data on breakdown of engagement of different investors group in the local debt market at the end of May (i.e. before the significant rise in yields). The sum of bonds owned by foreign investors almost did not change (PLN207.2bn). The most significant increase was observed in the case of local commercial banks (to PLN108.8bn from PLN103.8bn).

MPC and moods on core markets will be crucial

- This week investors' attention will focus on the MPC meeting, at which the new projections of CPI and GDP will be presented. MPC decision to cut rates by 25bps should come as no surprise, however the statement and the press conference will be of high importance for interest rate market. If the Council decides to introduce neutral bias in monetary policy already in July, it may have negative impact on the short end of the yield curve.
- Long end of the yield curve will remain more vulnerable to global factors. Therefore, better than forecast data from the US labour market may bring another wave of sell-off in the debt market.

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