

# Weekly economic update

26 August – 1 September 2013

Last week the market trade was mainly driven by expectations about minutes of the July's FOMC meeting and about economic recovery in the euro zone. Protocol of the FOMC meeting, released on Wednesday, showed that most members of the Committee are supporting a reduction of asset purchases this year already. Some members thought that this should happen "soon". This news bolstered market's worries that QE3 tapering may begin as soon as in September, which weighed on risky assets. Information from the euro zone exerted an opposite influence; flash PMI indices for manufacturing in Germany and the whole monetary union expanded more than expected and reached the highest levels since mid-2011. A good result was posted also by the Chinese indicator. Information from the biggest economies were negatively affecting the core debt market, bringing yields of German and US bonds to the highest level for months.

In Poland we have seen another bunch of good macroeconomic data, which confirmed that the Polish economy has entered a path of recovery. Government accepted a draft bill of budget amendment, assuming spending cuts worth PLN7.7bn (slightly less than previously announced) and rise in deficit by PL16bn. In our view, stronger economic recovery later in the year should cause that the actual deficit will be lower by a couple billions than the level suggested in amendment. Media also showed a rumour about resignation of minister Rostowski, but it did not affect the trade, given a late hour of release and a quick denial.

This week we will see the last August's releases, including preliminary GDP estimate for Q2 together with detailed breakdown. Most important releases globally are the US data (confidence indexes, GDP, incomes and spending), which will be affected expectations about timing of QE3 tapering. Market will probably be also focused on Jackson Hole, where Janet Yellen, potential successor of Ben Bernanke, is present.

## Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (26 August)</b>							
10:00	PL	Retail sales	Jul	%YoY	2.8	1.6	1.8
10:00	PL	Unemployment rate	Jul	%	13.1	13.1	13.2
14:30	US	Durable goods orders	Jul	%MoM	-4.0	-	3.9
<b>TUESDAY (27 August)</b>							
10:00	DE	Ifo index	Aug	pts	107.0	-	106.2
14:00	HU	Central bank decision	Aug	%	-	-	4.00
15:00	US	S&P/Case-Shiller home price index	Jun	%YoY	12.0	-	12.2
16:00	US	Conference Board index	Aug	pts	80.3	-	80.3
16:00	US	Richmond Fed index	Aug	pts	-	-	-11
<b>WEDNESDAY (28 August)</b>							
8:00	DE	GfK index	Sep	pts	7,1	-	7.0
16:00	US	Pending home sales	July	%MoM	0,0	-	-0.4
<b>THURSDAY (29 August)</b>							
14:30	US	Preliminary GDP	Q2	%YoY	2.2	-	1.7
14:30	US	Initial jobless claims	week	k	330	-	336
<b>FRIDAY (30 August)</b>							
10:00	PL	GDP	Q2	%YoY	0.8	0.8	0.5
10:00	PL	Fixed investments	Q2	%YoY	-3.2	-5.0	-2.0
10:00	PL	Private consumption	Q2	%YoY	0.4	0.5	0.0
14:30	US	Personal spending	Jul	%MoM	0.3	-	0.5
14:30	US	Personal income	Jul	%MoM	0.2	-	0.3
15:45	US	Chicago PMI index	Aug	pts	53,0	-	52.3
15:55	US	Michigan index	Aug	%YoY	80,5	-	85.1

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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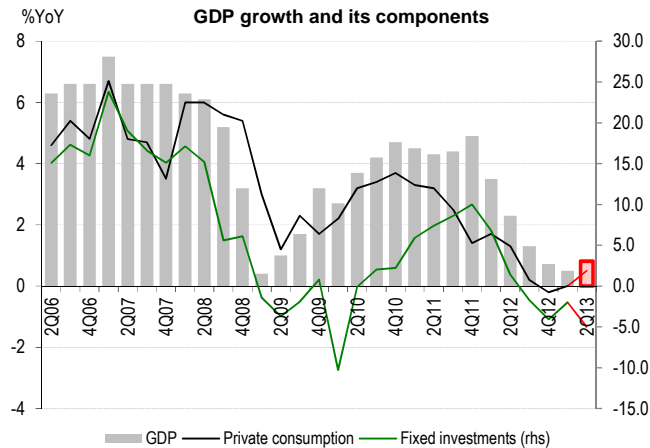
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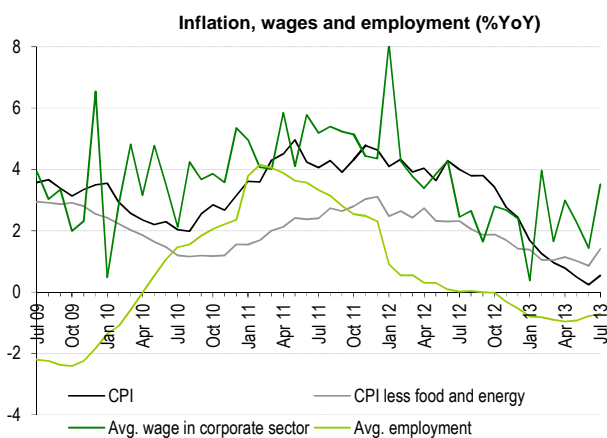
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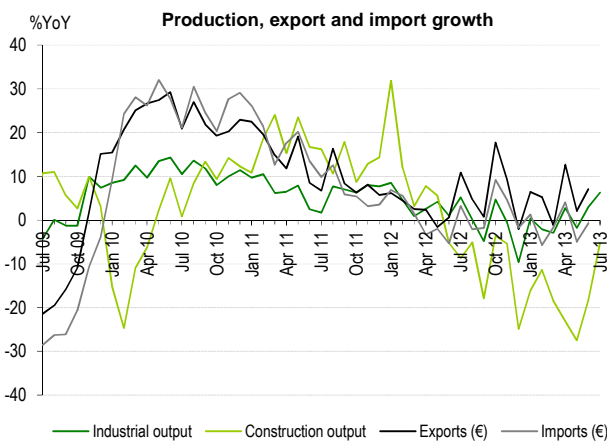
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**What's hot this week – Last data this month**

- Our forecast of July's retail sales is below market consensus, but after data about car registrations we see upward risk to our prediction. Thus, the release should not undermine the market's faith in economic recovery.
- Expected drop in unemployment rate to 13.1% in July may be the last one this year – in the following months we expect to see stabilisation and then a seasonal rise in unemployment. Still, there are signs of improvement visible in the labour market.
- Flash data released by the CSO showed that GDP growth in Q2 accelerated to 0.8%YoY. Second release may bring some slight revision, but more importantly, it will show the structure of growth. We expect to see a large positive contribution of net exports, a slight acceleration of private consumption growth, and a deepening contraction in investment spending.

**Last week in the economy – Growing evidence of economic recovery**

- CPI inflation rose in July to 1.1%YoY, much above forecasts. Main source of surprise was the weaker than usually seasonal drop in vegetable prices, and the scale of hikes in waste management costs after introduction of waste management bill. Core inflation also increased (excl. prices of food and energy to 1.4%YoY). However, one-off type of price hike, and weakness of domestic demand imply lack of inflationary pressure. PPI growth remains in red (-0.8%YoY) showing low cost pressure on enterprises.
- Average employment in companies rose again in monthly terms in July. Meanwhile, wage growth soared to 3.5%YoY, much above forecast. Although data about wages could have been biased by shifts in bonus payments in some companies, in general the data from the labour market joined the set of information, confirming gradual economic recovery in Poland.



- Industrial production growth accelerated in July to 6.3%YoY and drop in construction output slowed to -5.2% YoY. Although data were under positive impact of higher number of working days, after eliminating this effect the data still confirm continuation of revival in Polish industry and some signs of bottoming out in construction. The latter element is particularly important as it may herald the beginning of recovery in investment activity.
- The biggest gains were recorded in export-oriented industrial branches, which confirms our scenario of export-led recovery. It was also confirmed recently by balance of payments data for June, according to which export growth accelerated to 7.1%YoY. Second quarter of 2013 was the first one in history when Poland's current account balance was in surplus (almost €1.5bn).

**Quote of the week – Interest rates should stay on hold for a prolonged time**

**Marek Belka, NBP Governor, 21.08, Obserwatorfinansowy.pl**

Let's wait until the end of the year and then we will think what's next. I want to stress that all MPC members (...) were unanimous that current level of interest rates should hold for prolonged time. There is very broad consensus in this area. There is no inflationary pressure, but economy is bottoming out, which means that output gap will start closing in a year's time. Therefore further reductions of interest rates could be pro-cyclical.

**Anna Zielińska-Giębocka, MPC member, 21.08, PAP**

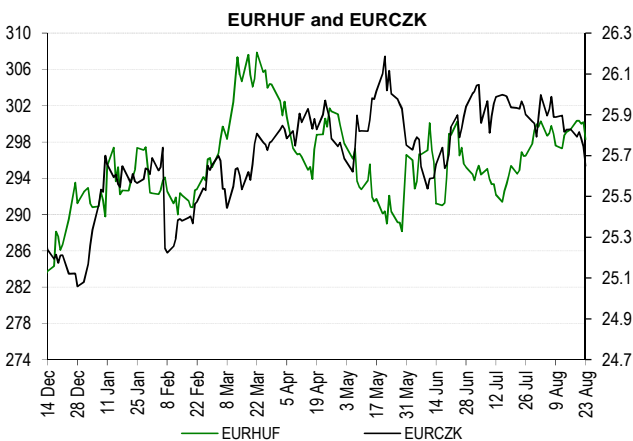
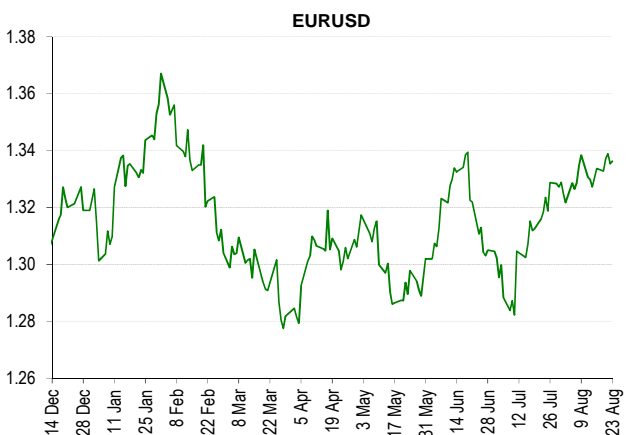
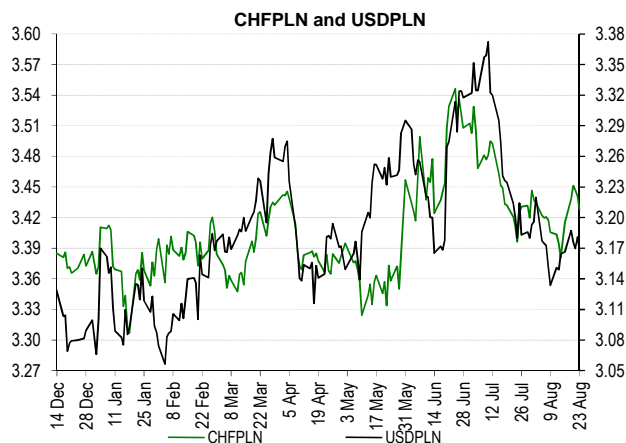
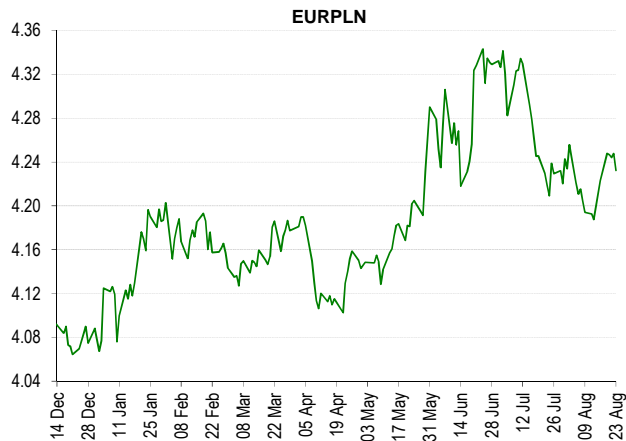
In my view this stage of rates' stabilisation may be extended. We can say for sure that there will be no changes until year-end.

**Jan Winięcki, MPC member, 16.08, TVN CNBC**

I believe the economy will be growing slowly and will reach 3% in the middle of 2014, there are no big pressures, so there are also no reasons to consider changes in interest rates.

Minutes of the July's MPC meeting showed that the Council members were quite unanimous as regards the fact that the monetary easing cycle should be ended and that economic recovery can be expected in H2. According to Marek Belka, the "very broad consensus" also concerned the opinion that interest rates should remain unchanged for a prolonged time, i.e. at least until the end of this year. This seems to be confirmed by recent comments of MPC members – even those who had opposing views until recently, are speaking with the same voice now. Until recently we had assumed that the first interest rate hike is possible in 3Q2014. An upward shift in CPI path after higher than expected inflation data for July may mean that hike will get slightly closer, but we are still talking about somewhere in the middle of next year. This is consistent with scenario currently priced-in by FRA market.

## Foreign exchange market – Global tendencies are crucial for the zloty



### High volatility on the zloty has remained

On the domestic FX market the summer mood has dominated, causing a higher volatility on the zloty. What is more, the zloty still depends on global trends, in particular on expectations about future monetary policy of Fed. Concerns that the US central bank is poised to begin QE3 tapering as early as in September (July's Fed minutes did not allay such fears) caused an increase of EURPLN towards 4.26 (weekly maximum was at 4.254). End of the week brought some rebound in global mood, and exchange rate fell to 4.23, trimming part of earlier losses.

As regards quotation of the zloty against other main currencies, we also noted high volatility. In bi-weekly terms zloty lost by most against the British pound (by 1.6%) and against the US dollar (1.1%).

We expect that the zloty will still strongly depend on external factors – macroeconomic data from the US economy might serve as a gauge of further Fed's action. A strengthening of expectations on QE3 tapering in September will put a negative pressure on the domestic currency. On the other hand, the last set of macroeconomic data, due for release this week (retail sales, registered unemployment rate Q2 GDP data together with its breakdown) should confirm signals of the economic rebound. Consequently, we think that this will be a supportive factor for the zloty. The EURPLN is consolidating in wide range 4.20 – 4.26 and upcoming data should not change this situation. We believe that the better-than-expected readings from domestic economy might cause the EURPLN to be traded closer to the bottom of this channel.

### EURUSD below 1.34

The European currency has remained under pressure of uncertainty about Fed's actions (expectations on QE3 tapering in September strengthened after better macro data). Positive surprises of macro data for the euro zone resulted in a temporary increase of EURUSD above 1.34. Minutes of the July's FOMC meeting did not calm the investors. Consequently, EURUSD fell towards 1.33. The euro slightly rebounded after upbeat data from the euro zone and China as well as after the weaker than predicted weekly data from the US labour market. As a consequence, the EURUSD ended the week slightly below 1.34 due to weaker than expected data from the US real estate market.

This week we will see the last piece of data for the US and the euro zone (including Ifo index for Germany). However, we do not expect these data to change situation on the EURUSD chart. We still expect EURUSD to be traded between 1.327 and 1,345.

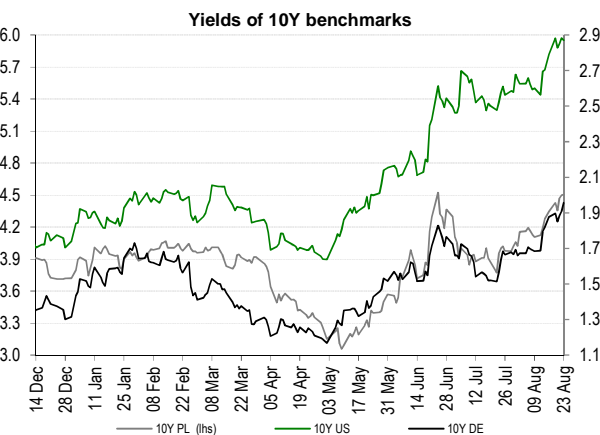
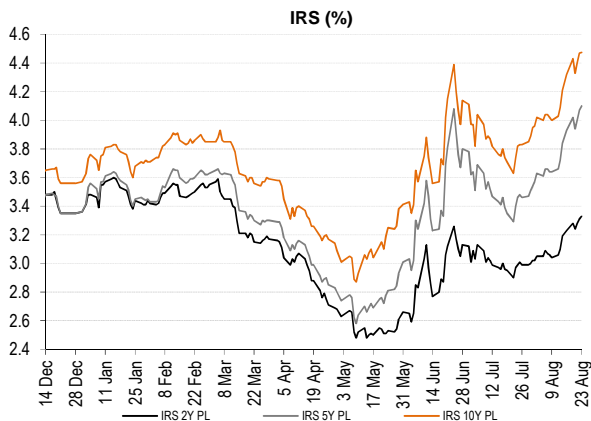
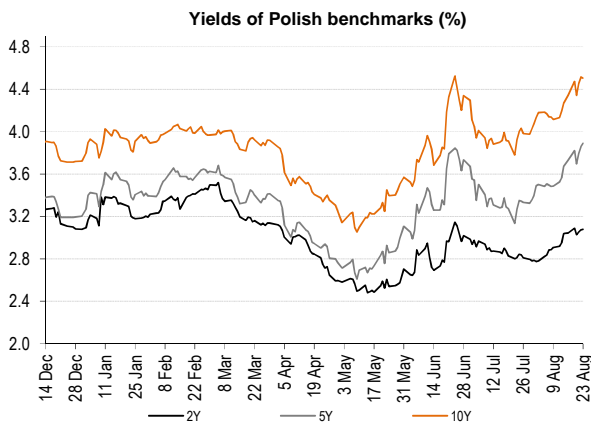
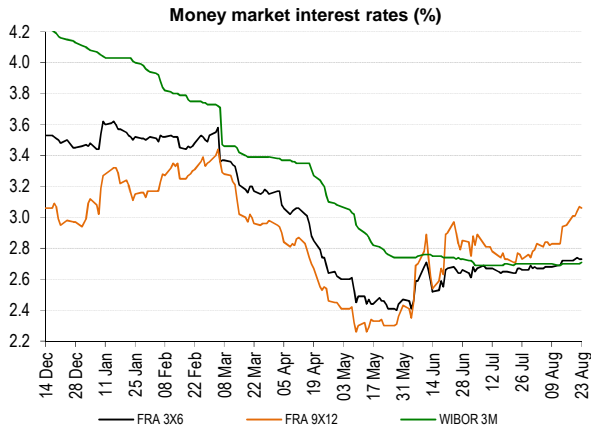
### CEE currencies also under influence of global factors

Fluctuations on the Hungarian forint and Czech koruna were high during the week. EURHUF reached maximum level at 301.3, EURCZK at 25.87. The end of the week brought some rebound due to global sentiment improvement.

This week the forint might be under influence of the central bank decision. It is widely expected that NBH will again trim official rates, but at a lower scope in comparison with previous months. Such a decision together with fears that Fed will start QE tapering in September might cause further increase of the EURHUF.

Situation on the EURCZK chart should not change significantly. Fluctuation channel between 25.5 and 26 is still valid.

**Interest rate market – Under pressure of sell-off in core markets**



**Gradual rise of WIBOR rates**

- Money market remained in holiday mood in the last few weeks. WIBOR rates remained quite stable, although 3M, 6M and 12M rates inched up by 1bp in the last week. More volatility was displayed by FRA market. Recent significant rise in IRS rates and bond yields pushed up FRAs with longer maturities, with FRA9x12 heading towards 3.10% (above maximum reached after June's Fed meeting).
- In the last week of holidays, more signals of economic recovery accompanied by assurances from MPC members that rates will stay on hold for a prolonged time should stabilise WIBOR market around current levels. However, until the end of the year the upward trend should persist.

**Sell-off in IRS and bond markets**

- Last weeks confirmed that domestic interest rate market is strongly dependent on trends in international markets. Concerns that the Fed may start tapering of QE3 already in September triggered a sell-off not only in US and German bonds, but also in more risky bond markets, including Polish debt. As a result, yields of 5Y and 10Y bonds rose above maximum levels reached after June's Fed meeting, when Ben Bernanke declared possibility of limiting asset buying programme already this year. It is worth noticing that increase of 10Y bond yield above 4.5% (local maximum was 4.55%) activated the demand side.
- The sell-off in core debt markets triggered also a significant correction in domestic IRS market. Similarly as in the case of bonds, 5Y and 10Y IRS rates increased above June's peaks. Since the start of August the IRS curve moved up between 14bp (for one year maturity) and 53bp (for 5Y and 10Y).
- Bonds and IRS rates at the short end of the curve were more stable, supported by comments of MPC members that the official interest rates will remain unchanged for a prolonged period. As a result, 2-10Y spread widened to 144bp for bonds and to 116bp for IRS.

**Focus on macro data and supply plan**

- This week investors' attention will focus on new macro data releases (retail sales, Q2 GDP and its structure). The data should confirm gradual economic recovery, which may give impulse for a rebound after recent rise in yields, mainly in the middle and long end of the curve.
- Global trends may be still putting a pressure on domestic interest rate market. Better than forecast US data, strengthening expectations for starting of QE3 tapering in September may cause further pressure on weakening of domestic debt. If yield of 10Y bond breaches resistance at 4.55%, it will open the door towards 4.60%.
- This week we will also see the Finance Ministry's supply plan for September. We do not expect significant differences as compared to earlier presented issuance plans for Q3. To remind: in September the Ministry plans to hold a regular auction and a switching auction, at which it will want to buy back bonds maturing in October 2013 – January 2014. The offer at the former tender will be strongly dependent on market moods and on demand declared by investors.

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