

Weekly economic update

16 – 22 September 2013

Last week was a period of rebound: in Poland after panic due to government's plan of OFE overhaul, abroad after concerns about scale of Fed's QE3 tapering (at least temporarily, after weaker labour market data) and uncertainty due to situation in Syria (rising chances that military intervention can be avoided). Domestic bonds, stocks and currency trimmed losses incurred in the previous week, returning to levels seen prior to presentation of OFE changes. Data on inflation and balance of payments did not affect the market considerably.

Upcoming days may be crucial for financial market trends in the upcoming weeks or even months. Main focus will be on the Fed meeting, where decision about start of QE3 tapering will probably be made. According to Bloomberg survey, investors expect the monthly bond purchases will be trimmed by \$10bn. We think that if scale of tapering is not greater, then the market will show positive reaction to such decision. Still, it is worth keeping in mind that any hints about circumstances that may lead to further cutting bond purchases may also prove vital. Before the Wednesday's Fed decision important US macro data are due to be released and thus higher volatility may persist on the market also at the beginning of the week. Domestic data releases will probably be less important for the market. Parliamentary election in Germany is scheduled for Sunday 22.09 and its result can strongly affect moods in the week to follow.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (16 September)							
11:00	EZ	HICP	Aug	%YoY	1.3	-	1.3
14:00	PL	Core inflation	Aug	%YoY	1.4	1.4	0.6
15:15	US	Industrial output	Aug	%MoM	0.4	-	0.0
15:15	US	Capacity utilization rate	Aug	%	77.8	-	77.6
TUESDAY (17 September)							
11:00	DE	ZEW index	Sep	pts	45.5	-	42.0
14:00	PL	Wages in corporate sector	Aug	%YoY	2.8	2.9	3.5
14:00	PL	Employment in corporate sector	Aug	%YoY	-0.6	-0.6	-0.7
14:30	US	Core CPI	Aug	%MoM	0.1	-	0.2
WEDNESDAY (18 September)							
14:00	PL	Industrial output	Aug	%YoY	2.7	0.5	6.3
14:00	PL	Construction and assembly output	Aug	%YoY	-9.0	-9.1	-5.2
14:00	PL	PPI	Aug	%YoY	-0.7	-0.9	-0.8
14:30	US	House starts	Aug	k	923	-	896
14:30	US	Building permits	Aug	k	950	-	943
20:00	US	Fed decision on the scale of QE3		\$bn/mth	75	-	85
20:30	US	Press conference of Bena Bernanke					
THURSDAY (19 September)							
14:00	PL	MPC minutes					
14:30	US	Initial jobless claims	week	k	330	-	292
16:00	US	Philly Fed index	Sep	pts	10.0	-	9.3
16:00	US	Home sales	Aug	m	5.25	-	5.39
FRIDAY (20 September)							
16:00	EZ	Consumer confidence index	Sep	pts	-14.3	-	-15.6
SUNDAY (22 September)							
	DE	Parliamentary elections					

Source: BZ WBK, Bloomberg, Reuters, Parkiet

Maciej Reluga Chief economist +48 22 534 1888

Piotr Bielski +48 22 534 1887

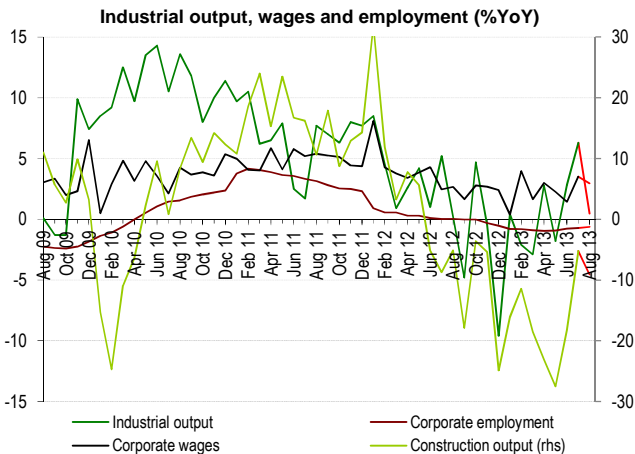
Agnieszka Decewicz +48 22 534 1886

e-mail: ekonomia@bzwbk.pl

Marcin Sulewski +48 22 534 1884

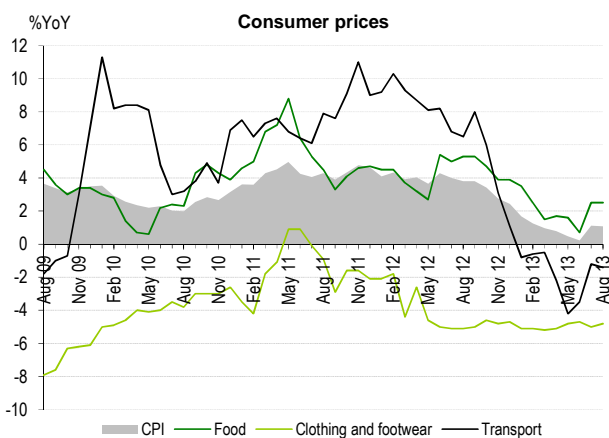
Marcin Luziński +48 22 534 1885

What's hot this week – Slightly weaker output, improvement on the labour market

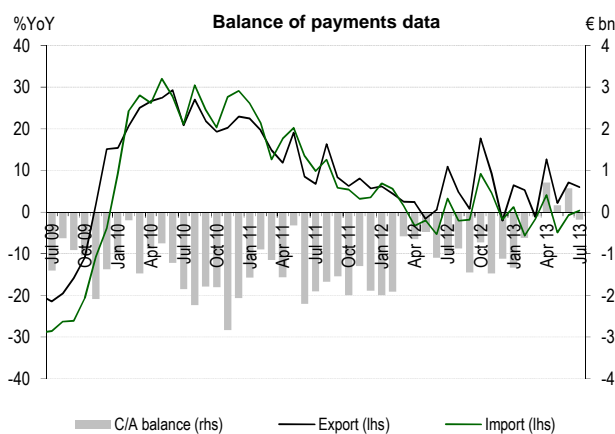


- In August we are expecting slightly weaker results of industrial and construction output than in July, which however is mainly due to negative working day effect. Moreover, we see some upward risk for our industrial output forecast after PMI and good SAMAR's data on car production. We are expecting further improvement in both sectors in the upcoming months.
- In our view, August's labour market data will show a further slight improvement. We think that pace of decline of corporate sector employment will ease for the fourth time in a row. Wage growth will decline somewhat as compared to July (when it was raised by bonus payments), but will still run at decent level.
- According to our estimates, core inflation excluding food and energy prices was stable in August, at 1.4%YoY.

Last week in the economy – CPI did not surprise, trade balance still in surplus



- Inflation rate in August remained at July's level, i.e. at 1.1%YoY. We saw seasonal declines of prices of food and non-alcoholic beverages (-1.2%MoM) and clothing and footwear (-2.7%MoM). Price reductions in these two categories were slightly deeper than we expected, but this was offset by moderate rise of fuel prices, which climbed by 0.5%MoM, i.e. more than we assumed. Changes of prices in other categories were insignificant.
- In the upcoming months, inflation will be probably gradually increasing – in our view it will reach 2% at the beginning of 2014 and will approach inflation target at 2.5% in mid-2014.
- Growth rate of M3 money supply eased in August to 6.2%YoY from 6.6%YoY in July. Data on money supply did not bring a considerable change of credit and deposit market trends.



- Current account balance was in red in July, recording a deficit of €178m, after three months of surplus and expectations for another positive result. Deterioration of current account balance as compared to June (+€574m) resulted mainly from lower inflow of EU funds recorded in the current transfers balance (in July the surplus was €368m versus €626m in June). Current account gap was much lower than in the corresponding period of last year, so the 12-month cumulative deficit fell to 1.7% of GDP and was the lowest since 2000, i.e. since comparable data is available.
- Exports amounted to €13bn and are performing quite well (+6%YoY in July) and in our opinion this momentum will be sustained in coming months. Imports were close to our reached €12.7bn (+0.4%YoY). Surplus in trade balance reached €293m, so a positive number was recorded for the fourth month in a row.

Quote of the week – OFE will probably be banned from investing in foreign bonds

Wojciech Kowalczyk, deputy finance minister, 13.09, RTRS

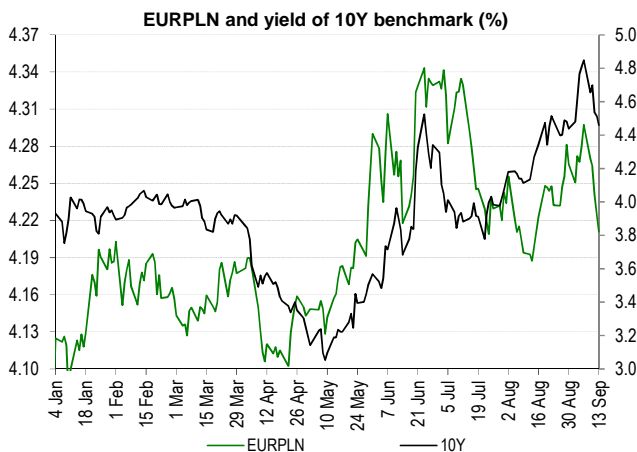
We probably will not allow OFE to invest in treasury securities of other sovereigns. If our (Polish bonds) are banned, then others should also be.

Finance Ministry, 13.09, communiqué for PAP

Non-treasury state-guaranteed bonds will be transferred to the Demographic Reserve Fund (FRD). Other financial market instruments will probably also go to this fund and they will be managed passively. All stocks will remain in OFE (...) Option to transfer treasury bonds to FRD is not taken under consideration.

Recent comments of the MinFin representatives suggest that OFE may be banned from investing in sovereign bonds: both domestic and foreign. Ban of investing stands for a ban of purchasing, which means that debt assets, which will remain in OFE portfolios after transferring 51.5% of assets to ZUS, can be held to maturity (but can be sold as well). Let us remind that in line with guidelines from the European Commission, investment limit on foreign assets is to rise to 30% in 2016. However, other details about regulations on OFE investment policy are yet unknown and they will surely be of great importance for the markets.

Foreign exchange market – Scale of QE3 tapering crucial for currencies



Changes in QE3 vital for the zloty

▪ Disappointing data from the US labour market released last Friday tamed investors' worries over deep tapering of the QE3 by the FOMC already at the nearest meeting. After strong depreciation triggered by Polish government's plans in private pension funds, bonds and stocks pared losses. US data and developments on the domestic debt and capital market had clear positive impact on the zloty. EURPLN dropped to nearly 4.20 from 4.27 at the end of the past week. USDPLN plunged from 3.24 to 3.16.

▪ While the zloty was gaining steadily since the beginning of the week (EURPLN stabilized at ca. 4.20 only at the end of the week), appreciation of risky assets on the global market halted quite quickly. Dynamic intraday changes on the European stock exchanges and in case of EURUSD suggest high uncertainty on the scale of QE3 tapering persists on the market. According to Bloomberg survey, investors expect the monthly bond purchases will be trimmed by \$10bn. We anticipate that if tapering occurs not to be greater, then the market will show positive reaction to such decision. Still, it is also worth to be aware that hints on circumstances that may lead to further cutting bond purchases may also prove vital. Before the Wednesday's decision important US macro data are due to be released and thus higher volatility may persist on the market also at the beginning of the week. Next support for EURPLN (below 4.20) is at 4.17.

Volatile market as investors await FOMC

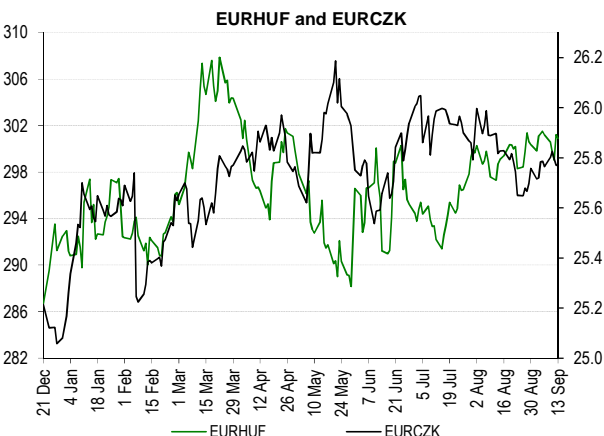
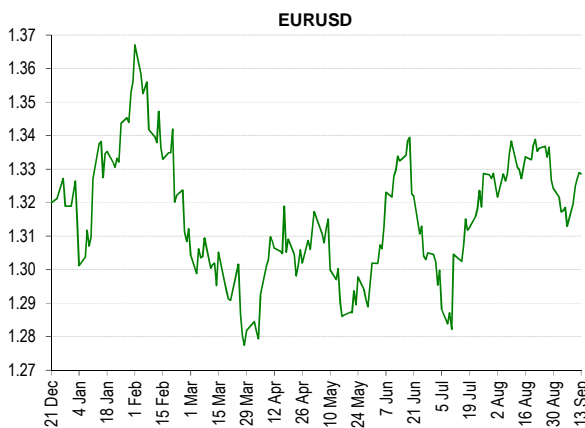
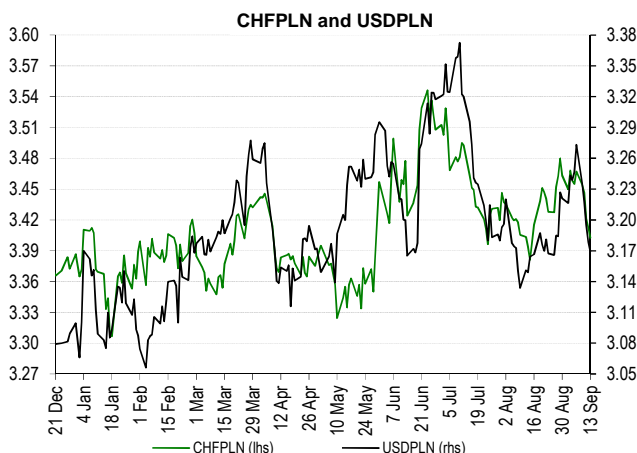
▪ Past week was pretty rich in quite broad intraday changes on the EURUSD market. Monthly data from the US labour market was supporting the euro while uncertainty regarding the scale of QE3 tapering was generating higher volatility. After the exchange rate reached 1.332 (vs. nearly 1.32 after nonfarm payrolls) the upward momentum stopped.

▪ Despite a rebound of EURUSD from 1.31 temporarily above 1.32, the market prices in to some extent tapering of the QE3. If the scale of reduction of monthly bond purchases is not greater than \$10bn, then the single currency may gain versus the dollar. Next to Wednesday's decision, investors will also focus on the statement and the press conference where suggestions of scale and pace of tapering of the QE3 in the future may be included. Earlier, data on industrial output and on the situation on the real estate market will be released and may – just like Friday's retail sales and Michigan index – trigger sudden changes on the market. Crucial levels for this week for EURUSD are at 1.31 and 1.34.

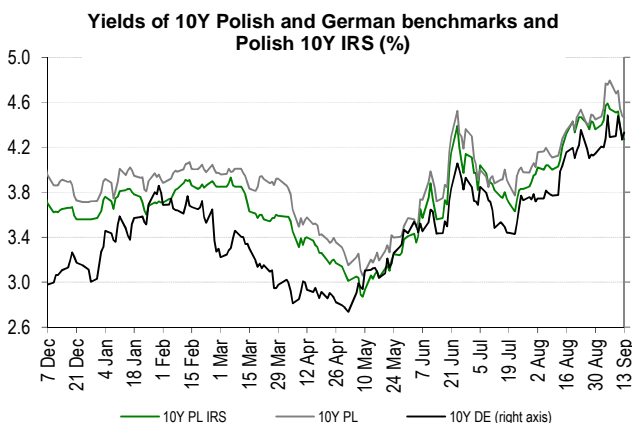
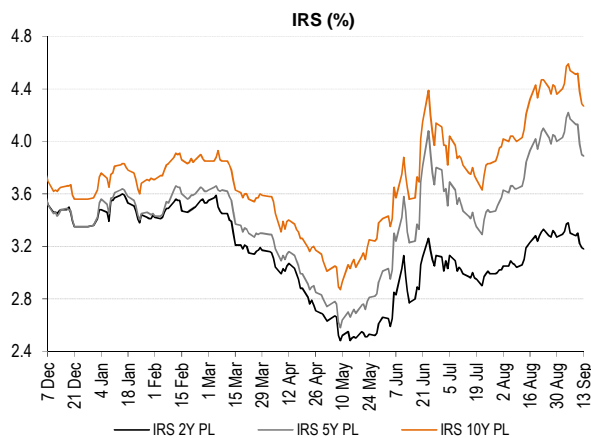
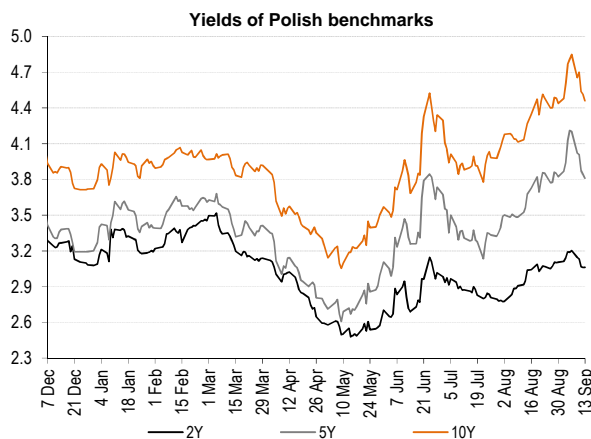
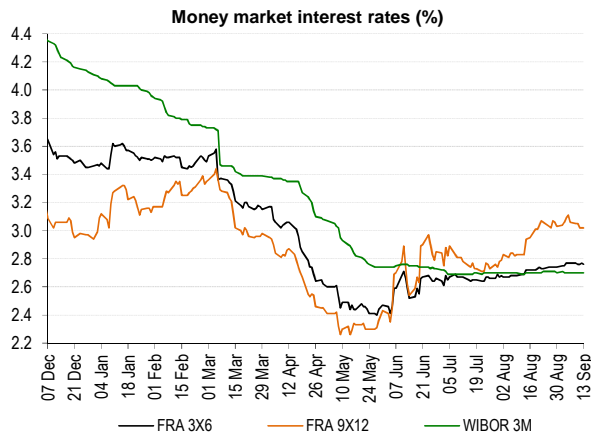
EURHUF and EURCZK in horizontal trend before Fed

▪ No breaking changes occurred on the forint and koruna market during the past week. Both exchange rate were hovering around Friday's closing level. Hungarian currency depreciated temporarily to nearly 302 per euro (lower than expected did not have much impact on the market) while EURCZK stayed close to 25.76.

▪ This week's calendar does not include any vital data from Hungary and Czech Rep. That could trigger any changes on the market. Thus, forint and koruna may be under biggest impact from the FOMC decision. Reaction of EURHUF may be similar to developments on the EURPLN market, while EURCZK should be more stable than these two former exchange rates.



Interest rate market – FOMC meeting in focus



Stable WIBOR rates

■ Another week of stable money market behind us. WIBOR rates remained unchanged (WIBOR3m at 3.70%), while FRA rates declined slightly (mainly short-term). FRA9x12 remains slightly above 3%, anchoring expectations for first rate hike in the middle of 2014, which is consistent with our expectations.

■ Outlook for stable NBP interest rates until the end of this year (which was declared in the last MPC's statement) or even for longer (which was suggested by recent comments of MPC members) cause WIBOR rates to consolidate at current levels. However, we expect to see a slight increase before the end of this year. More volatility is likely in case of FRA market, which is quite sensitive to domestic data releases.

... and rebound in bond and IRS markets

■ Last week saw a rebound in bond and IRS markets, which saw a significant weakening after the announcement of government's plans of OFE overhaul. In the first part of the week the strengthening of domestic bonds took place even despite further sell-off in the core debt markets (yield of 10Y German Bund temporarily reached 2.09%). At the end of the week a drop of Polish 10Y yield to ca. 4.46% was the effect of strengthening of Bund. Demand for domestic debt was generated by both local and foreign investors. In case of IRS, significant strengthening took place only in the second half of the week.

■ The biggest changes took place in the middle and the long end of the curve, which resulted in narrowing of spreads 2-10Y by correspondingly 145bp in bond market (from 165bp last week) and 110bp in IRS market (from 124bp). Moreover, bond yields and IRS rates fell to lowest level since end of August, fully erasing earlier losses. Over the week, yield curves moved down by 14-24bp for bonds and 10-25bp for IRS.

Fed and domestic data in the center of attention

■ This week will be heavy of both domestic (publication of data from real economy) and external events (FOMC meeting, election in Germany). Domestic macroeconomic data releases (labour market, industrial output and PPI) should confirm signals of rebound in economic activity. Consequently, we think that expectation on stable rates for longer period, not only till year-end, might strengthen. As a result we foresee the front end of curves to anchor near current levels.

■ Mid and long-end of curves will remain under influence of expectations about Fed decision (19.09) and results of German parliamentary election (22.09). Expectations that reduction of asset purchases will be implemented this month already weakened somewhat after weaker-than-expected August's data from the US labour market. In our view, the Fed may announce "QExit" at the upcoming meeting, but the scale of reduction will be so small that it can strengthen core debt markets and hence also the domestic debt. End of the week may be a bit more volatile while awaiting results of election in Germany.

■ At the end of the week the Finance Ministry is likely to reveal information on treasury bonds supply at auction scheduled for 25 September. Earlier the deputy finance minister W. Kowalczyk announced that the ministry does not rule out a regular auction instead of switch tender (as planned before). Information on planned offer can affect market sentiments in the short term.

This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. Information presented in the publication is not an investment advice. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Forecasts or data related to the past do not guarantee future prices of financial instruments or financial results. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication. 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>