Bank Zachodni WBK

Weekly economic update

7 – 13 October 2013

Last week began with a series of disturbing news: risk of early election in Italy after Berlusconi's party recalled its support for Enrico Letta's government; government shutdown in the USA due to lack of agreement on 2014 budget in the Congress; weaker PMI index for manufacturing in China, awaking worries about persistence of recovery in this region. Despite uncertainty caused by these factors, market situation was stabilized by opinions that US government shutdown may postpone the Fed's decision on QE3 tapering. The ECB maintained its dovish tone (yet it was not as dovish as some expected), while political crisis in Italy was resolved quite quickly, which fuelled a quite significant strengthening of the euro and the zloty. MPC meeting was unexciting, as predicted. However, PMI index for Polish manufacturing surprised to the upside again, supporting forecasts of a strong rise of output in September and confirming labour market recovery.

Macro calendar for this week is rather light. However, if government shutdown in the USA ends, then quite important data releases that have been postponed (including September's non-farm payrolls) will be published, and may affect the market. Obviously, the progress in talks on ending budgetary impasse in the USA will be crucial for the market moods in the upcoming days. As the critical date of October 17th (when debt ceiling may be surpassed) will be getting closer, continuing lack of agreement may have increasingly negative implications for market moods, as the technical default of the USA, resulting from breaching debt ceiling, will be much more dangerous event (for the US and global economy) than the government shutdown.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (7 October)					
14:00	**PL**	**Reserve assets**	**Sep**	**€m**	**-**	**-**	**82 604**
		TUESDAY (8 October)					
3:45	CN	PMI – services	Sep	pts	-	-	52.8
8:00	DE	Exports	Aug	%MoM	1.2	-	-1.1
8:00	DE	Imports	Aug	%MoM	1.0	-	0.5
12:00	DE	Industrial orders	Aug	%MoM	1.0	-	-2.7
		WEDNESDAY (9 October)					
12:00	DE	Industrial output	Aug	%MoM	0.8	-	-1.7
		THURSDAY (10 October)					
13:00	UK	BoE meeting		%	-	-	0.50
14:30	US	Import prices	Sep	%MoM	0.3	-	0.0
14:30	US	Initial jobless claims	week	k	310	-	308
		FRIDAY (11 October)					
8:00	DE	HICP	Sep	%YoY	1.6	-	1.6
14:00	**PL**	**Exports**	**Aug**	**€m**	**12 478**	**12 300**	**12 952**
14:00	**PL**	**Imports**	**Aug**	**€m**	**12 150**	**11 881**	**12 659**
14:00	**PL**	**Current account**	**Aug**	**€m**	**-230**	**-244**	**-178**
14:30	US	Retail sales	Sep	%MoM	0.3	-	0.2
15:55	US	Flash Michigan	Oct	pts	76	-	77.5

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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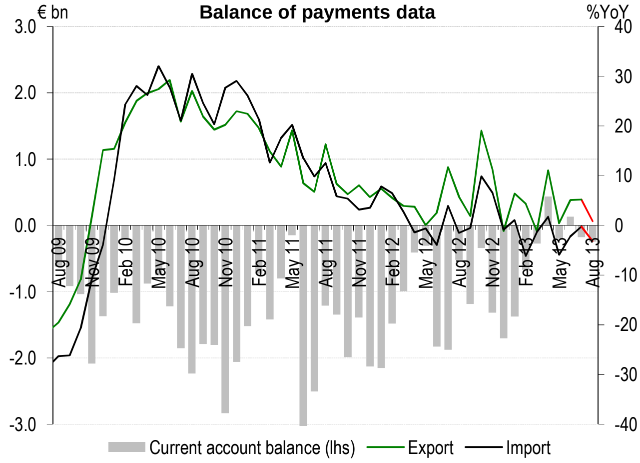
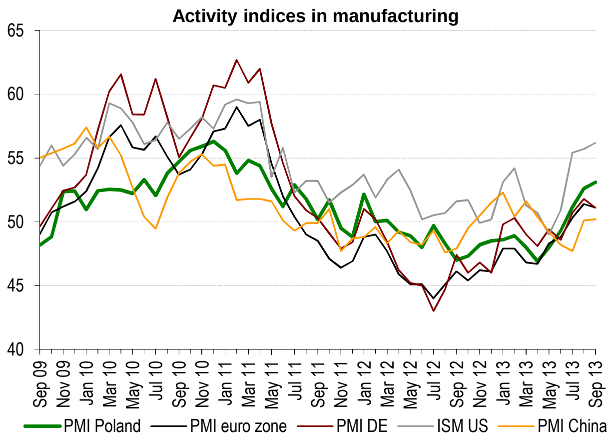
What's hot this week – Foreign trade still in surplus



▪ August's balance of payments is the only important domestic data release this week. Let us remind that quarterly data published last week by the NBP have introduced a marked revision – current account surplus in Q2 proved lower by €1bn than suggested earlier by monthly readings. However, this was mainly due to revised income balance, while trade balance still shows a considerable surplus in Q2 (the first one since the data are recorded).

▪ We are expecting that August's data will show another month with significantly positive trade balance, but growth rate of exports (and imports) will probably be temporarily lower (working days effect, similarly as in the case of industrial output). Current account balance will show moderate deficit according to our forecast (low inflow of EU funds in August).

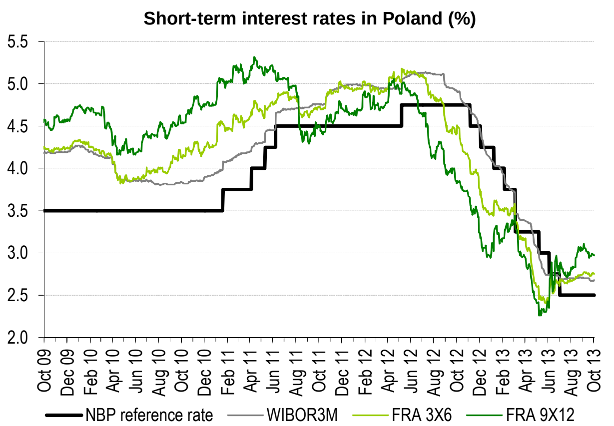
Last week in the economy – Economy accelerating, interest rates stable



▪ September's reading of PMI index for manufacturing once again beat expectations, reaching 53.1, the highest level since April 2011.

▪ After strong rise in subindices for production and new orders in the previous months, September saw a slight correction. However, both indicators remained clearly above the neutral mark 50. At the same time, employment growth clearly accelerated in September, reaching the highest level since May 2007 and the fourth highest reading in the history of the survey (since 1998). At the same time, index of costs of production still remains close to 50.

▪ PMI report, confirming the labour market recovery, seems to be consistent with our scenario, where export (being the only driver of growth until recently) will be gradually joined by private consumption.



▪ The Monetary Policy Council left NBP's rates on hold again at its October meeting, which was in line with expectations. Reference rate is still at all-time low 2.50%.

▪ The official statement repeated that interest rates should be kept unchanged at least until the end of 2013. According to the MPC, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressure will remain subdued.

▪ In our opinion, there is a chance that November's meeting of the MPC will more interesting, as the new inflation and GDP projection might affect the so-called forward guidance (longer suggested period of stable rates). We still expect flat interest rates until mid-2014 and cumulative increase in rates by 75bp next year.

Quote of the week – Lower safety thresholds incorporated into spending rule

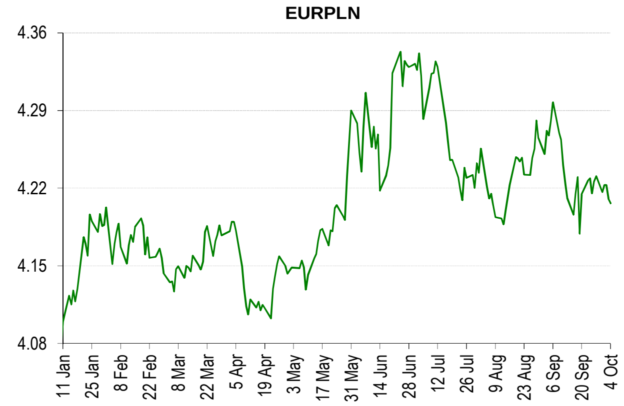
Wojciech Kowalczyk, deputy finance minister, 02.10, PAP

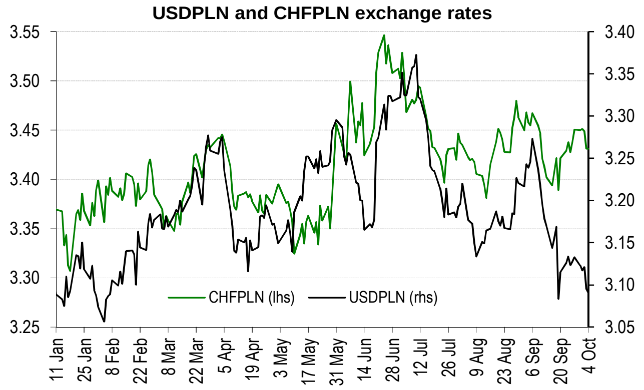
In our view OFE should be able to invest in stocks and commercial bonds: corporate and communal bonds. We surly want to introduce a possibility to invest 30% of assets abroad, namely in the European Union and in OECD.

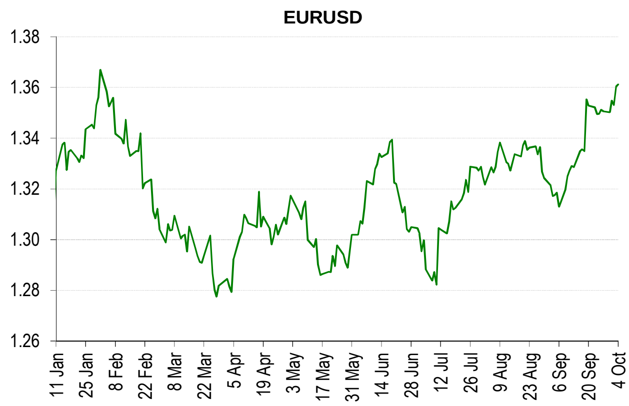
OFE act will include a proposal to lower safety thresholds of public debt in relation to GDP and they will be incorporated into new spending rule. New thresholds will be at 43% and 48% of GDP. New thresholds will be active inside the spending rule, while 55% and 60% threshold from the public finance bill will remain unchanged.

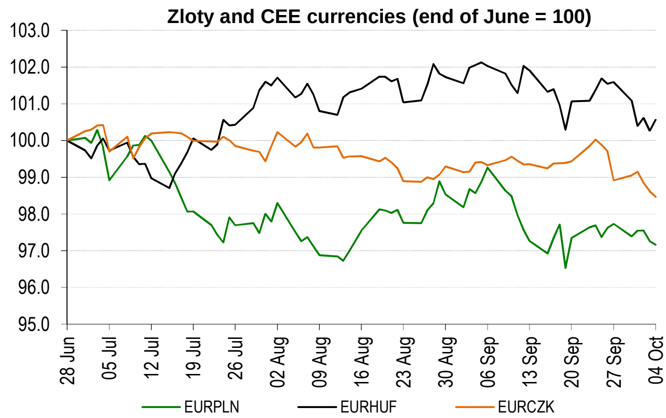
Recent comments of FinMin representatives confirm that after the transfer of assets from OFE to ZUS, the corresponding reduction of safety thresholds for debt-to-GDP ratio will apply only to the new spending rule, while limit 55% already present in the public finance act will be left where it is. In due course, surpassing 43% of GDP by public debt will cause a lowering of spending limit in the rule by ca. 1.5% (but not during economic slowdown), while surpassing of 48% will lower spending limit by ca. 2%. Restrictions after surpassing 55% remain unchanged. As a result, changes in OFE make some room for a rise in public spending, especially in a situation, if the economy does not leave the slowdown phase anytime soon.

Foreign exchange market – Situation in USA still in focus









Zloty stronger against main currencies

- Last week started from weakening of the zloty, EURPLN temporarily approached 4.24. It was the effect of negative moods connected to situation in the USA and political crisis in Italy. In the subsequent days the domestic currency was gaining strength, supported by improvement of global moods and rising risk appetite. Consequently, the EURPLN broke through the lower bound or consolidation range 4.20-4.23 and for a while decreased to 4.199. However, at the end of the week it returned above 4.20 again.
- Zloty appreciated also against other currencies. In the weekly horizon, the domestic currency gained most against US dollar (1.4%) and British pound (1.1%). USDPLN, supported by rising EURUSD, fell temporarily to 3.06, the lowest level since February.
- Market volatility remains high and this situation is unlikely to change until situation in the USA is resolved. Therefore, investors will follow any news from the USA about progress in negotiations to end impasse as regards budget and debt limit. Technical picture of EURPLN has not changed significantly, the consolidation range 4.20-4.23 is still valid. In current market situation one cannot rule out testing of both the lower and the upper end of the range.

EURUSD in upward trend

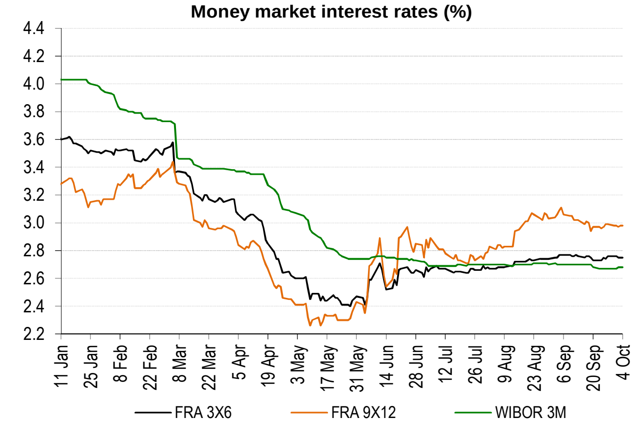
- Developments in the USA, averting the political crisis in Italy, and good data from European economy were the main factors that contributed to euro strengthening against dollar. Additional support for European currency came from the ECB, as the President Mario Draghi, contrary to some expectations, did not announce the new LTRO (although he did not rule it out, if necessary). The EURUSD rose temporarily to 1.365, reaching the highest level since February and approaching this year's maximum level 1.371. The end of the week brought a clear profit taking and the rate declined below 1.36.
- Due to partial government shutdown the publications of some macroeconomic data in the US have been suspended, including the key non-farm payrolls data. Thus, all investors are focusing on the situation in the US Congress and talks between Democrats and Republicans about 2014 budget and debt ceiling. This will support high volatility in the market – one cannot rule out that a delay in compromise may give another impulse for depreciation of US dollar. First support is at 1.356, and then at 1.346. The return of upward trend in EURUSD may imply another attempt at testing 1.371.

CEE currencies also slightly stronger

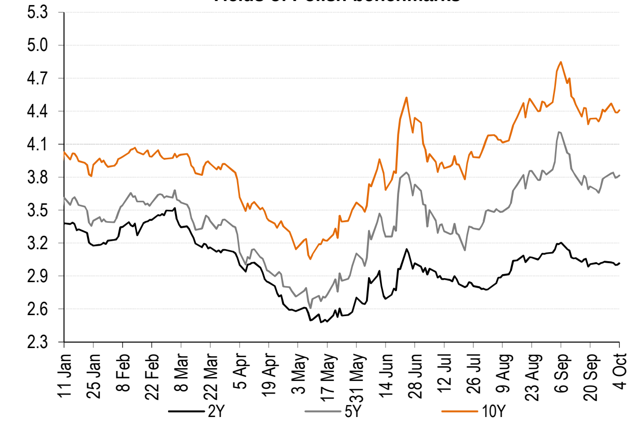
- Other currencies in the CEE region were gaining strength, similarly as the zloty. Over the week the Hungarian currency recorded the biggest move (ca. 1%). The forint was supported by news from the economy and relatively high demand for Hungarian bonds from foreign investors.
- This week in Czech Republic and Hungary new important macroeconomic data will be released (industrial production and inflation in both countries). However, similarly as in Poland, the local factors may be overshadowed by situation in international markets.

Interest rate market – Under pressure of external factors

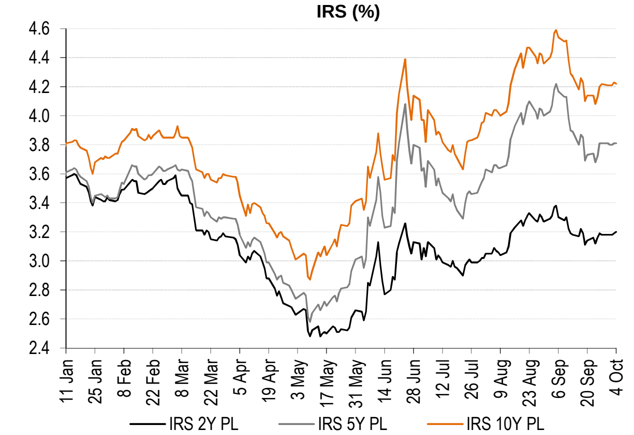
Money market interest rates (%)



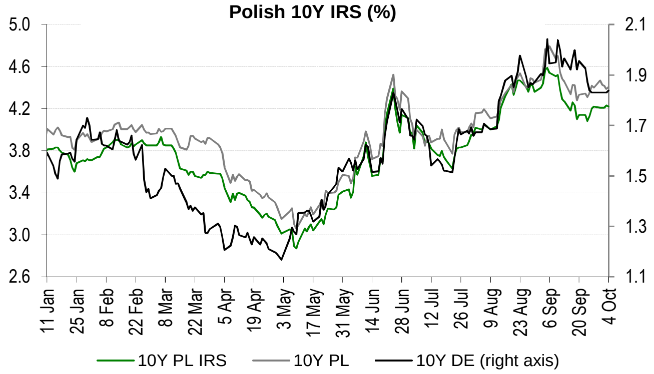
Yields of Polish benchmarks



IRS (%)



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



Money market rates have remained stable

- The beginning of October did not bring significant changes on the money market rates. Both WIBOR and FRA rates were more or less stable, supported by dovish rhetoric of the MPC. The Council (as expected) upheld its stance that official interest rates might stay unchanged at least till year-end. Stable FRA rates suggest that expectations on future interest rates path do not change in comparison with previous period. Still, market expects the first rate hike in 9 month horizon – FRA9x12 stabilised near 3%.
- This week will not bring any significant changes on the money market rates as macro calendar is very light. We expect WIBOR rates to be traded near current levels. In our opinion only the following week will be more interesting due to releases of macro data (CPI, labour market, industrial production) that might influence expectations on future interest rates level.

Interest rate market remains under pressure

- After a quite considerable weakening of bonds at the end of September, beginning of the new month brought some rebound. Volatility of the bond market was still high (mainly at the mid and the longer end of curve), which was partially due to US situation (lack of agreement on budget, causing government shutdown) and partially to expectations about Thursday's auction. Results of 5Y bond auction can be viewed as disappointing, which gave an impulse for a short-lived correction. Weakening of bonds along the curve encouraged demand, so earlier losses were erased.
- IRS market was more stable than bond market. However, the curve is still steep, 2-10Y spread runs above 100bp. Moreover, asset swap spread narrowed in 5Y and 10Y segments, to 0 and 16bp, correspondingly.
- Plans of treasury securities' supply for Q4 announced by the Ministry of Finance did not bring any major surprises. Supply on the domestic market is concentrated in October, when two regular auctions (03.10 and 22.10) and one buyback auction (16.10) of euro-denominated bonds maturing in February 2014 will take place. Supply will be concentrated on the second auction (offer amounts to PLN6-12bn with a wide package of possible issues, conditional on market situation), which is connected to liquidity situation – in this period almost PLN30bn are appearing on the market (redemption of DS1013 and PP1013 and coupon payments). It is worth to notice that the Finance Ministry did not rule out a return to issuance of T-bills in the event of unfavourable market tendencies. After Thursday's auction we estimate that gross borrowing needs are covered in 92%. In our view, realization at 100% at the end of October is highly probable.

External factors still crucial

- Last weeks showed that domestic bonds did not take advantage of core market situation, given high risk aversion. Short end of the bond curve (2Y) is oscillating around 3%, supported by expectations that rates may remain stable for a longer time, not only until the year-end.
- We are expecting more considerable moves at the mid and the longer end of curves. The prolonging government shutdown in the USA is overshadowing expectations about future Fed policy. Still, this is a main uncertainty factor, which will be affecting moods in the upcoming weeks. We are expecting that curves will remain steep and will return to upward trend after a period of consolidation of yields.

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