

WEEKLY ECONOMIC UPDATE

16 – 22 June 2014

Last week we saw a bunch of new comments of MPC members. Some of them (Belka's, Bratkowski's and Hausner's) suggested that in July the Council may abandon its declaration of stable interest rates (forward guidance). While some members (Kaźmierczak, Bratkowski) were cooling expectations for interest rate cuts, others were fuelling them (Glapiński suggested a cut in 2015, Chojna-Duch even in July 2014). May's CPI reading (0.2%YoY) proved considerably lower than expected, which also fuelled hopes for cuts and gave a renewed impulse for decline of yields/IRS rates. The zloty weakened in weekly terms, despite Friday's very positive data on April's balance of payments.

We have a very interesting week ahead, rich in publications of macro data from Poland and from abroad, but also due to the FOMC meeting. Domestic data will be interpreted in context of the MPC decision, as some members are more and more worried about economic growth outlook. Our forecast of industrial output is below market consensus, while forecast of wage growth is higher. Releases of domestic data may be overshadowed by the Fed meeting, as the FOMC will see the newest forecast for the US economy. These projections will determine the future monetary policy in the USA. However, reaction of the domestic market may be limited due to holiday on Thursday and lower activity of domestic investors.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (16 June)							
11:00	EZ	HICP	May	%YoY	0.5	-	0.7
14:00	PL	Core inflation	May	%YoY	0.9	0.8	0.8
15:15	US	Industrial output	May	%MoM	0.4	-	-0.6
TUESDAY (17 June)							
11:00	DE	ZEW index	Jun	pts	62.6	-	62.1
14:00	PL	Wages in corporate sector	May	%YoY	4.3	4.7	3.8
14:00	PL	Employment in corporate sector	May	%YoY	0.7	0.7	0.7
14:30	US	CPI	May	%MoM	0.2	-	0.3
14:30	US	House starts	May	k	1034	-	1072
14:30	US	Building permits	May	k	1075	-	1059
WEDNESDAY (18 June)							
11:00	PL	Bond auction					
14:00	PL	Industrial output	May	%YoY	5.9	5.1	5.4
14:00	PL	Construction and assembly output	May	%YoY	14.2	12.1	12.2
14:00	PL	PPI	May	%YoY	-0.7	-0.6	-0.7
20:00	US	FOMC decision					
THURSDAY (19 June)							
	PL	Market holiday					
14:30	US	Initial jobless claims	week	k	315	-	317
16:00	US	Philly Fed index	Jun	pts	14.8	-	15.4
FRIDAY (20 June)							
14:00	PL	MPC minutes	Jun				

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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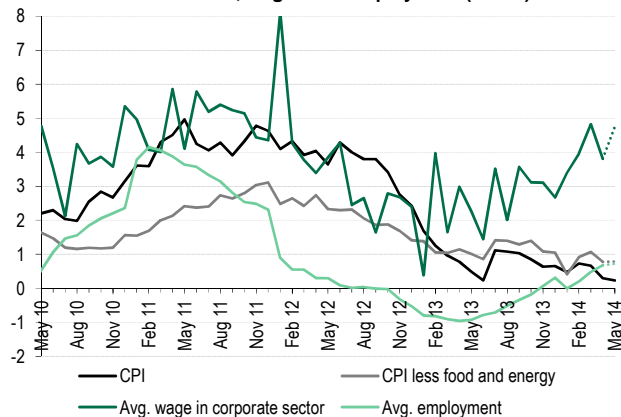
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What's hot this week – Shorter week, yet full of publications

Inflation, wages and employment (%YoY)

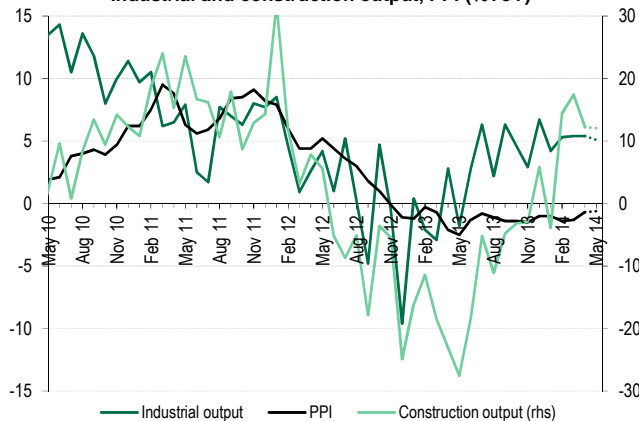


- We expect a continuation of improvement of labour market situation in May – acceleration of wage growth to 4.7%YoY and maintaining pace of employment growth in corporate sector at 0.7%YoY. It would have positive impact on households' purchasing power and private consumption growth in 2Q14. We think those positive trends should be maintained in coming quarters.

- Data on core inflation and PPI inflation for May will be probably still showing no inflationary pressure.

- MPC minutes will be released on Friday. The market may focus on this document more than usually, taking into account the last change in tone of the Council. Maybe the description of discussion will help explain what made the MPC not rule out cuts and will shed more light on the way the central bankers are thinking.

Industrial and construction output, PPI (%YoY)



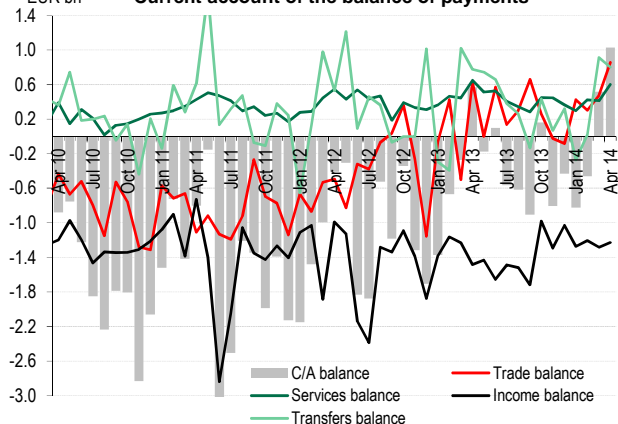
- We are expecting the industrial output to expand by c5%YoY in May, i.e. at a pace similar to last months. This figure will be probably observed by the market due to disappointing reading of the PMI index for manufacturing in May. Weak results of industry may significantly support expectations for a slowdown of the recovery and for cuts of NBP interest rates.

- Output in industrial manufacturing will be crucial, in our view. In last months the result for the whole industry was undermined by weak output in energy and mining, among other factors due to favourable weather conditions. Meanwhile, output in manufacturing added more than 7%YoY and we are expecting this tendency to hold.

- We are also expecting a continuation of recovery in construction and a two-digit growth in this sector. Detailed data are likely to show a solid growth in all subsectors.

Last week in the economy – Inflation record low again, export keeps growing

Current account of the balance of payments



- Inflation eased to 0.2%YoY in May. The decline was again driven mainly by falling food prices. We estimate that core CPI after excluding food and energy prices stabilized at 0.8%YoY. Inflation rate may drop below zero in the summer months but we do not think that there is a serious threat of prolonged deflation in Poland as the recovery of the domestic demand will push prices up in the coming months.

- Current account posted a record-high surplus in April (€1bn) with very good results of exports (increase by 6.8%YoY), which confirms our claim that weaker trade volumes with Russia and Ukraine are more than offset by the euro zone recovery.

- FX-adjusted loan growth accelerated again, showing that the economy is still pursuing a path of moderately fast growth.

Quote of the week – There is no need for a sudden rate cut

Andrzej Kaźmierczak, MPC member, 13.06, Reuters

There is no need to cut rates suddenly. In my opinion, we can see a row of factors, which will fuel price growth in the medium term.

Eiżbieta Chojna-Duch, MPC member, 12.06, Reuters

When the ECB cut interest rates (...) the MPC should consider a possibility and consequences of interest rate cut in Poland in July.

Marek Belka, NBP governor, 11.06, Reuters

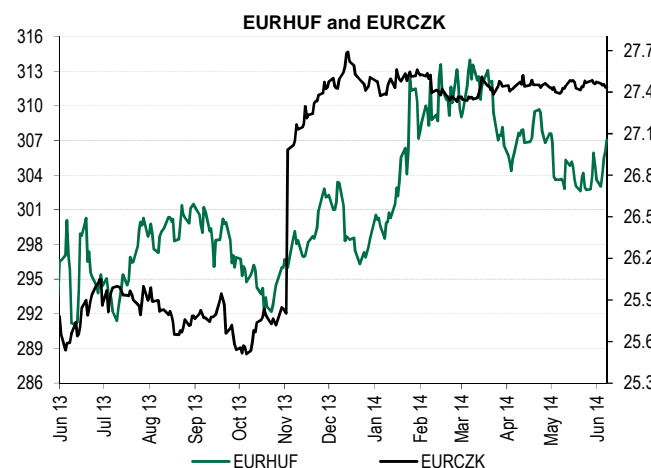
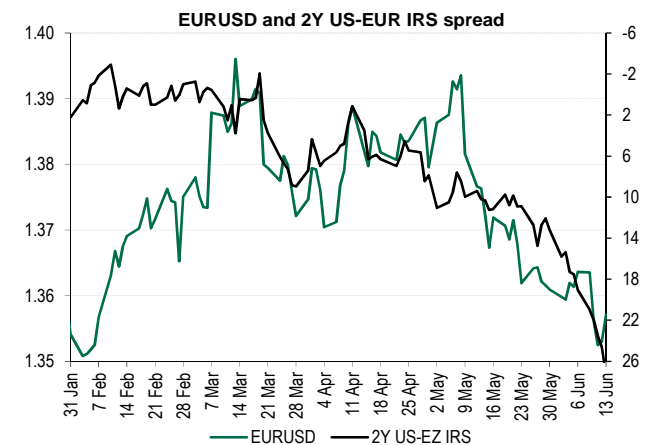
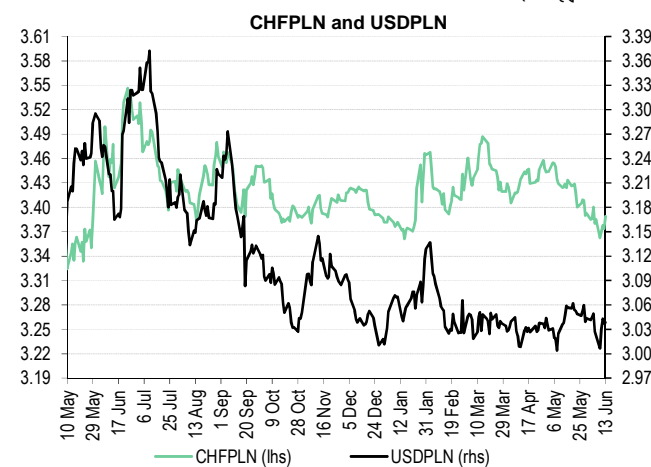
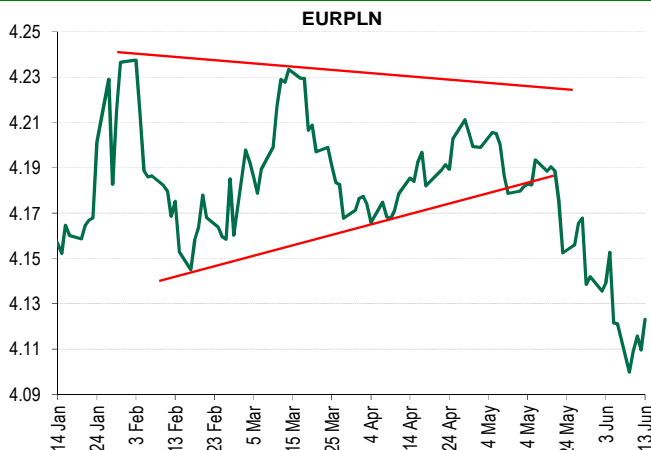
Earlier only a hike was possible. At the last meeting we assessed that situation is more balanced, i.e. we cannot rule out also a cut, but I keep on stressing that this is neither a probable nor a baseline scenario.

Adam Głapiński, MPC member, 09.06, Reuters

I think that interest rates should remain unchanged until the year-end. A cut can be considered at the beginning of 2015.

Even though Marek Belka ensured recently there is a broad consensus in the MPC about monetary policy outlook, recent comments suggest that opinions of Council members on possible decision start to diverge. This can be an argument for the Council to abandon the *forward guidance*. Belka, Bratkowski and Hausner suggested recently that the Council may drop this strategy already in July. The market would probably interpret such a decision as a strong signal increasing chances for a cut in September. However, in our view supporters of cuts are still a minority within the MPC, and the data due for release until September will confirm the scenario of economic acceleration and lack of the deflation risk, which will mean no need for monetary policy easing.

Foreign exchange market – Zloty under pressure of rate cut speculation



Profit taking and risk of rate cut weigh on the zloty

Series of three consecutive weeks of zloty's appreciation vs. the euro, dollar and British pound has ended. After a significant strengthening driven by expectations for monetary policy easing by the ECB and its final delivery some profit taking has been recorded. The main driver of the appreciation trend – expectations of monetary policy easing in the Euro zone – has disappeared. Instead, speculation of rate cuts in Poland has intensified. This has been fuelled even further after recent inflation data and next comments of the MPC members. The negative impact of the May's CPI release has been neutralized by nearly twofold higher C/A surplus. Still, EURPLN has stayed in the upward trend during the whole past week and finally reached 4.13 vs. 4.09 just after the ECB decision. USDPLN again did not manage to stay below 3.0 for longer. This support constrains the room for any deeper zloty's appreciation vs. the dollar since already late 2013 – last week the exchange rate rebounded to nearly 3.05.

Recent signals of slower growth (PMI index for Polish manufacturing dropped to 50.8 points in May after the biggest three-month drop since December 2008) and market expectations for rate cuts may continue to pressure the zloty domestic currency in the nearest future. Data on industrial output are due to be released this week and our forecast points to slower growth than the market expects. Also the technical analysis suggests EURPLN may rebound slightly in the short term after recent significant decline. Important resistance area is at 4.15-4.17.

EURUSD waits for a strong impulse

No major changes occurred in the case of EURUSD. First days of the past week saw dollar's appreciating due to widening interest rate spread between the US and the euro zone. This encouraged investors to shift their capital to the US. Only the disappointing macro data from the world's biggest economy and the above-consensus releases in the euro zone triggered a rebound of the exchange rate from 1.35 to 1.356.

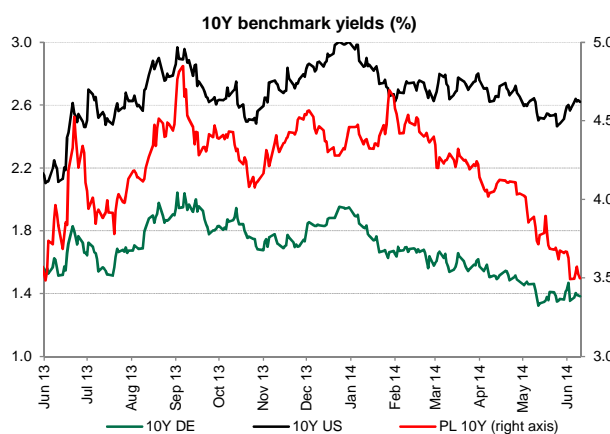
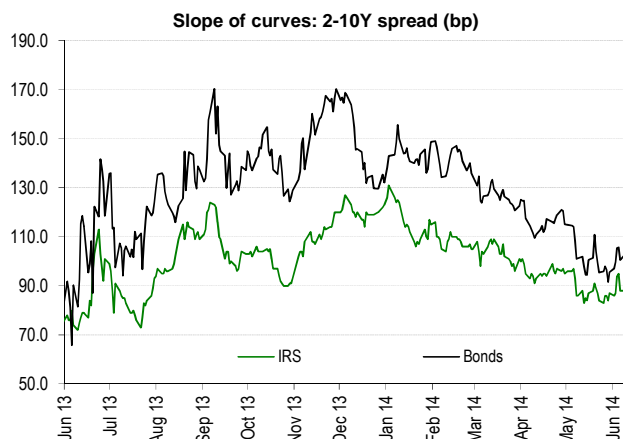
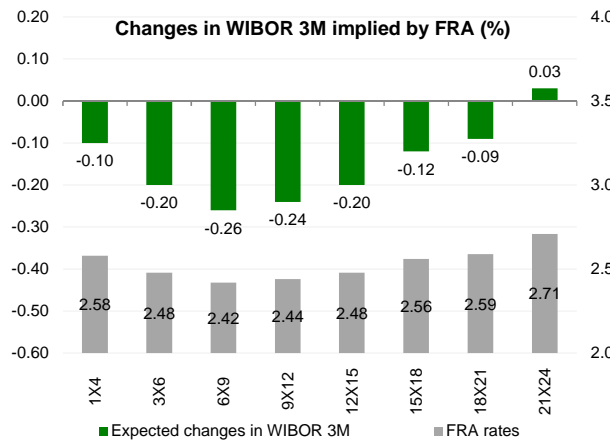
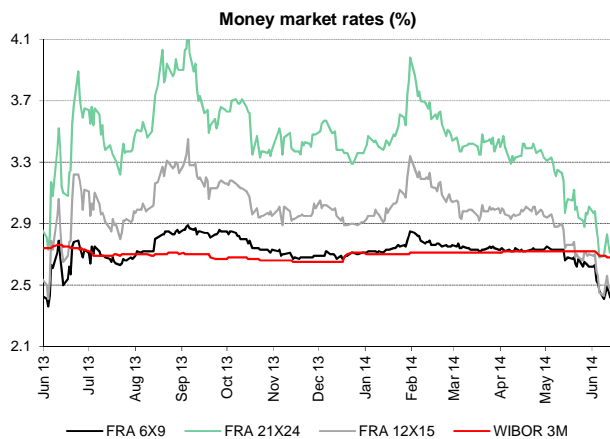
Despite strong oscillations – especially at the end of the week – the rate remains close to 1.35, level reached in reaction to the ECB decision. We will see a row of data readings from the US and final inflation for May in the euro zone, we will also see the result of FOMC meeting. Recent FOMC minutes showed that the US central bankers are analysing the proper way and time to exit from the loose monetary policy. Thus, if euro zone inflation does not surprise, the investors will be able to focus on important releases from the US, as they will be important for assessment how long can Fed rates remain at current low level. Events of the upcoming week can set the direction for EURUSD for the closest future and decide of 1.35 will be broken (next support is at 1.335) or if the euro will trim some of its losses.

The forint weaker for the same reasons as the zloty

Apart from the zloty, also the forint weakened as regards the CEE3 currencies. The Hungarian currency was undermined by profit-taking recorded on the global market and by domestic data, which showed a second month in a row of deflation. The latter factor contributed to expectations that monetary policy easing in Hungary did not come to an end yet.

Czech inflation was in line with expectations (0.4%YoY) and did not affect EURCZK, which is oscillation in a horizontal trend. After these numbers, the deputy Czech central bank governor Mojmir Hampl said that floor for EURCZK at 27.00 may be abandoned later than at the end of 2015. His comment was in line with earlier signals from the Czech central bank.

Interest rate market – Macro data and Fed's outcome important for market outlook



Market still strongly believes in rate cuts

▪ Last week WIBOR 1M-12M rates fell by 1bp or by 2-5bp across the curve from the June's MPC meeting (with the highest decline in 12M rate). More significant changes took place in FRA market. There was some correction on the market after sharp decline in rates (due to expectations on rate cuts), but it was only short-lived. FRAs again strengthened after surprisingly low CPI reading for May.

▪ Currently, the market is pricing-in a 25bp cut in interest rates in the next six months and rates remaining there until this time next year, after which they could rise, but would not exceed current levels at least until the start of 2016. Domestic macro data, which will be released this week, might influence market expectations about monetary policy outlook. Weaker than expected readings might fuel speculation about rate cuts, providing impulse (yet more limited) for further FRA decline.

May inflation supported T-bonds and IRS

▪ The beginning of last week opened stronger as positive mood after MPC and ECB meetings continued. Sharp decline in yields/IRS rates encouraged some investors to take profit after significant strengthening, but it was only short-lived. Market again strengthened ahead of domestic macro data releases (CPI, balance of payments), supported by comment from MPC's member Elżbieta Chojna-Duch, who said that the Council may consider rate cut in July. Later comment of MPC's Kazmierczak who cooled down hopes for rate cuts triggered another slight correction, but lower than expected CPI (0.2%YoY in May) again supported bonds and IRS (10Y bond yield temporarily fell to c3.49%).

▪ Bond yield curve flattened last week (spread 2-10Y narrowed to 99bp) and IRS curve steepened. Spread versus German bunds widened for 2Y and 5Y benchmarks, while narrowed for 10Y bond as compared to the previous week.

More macro data and bond auction ahead

▪ Next week may be very interesting, with calendar full of data releases in Poland and abroad, and also the FOMC meeting and debt auction. Our forecast of industrial output is below market consensus, so its materialisation may support debt/IRS market.

▪ Results of the FOMC meeting (17-18 June) can also prove important for the debt markets, especially as recently numerous Fed members suggested a possibility that discussion on monetary tightening will be started. The market agrees that the FOMC will keep interest rates unchanged and will cut QE3 programme by another \$10bn. The newest macroeconomic projections, which will be presented to the FOMC, may bring some suggestions about the future US monetary policy. The more hawkish the FOMC statement, the higher the upward potential of US bond yields. Impact on the domestic market may be limited due to holiday on Thursday and low activity of investors at the end of the week.

▪ At the beginning of the week the Ministry of Finance will present details regarding the Wednesday's auction. The ministry will repurchase OK0714 and WZ0115 and may offer 5Y benchmark PS0719 and other less liquid bonds after the OFE transferred their holdings to ZUS. The offering should attract high interest given the fact the debt supply will be limited in the following months (only one standard auction is scheduled for July).

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