Bank Zachodni WBK

Weekly economic update

8 – 14 July 2013

The main events of last week were meetings of central banks in Europe. Polish Monetary Policy Council cut main interest rates by 25bps reference rate to 2.5%), in line with expectations, at the same time announcing that this decision concludes the easing cycle. Even though new projections of inflation and GDP proved to be lower than previous ones, MPC believes that worst is over for Polish economy. Interestingly, while NBP president Marek Belka was clearly optimistic about economic outlook and happy that yields of Polish bonds increased in recent weeks above the NBP rate, one day later the ECB and BoE made unprecedented steps to curb rise in market interest rates that could potentially harm their economies. Governors of both the ECB and BoE pledged to keep highly accommodative monetary policy for a long time. Apparently, there are still substantial risks to economic growth, however our forecasts suggest that we should see a gradual revival in the next quarters. Recently released PMI indicators of economic activity supported such scenario, showing a rise in most of the countries, including Poland.

In the nearest week the number of key data releases that could have significant impact on the market will be limited. On Monday the new Inflation report will be published, including the details of projections of inflation and GDP. However, its impact on investors' moods should be marginal. More important may be government's statement about potential budget amendment, which PM Tusk said may be released this week. Balance of payments data for May, which will be published on Friday, will be probably not as optimistic as those for April, however they should not harm Polish currency. As regards publications abroad, after recent disappointments from German economy (PMIs, industrial orders), next indicators from this country will be interesting (exports, industrial production), showing condition of Poland's biggest trading partner.

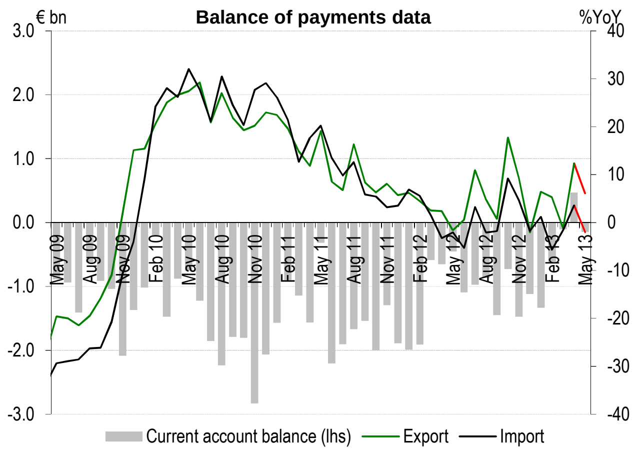
Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (8 July)					
8:00	DE	Exports	May	%MoM	-0.4	-	1.9
9:00	**PL**	**Release of *Inflation Report***					
10:30	EZ	Sentix index	Jul	pts	-10	-	-11.6
12:00	DE	Industrial output	May	%MoM	-0.5	-	1.8
		TUESDAY (9 July)					
10:30	UK	Industrial output	May	%MoM	0.2	-	0.1
		WEDNESDAY (10 July)					
	CN	Trade balance	Jun	$bn		-	20.4
16:00	US	Wholesale inventories	May	%MoM	0.3	-	0.2
		THURSDAY (11 July)					
14:30	US	Import prices	Jun	%MoM	0.1	-	-0.6
14:30	US	Initial jobless claims	week	k	340	-	343
		FRIDAY (12 July)					
11:00	EZ	Industrial output	May	%MoM	-0.2	-	0.4
14:00	**PL**	**Exports**	**May**	**€m**	**12930**	**12753**	**13279**
14:00	**PL**	**Imports**	**May**	**€m**	**12725**	**12603**	**12678**
14:00	**PL**	**Current account**	**May**	**€m**	**-143**	**-169**	**468**
14:00	**PL**	**M3 money supply**	**Jun**	**%YoY**	**6.7**	**6.5**	**6.5**
15:55	US	University of Michigan consumer confidence	Jul	pts	85.0	-	84.1

Source: BZ WBK. Bloomberg, Reuters, Parkiet

Maciej Reluga Chief economist +48 22 586 8363 e-mail: ekonomia@bzwbk.pl
Piotr Bielski +48 22 586 8333 **Marcin Sulewski** +48 22 586 8342
Agnieszka Decewicz +48 22 586 8341 **Marcin Luziński** +48 22 586 8362

What's hot this week – Surplus in current account unlikely to be repeated



▪ May's data on balance of payments will not probably be as optimistic as April's numbers – we are expecting that exports decelerated somewhat following industrial output (among other factors due to working days effect). Surplus in goods trade was probably lower than one month earlier, but in our view the entire year will end with positive balance (for the first time since early 90s!). Still, we can see a slight deficit in current account in May. Despite record high inflow of EU funds to Poland in May, only a small part of these means was classified as current transfers.

▪ Data on money supply will show in our view a slightly stronger growth rate of loans in June, but this effect will be mostly due to the weakening of the zloty. It will be interesting to see if rising volatility on the financial markets stopped the flow of savings from bank deposits to mutual funds.

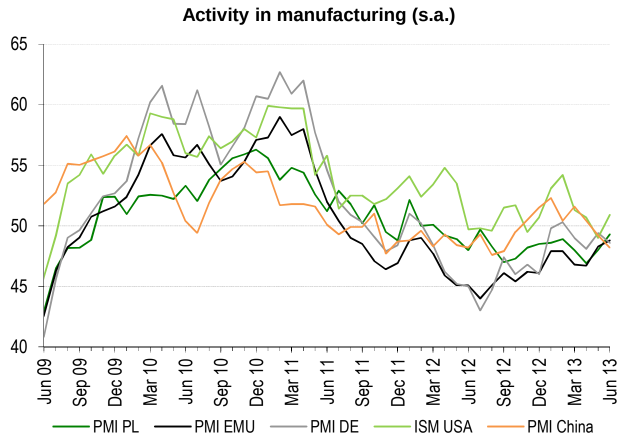
Last week in the economy – MPC optimistic, contrary to the ECB and BoE

NBP projections in subsequent *Inflation Reports*

	GDP growth			
	Jul 12	**Nov 12**	**Mar 13**	**Jul 13**
2013	1.0-3.2	0.5-2.5	0.6-2.0	0.5-1.7
2014	1.7-4.2	1.1-3.5	1.4-3.7	1.2-3.5
2015	x	x	1.9-4.4	1.6-4.2
	CPI inflation			
	Jul 12	**Nov 12**	**Mar 13**	**Jul 13**
2013	2.0-3.4	1.8-3.1	1.3-1.9	0.6-1.1
2014	1.0-2.7	0.7-2.4	0.8-2.4	0.4-2.0
2015	x	x	0.7-2.4	0.7-2.4

▪ The MPC cut interest rates by 25bps and declared that it has ended the monetary policy easing cycle and that now the Council is in neutral bias. According to the NBP governor, this is reflecting the MPC's optimism about economic outlook. As we wrote one week ago, in our view it would have been a better decision to leave the door ajar for further adjustment in autumn, given the scale of economic uncertainty. In our view such a stance would be supported by new projection of inflation and GDP (lower than in March).

▪ Optimism of the Polish MPC is clearly contrasting with statements of the ECB and of the Bank of England, which remain rather cautious. Governors of both these banks stressed that risks for the economic growth are skewed downwards and they declared in an unprecedented way that interest rates will stay at all-time lows for an extended period.



▪ PMI index for Polish manufacturing climbed in June to 49.3pts from 48.0 in May, reaching the highest value in almost a year. Reading was better than we (48.8pts) and the market (48.3pts) expected. Subindex for output almost reached and new orders slightly surpassed level of 50pts. Breaching this mark suggests a revival and companies were explaining improving orders by higher export demand. However, a part of June's improvement in PMI (in our view ca. 0.3-0.4pts) was due to jump in component of suppliers' delivery time caused by recent floods. This means that part of this increase was not due to better economic climate but to one-off factors. Still, we think that in the upcoming months PMI will be moving in upward trend, suggesting an approaching recovery.

▪ Improvement was also posted by most PMI indicators in the euro zone (apart from Germany), underpinning expectations for an economic revival in H2.

Quote of the week – End of the easing cycle is a sign of optimism

Marek Belka, NBP governor, 3.07, MPC press conference

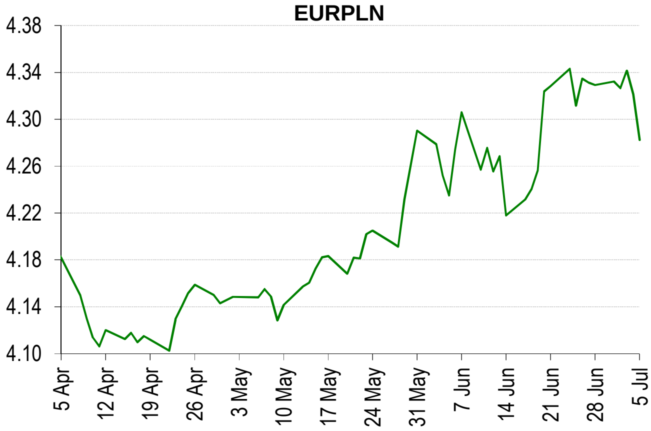
After cutting rates by 225bps we are ending the easing cycle and entering a state, which can be called a neutral bias (…) In my view interest rates should remain unchanged at least until the year-end (…). We are quite sure that the economy has the worst times behind it and we will see a recovery. We can say that end of the cycle is a sign of optimism among the MPC and I wish that this is treated as a signal send to the economy that the way to recovery stays wide open.

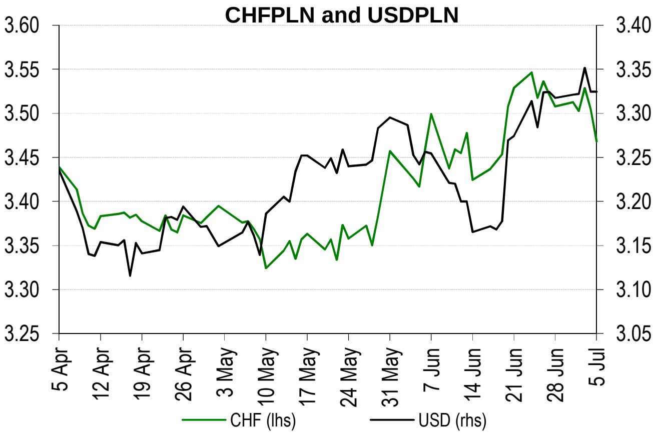
Andrzej Bratkowski, MPC member, 3.07, MPC press conference

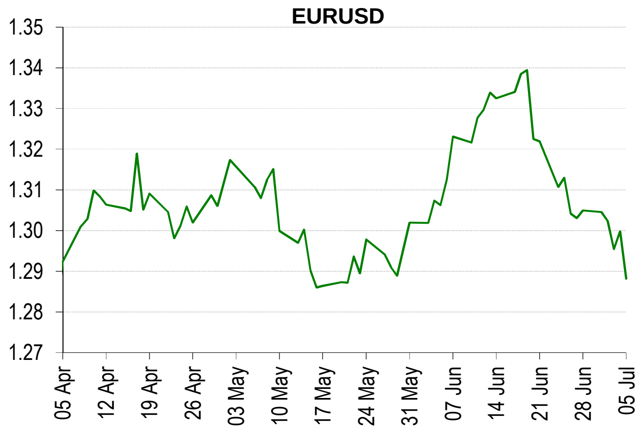
I think that the situation is ripe enough that we can say we are more optimistic about economic situation. Continuation of loosening cycle, cutting rates may prove pro-cyclical.

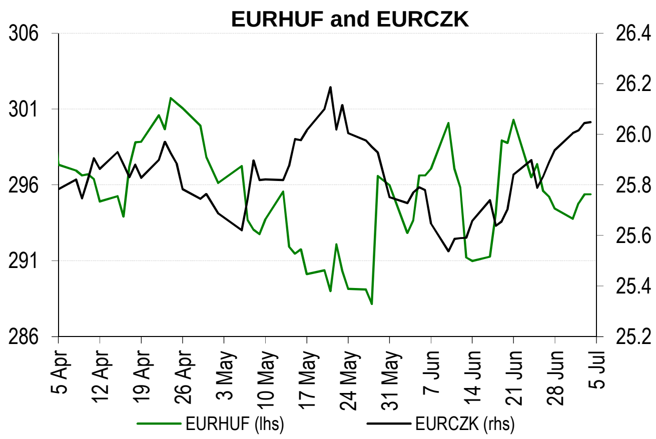
We agree with the Monetary Policy Council that the Polish economy probably has the worst time behind. At the same time, one should be aware that the uncertainty about the situation in the upcoming quarters is very high – bottoming out is to be based mostly on improving exports, while forecasts of recovery in the euro zone are still prone to high downward risk (which was also stressed by recent ECB and BoE statements). In this situation the declaration of MPC's neutral bias seems a bit premature. Still, if the economic situation follows our forecasts, then the MPC will have no reasons to retreat from this declaration. On the contrary, CPI will start rising in July, probably followed by analysts' inflation expectations (which are important for the Council, as Marek Belka said, and are already quite high). This can fuel market expectations for NBP interest rate hikes in couple of months' time.

Foreign exchange market – US labour market data weakened risky assets, including zloty









Zloty strengthened after the central banks' meetings

- The start of last week brought zloty depreciation due to global mood deterioration (effect of political turbulences in Portugal, Egypt, but also weak macro data from China). Investors' mood on the domestic market has improved in next days, supported by MPC's statement. Zloty appreciated after the MPC's announcement that it ended the easing cycle and this trend strengthened after ECB's dovish comment. As a result, the EURPLN broke support at 4.30 and reached local minimum at ca 4.26. Another wave of zloty weakening appeared after the US labour market data release. Better than expected reading caused the exchange rate to test resistance at 4.30.
- Zloty gained also against other main currencies. In weekly term domestic currency strengthened the most versus British pound (by 1.5%), while against the US dollar weakened by 0.2% (effect of dollar strengthening on the international market). One should notice that the USDPLN has stayed in range between 3.30 and 3.35.
- After sharp decline towards 4.26, the EURPLN quickly returned to 4.28. We think that breaking the level of 4.26 might open the door to further decline to 4.24, or even 4.22. The important resistance is 4.30, which breaking might mean that the EURPLN will return to the range between 4.30-4.35.

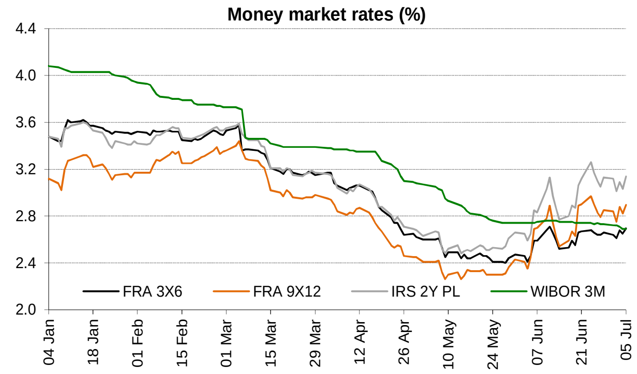
Euro under pressure of situation in peripheries and ECB

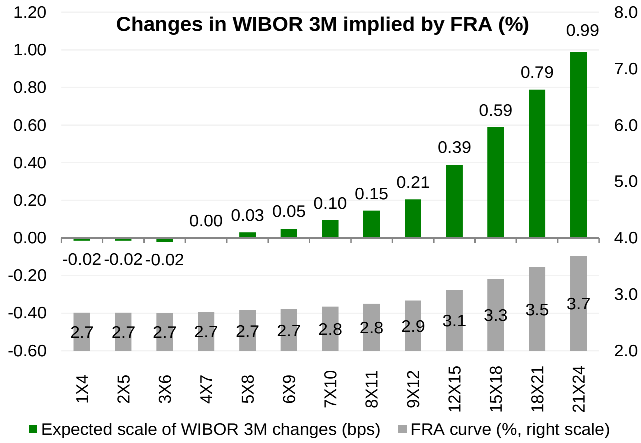
- Last week the single currency was under pressure of situation in euro zone's peripheries (mainly political turmoil in Portugal), but also the comments of the ECB president. While PMI indices have slightly offset the effect of Portugal, the dovish statement of the ECB (not expected by the market) triggered a sharp euro depreciation. After the release of better than forecast data from US labour market, EURUSD approached the important support 1.28.
- More dovish than expected was also statement of the Bank of England. The statement released after the meeting chaired for the first time by new governor Mark Carney suggested that path of future interest rates expected by the market is unwarranted given economic conditions. This was an impulse for weakening of the pound.
- Rising discrepancy between policies of the ECB and the Fed may lead to further weakening of euro against dollar. After recent changes in the chart, level 1.30 became an important resistance for EURUSD, while 1.28 is an important support. Breaching 1.28 would open door towards 1.2745.

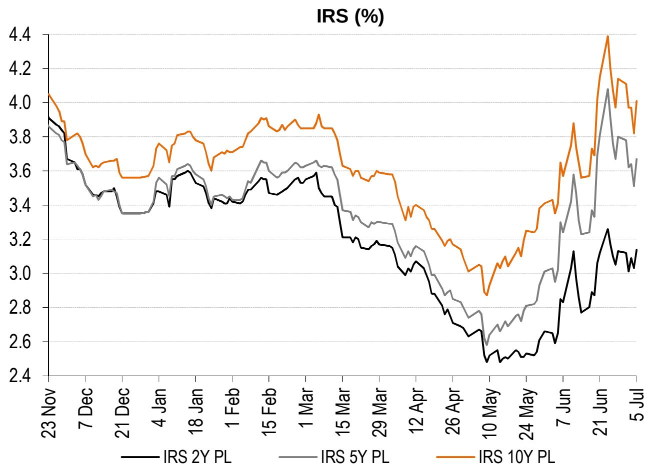
Data releases overshadowed by the ECB

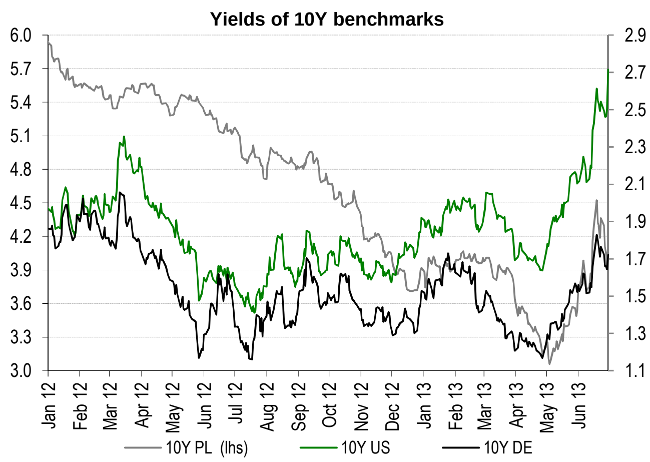
- After relatively weak opening of the week, the following days brought, similarly as in the case of the Polish zloty, the strengthening of CEE currencies. The most significant impact came from the softer-than-expected communique of the European Central Bank. As a result, EURCZK decreased from 26 to 25.75 and EURHUF fell from 296 to 292,5. On Friday forint lost some ground against the single European currency after weak data on industrial production (decrease by 2.1%YoY in May). On the other hand, the Czech koruna remained stable, supported by a positive release of retail sales figure. However, the better-than-expected data from the US labour market gave negative signals to risky assets, including CEE currencies.
- The situation in the region's FX market will remain strongly dependent on external factors and domestic data will be less important. The market reaction to Friday's NFP release (weaker both koruna and forint) shows that expectations regarding monetary policy in the US will be the key element for the strategy in CEE3 foreign exchange markets.

Interest rate market – Under influence of central banks









Limited drop of short-term WIBORs after MPC

▪ The most important even for the money market was the MPC meeting. Anticipating a reduction of NBP reference rate, the 1M WIBOR continued downward trend, while other rates were stable. MPC's decision to cut rates by 25bps triggered an impulse for further drop in 1M and 3M rates, while longer rates returned to upward trend.

▪ FRA market was characterised by higher volatility. The announcement of end of monetary easing cycle have impulse for increase in FRA rates, but after dovish statements of the ECB they declined again. In the long run, the market remains quite hawkish, pricing-in a rise in money market rates of ca. 100bps in the horizon of next two years.

▪ This week there will be no crucial data releases that could impact the market (balance of payments figures due only on Friday afternoon). WIBOR and FRA rates will be more dependent on situation in IRS and bond markets. While 1M WIBOR may continue decreasing, 3M rate should start consolidating, although inflation data for June (due 15 July) may trigger slight drop also in this rate.

ECB supported long end of yield curves

▪ Last week saw a number of surprises. The MPC, after cutting rates by 25bps (in line with expectations), announced the end of easing cycle, which has not been anticipated. As a result, there was a rise in yields at the short end of the curve, amid stabilisation (IRS) or even drop (bonds) at the long end of the curve. Next surprise was delivered by the ECB, which pledged to maintain accommodative policy, and even did not rule out a rate cut. This gave impulse for continuation of strengthening at the long end of yield curves (at short end a drop was more limited). As a result, yield curves became flatter (spread 2-10Y narrowed by ca. 35bps for bonds and IRS in the last two weeks).

▪ Additional support for strengthening of domestic debt was a drop of yields of German Bunds. Consequently, yield of 10Y Polish bond fell below 4% for the first time since June's Fed meeting. Situation changed after the release of US non-farm payrolls data – weakening of German bonds caused that domestic 10Y bond again was testing 4% level.

▪ Despite a rebound in interest rate market after ECB comments, 2Y IRS remained above 3%. This reflects market expectations for interest rate hikes, which are also discounted by FRA rates for longer tenors (in 9 months horizon).

Moods still under influence of global factors

▪ This week we will learn more details about NBP inflation projection (release of Inflation report on Monday at 9:00). In the statement after last decision the MPC distanced itself from the projection, showing more optimistic outlook for Polish economy, which justified ending the easing cycle. In our view, the next CPI data will show a drop towards zero (we predict June's inflation rate at 0.3%), which should create impulse for slight rebound at the short end of the curve.

▪ Yields in the middle and at the long end of the curve will remain under impact of global factors, mainly the behaviour of German Bunds (correlation since the start of May was above 90%). Market reaction after US employment data shows that Fed's policy will remain in the foreground and data to be released in the USA may increase volatility.

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