# WEEKLY ECONOMIC UPDATE

## 23 – 29 June 2014

**“Tape scandal” was the main event of the last week, not only for the media, but also for the Polish financial market. Priced-in political risk has increased, and revealed recordings with the NBP governor Marek Belka triggered worries about his further cooperation with the MPC of even resignation. A rebound, after it turned out that the PM Tusk is planning no dismissals in the government and the NBP head is not going to resign, was only temporary, as there appeared suggestions that early election may be necessary, while new comments of MPC members were less gentle than the MPC’s press release after the working meeting.**

**On the global financial markets moods were initially rather weak due to clashes in Iraq, rising oil prices and escalation of conflict in Ukraine. Additionally, rise of inflation in the US made investors expect an earlier monetary tightening by the Fed. On the other hand, the ECB representatives suggested that the central bank may wait with further actions. However, dovish tone of Fed’s Janet Yelled at conference after the FOMC meeting clearly improved moods, which pushed the US stock markets to new records.**

**Flash PMI indices for Germany and the euro zone are important this week. They were moving in a downward trend during the last months, which caused rising worries about recovery in the European economy. Moreover, we will see a row of US data (final GDP for Q1, consumer income and spending), which may affect the assessment of Fed monetary policy outlook. In Poland we will see the last pieces of data for May (retail sales and unemployment rate), but they may be overshadowed by domestic politics, while in the region meetings of Hungarian and Czech central banks are on the schedule.**

### Economic calendar

| CZAS W-WA | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (23 June)** | | | | | |
| 3:45 | CN | Flash PMI – manufacturing | Jun | pts | 50.0 | - | 49.4 |
| 9:30 | GE | Flash PMI – manufacturing | Jun | pts | 52.5 | - | 52.3 |
| 10:00 | EZ | Flash PMI – manufacturing | Jun | pts | 52.1 | - | 52.2 |
| 16:00 | US | Home sales | May | m | 4.74 | - | 4.65 |
| | | **TUESDAY (24 June)** | | | | | |
| 10:00 | DE | Ifo index | Jun | pts | - | - | 110.4 |
| 14:00 | HU | Central bank decision | | % | 2.30 | - | 2.40 |
| 16:00 | US | Indeks nastroju konsumentów | Jun | pts | 83.5 | - | 83.0 |
| 16:00 | US | New home sales | May | k | 442 | - | 433 |
| | | **WEDNESDAY (25 June)** | | | | | |
| 14:30 | US | Final GDP | Q1 | %QoQ | -1.8 | - | 2.6 |
| 14:30 | US | Durable goods orders | May | %MoM | -0.2 | - | 0.6 |
| | | **THURSDAY (26 June)** | | | | | |
| **10:00** | **PL** | **Retail sales** | **May** | **%YoY** | **6.2** | **5.4** | **8.4** |
| **10:00** | **PL** | **Unemployment rate** | **May** | **%YoY** | **12.5** | **12.5** | **13.0** |
| 13:00 | CZ | Central bank decision | | % | 0.05 | - | 0.05 |
| 14:30 | US | Personal income | May | %MoM | 0.4 | - | 0.3 |
| 14:30 | US | Consumer spending | May | %MoM | 0.4 | - | -0.1 |
| | | **FRIDAY (27 June)** | | | | | |
| 15:55 | US | Michigan index | Jun | pts | 82.0 | - | 81.9 |

Source: BZ WBK, Reuters, Bloomberg, Parkiet

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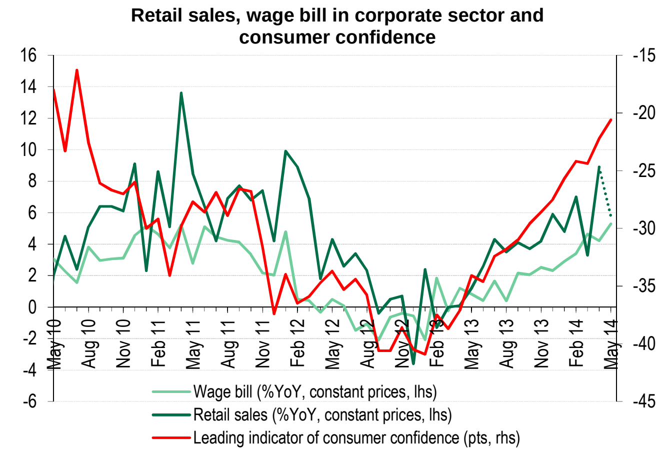
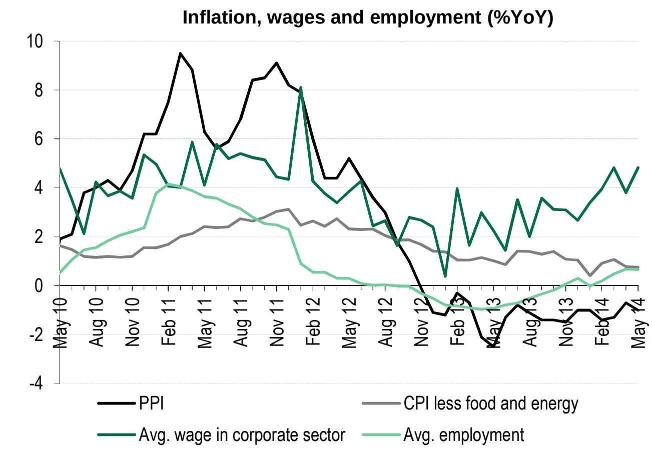
## **What's hot this week** – Retail sales up, unemployment down

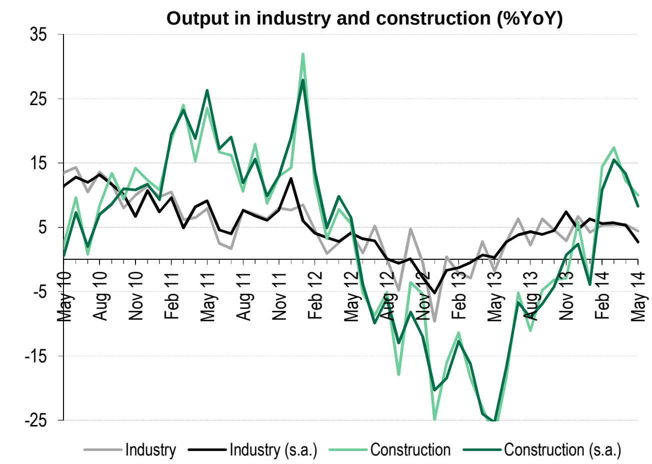



- Growth rate of retail sales in May was probably considerably less impressive than in April, but was considerably better than in March (results of these two months were distorted by base effects connected to timing of Easter). We are expecting a solid growth of sales, by more than 5%, backed by a solid growth of households' real disposable incomes and indicating that private consumption growth is not waning. However, market consensus is still above our forecast.
- Our forecast of unemployment rate is in line with estimate of the Labour Ministry, assuming its decline to 12.5% in May. This is still by 1 percentage point lower than on year ago. However, it seems that pace of improvement on the labour market declined somewhat, which is also shown by recent data on employment in the corporate sector.

## **Last week in the economy** – Wage growth accelerated, production growth slowed down




- Wage growth in corporate sector accelerated in May to 4.8%YoY, while employment growth remained at 0.7%YoY. Real growth of households' disposable income is at the highest level for many years and this is supporting a further recovery of consumption demand and, in longer horizon, probably also revival of price growth. Let us not however, that upward tendencies in employment slowed down, which can be a warning signal as regards the pace of recovery in the upcoming quarters.
- Core inflation excluding food and energy prices amounted to 0.8%YoY in May, i.e. remained at April's level. Other core inflation gauges also remained low.
- PPI inflation in May was below expectations and amounted to -1.0%YoY.




- Pace of industrial output growth decelerated in May to 4.4%YoY (and 2.7%YoY after seasonal adjustment), while construction and assembly output slowed to 10.0%YoY (8.3%YoY after seasonal adjustment). Industrial manufacturing expanded by 5.7%YoY, which is still quite a good result, but previous months were visibly better.
- Weaker growth of output may be a signal of decelerating pace of economic recovery in the second quarter, possibly due to the negative impulse from situation in Russia and in Ukraine. In our opinion, pace of the GDP growth in the second quarter of the year should be close to the one recorded in first quarter and even if it slides marginally, it should remain above 3%YoY. We expect the second half of the year to bring an improvement of results in industry due to further recovery of foreign trade with other euro zone countries.

## **Quote of the week** – The MPC assesses its cooperation with the NBP President to date as very good

**Monetary Policy Council Statement, 17.06, NBP**

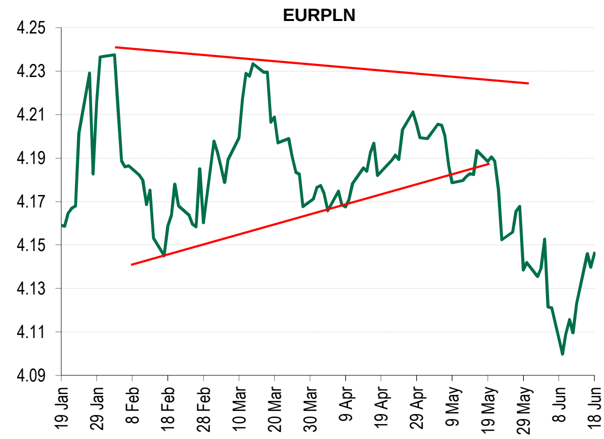
The Monetary Policy Council assesses its cooperation with the NBP President to date as very good. The Monetary Policy Council regrets that the utterances made by the NBP President and recorded by way of unlawful eavesdropping may create the impression that the Chairman of the Monetary Policy Council played a part in the political-electoral cycle. Such involvement would be unacceptable. The Monetary Policy Council assures of its sustained and unrelenting resolve to protect the value of the Polish currency.

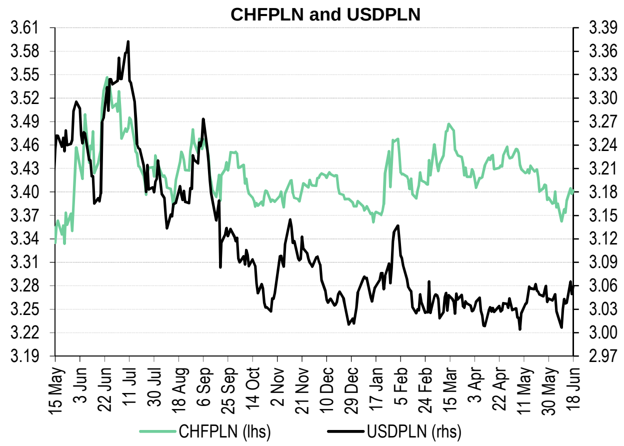
**Andrzej Rzońca, MPC member, 20.06, Gazeta Wyborcza**

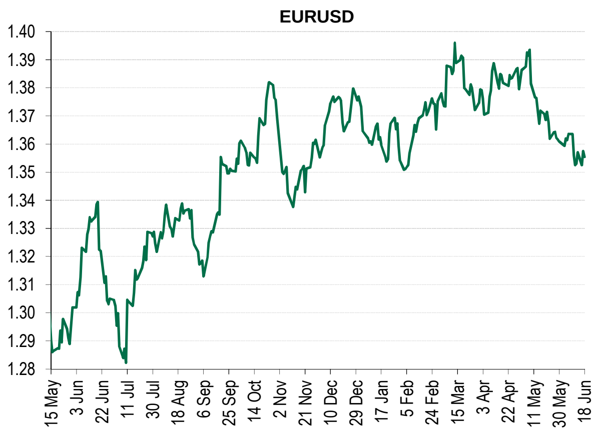
The statement is not a support for Marek Belka. (...) If the NBP president – against what he claims – got involved in politics, that disqualifies him from leading the Monetary Policy Council. (...) Without doubts, due to Marek Belka's behaviour the NBP's reputation suffered a significant blow, like never in the past. And this is a very serious problem for me.

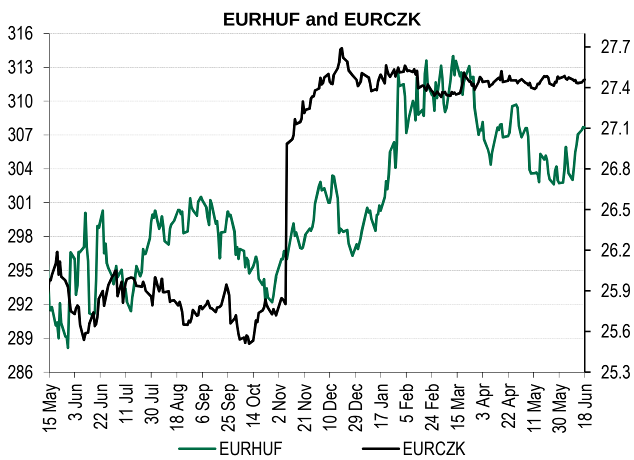
Working MPC meeting was held on Tuesday, 17 June and it was an opportunity for governor Marek Belka to explain his words said during talks with minister Sienkiewicz. After the meeting the Council released a statement suggesting that further cooperation with NBP president is possible. However, recent events may, in our view, affect the atmosphere of this cooperation, which has been very good in recent months, as Belka admitted himself. This is suggested, among others, by recent comments of MPC's Andrzej Rzońca. Also, please not forget that two MPC members were absent at the Tuesday's meeting: Adam Glapiński and Jerzy Hausner. The latter informed he will present his personal view on the situation on 1st July.

## **Foreign exchange market** – Politics may overshadow data releases




### PLN weaker due to domestic events and geopolitical risk

- Last week started with zloty weakening due to the wiretapping scandal and tensions in Ukraine and Iraq. Consequent, EURPLN temporary climbed above 4.15, while USDPLN reached 3.07. Zloty lost sharply against the British pound (GBPPLN surged temporary slightly above 5.20, its highest since November 2012). Next events related to the “tape affair”, including suggestions of PM Tusk and president Komorowski that earlier parliamentary elections are possible, caused that the zloty has only temporarily gained when global market sentiment improved and FOMC sent a dovish message to investors. At the end of the week, EURPLN was close to first resistance at 4.15.
- The political risk is likely to remain an important factor driving the zloty in the coming days (“Wprost” weekly announced it will publish more recordings on Monday). Flash PMI/ISM for euro zone and the US economy may also prove meaningful. Another weaker data may renew worries about strength of rebound in the euro zone, and consequently could generate additional negative pressure on the zloty. Vital levels for EURPLN are 4.09 (low reached after the ECB decision) and 4.15 (tested already at the end of the past week; next crucial resistance levels are at 4.17 and 4.20). At the same time, we do not change our forecasts assuming EURPLN close to 4.0 at the end of the year.

### Bank of England suggests monetary tightening

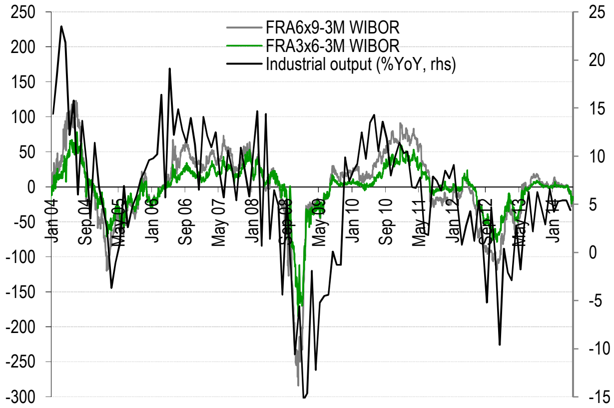
- The single currency gained vs. the dollar during the past week. The euro was supported in particular by anonymous comments of the ECB representatives saying that the central bank will wait with further actions at least a couple of months and dovish tone of Fed’s press conference. As a result, the EURUSD breached 1.36 at the end of the week. However, the scale of fluctuations was not huge and the market is still waiting for an impulse that would set the direction for the next days or weeks.
- Strengthening of the British pound should be noted. This is the effect of comment of governor of Bank of England, who suggested that interest rate hikes can be implemented earlier than currently priced-in by the market. This comment was supported by Bank of England’s minutes from the June’s meeting. As a result, EUGBP declined temporarily to 0.796, the lowest level in almost 2 years.
- This week investors will focus on flash PMI/ISM readings for the euro zone and Germany. After weaker ZEW for Germany, we are likely to see further decline of these indices for the euro zone. If such a scenario materializes, then the euro may lose against the US currency. Important support is at 1.35.

### Central bank meetings in the centre of attention

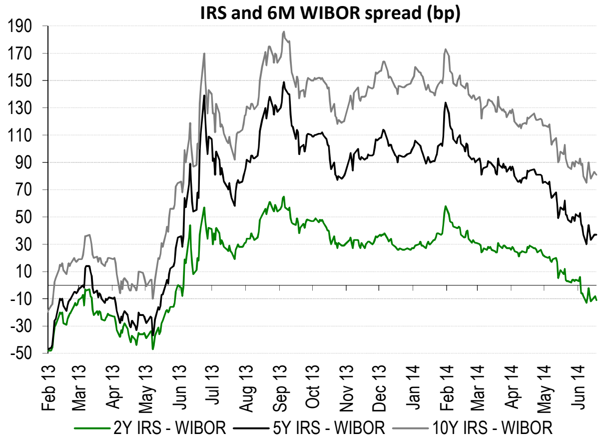
- The CEE currencies (the forint and the Czech koruna) did not react to the weakening of the zloty. EURHUF was hovering in 306-308 range (with a slight upward tendency), while EURCZK was oscillating between 27.4 and 27.5. Governor of the Czech central bank said that actions taken by the bank in November 2013, aimed at weakening the koruna translated into higher retail sales more than expected.
- In the upcoming week investors will focus on central bank meetings in the Czech Republic and in Hungary. We are expecting the Czech central bank to continue its monetary policy. As regards Hungary, another cut by 10bp (to 2.30%) cannot be ruled out, and this would be in line with market expectations. Thus, the forint’s reaction to this decision may remain limited. More important may be the bank’s statement, which will be affected by the new economic forecasts. Market may be sensitive to potential suggestion about looming end of monetary easing cycle.

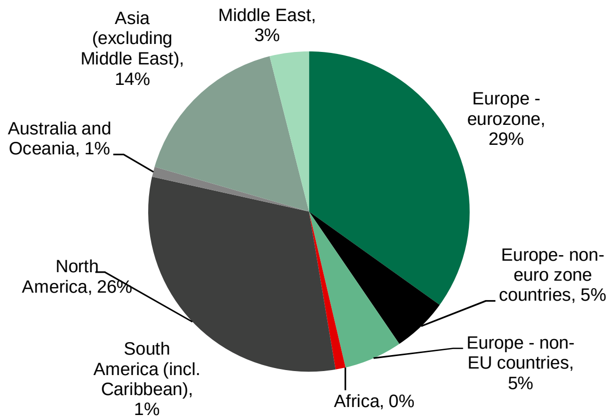
## **Interest rate market** – Political risk affecting the debt market

Change of 3M WIBOR priced by FRA and Polish industrial market

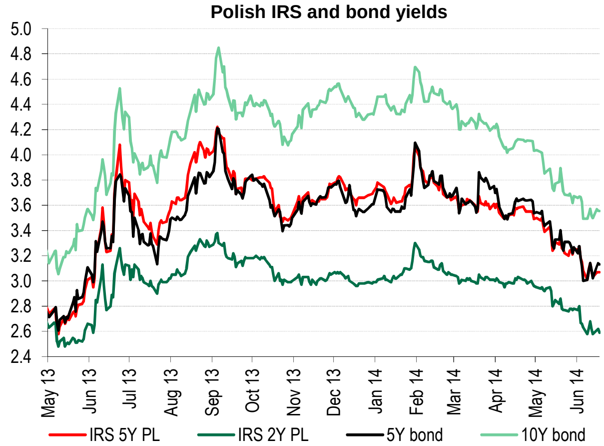



IRS and 6M WIBOR spread (bp)




Polish IRS and bond yields




### Market still expects 25bp rate cut in 6-9 months

- Since the last Friday, 9M and 12M WIBOR dropped by 1bp while the shorter rates (1M, 3M, 6M) stayed unchanged. Due to the wiretapping scandal, the market has temporarily revised slightly its expectations regarding the interest rate cuts, but due to the weaker than expected output numbers it is still pricing in 25bp cut in next 6-9 months.
- The "tape affair" is developing so the market may not react strongly to new macro data. Although according to our forecast retail sales may be below market consensus (which would fuel expectations for rate cuts in normal situation), impact of this data may be reduced by recent scandal. Moreover, FRA market may be affected by higher bond yields, which are negatively reacting to risk of early election.

### IRS and bonds influenced by domestic factors

- The very beginning of the week saw a surge of IRS and bond yields by even 15-20bp in reaction to tapes released by "Wprost" weekly on Saturday. However, lack of dismissals in the government and NBP head's announcement that he does not plan to step down stabilized the situation and the market recovered slightly. Next events, including PM and President's warning about possible early elections, convinced markets that the political crisis may last for some time, and at the end of the week IRS rates were 3-4bp higher and bond yields 8-13bp higher than on previous Friday.
- A the switch auction the Ministry of Finance sold PS0719 and WZ0119 for PLN3.02 and PLN3.1bn, respectively. The ministry released also data showing bond holdings of foreign investors and the breakdown given the type of holder and geographical region (data at the end of April). As regards the type of holder, biggest share of Polish marketable bonds is held by investment funds (17% in total and 42% of bonds held by nonresidents). Commercial banks, central banks, pension funds or nonfinancial entities had 6-7% of bonds held by foreigners and 2.5%-3% in total PLN, marketable debt outstanding. Hedge funds held 0.02% of Polish bonds (0.05% in amount held by nonresidents). Considering the region of residence, main investors are from the euro zone (over 29% of bonds held by foreigners), North America (26%) and Asia (excluding Middle East – nearly 14%). Among foreign central banks, biggest holders are the non-EU European banks (nearly 53%) and Asian (excluding Middle East – c34%).

### Next stage of "tape affair" may be important

- Start of the week may see next stage of the wiretapping scandal. The political crisis may persist, increasing the risk of political destabilisation priced-in by the market. Although recently released domestic macro data were dovish, and the result of last FOMC meeting was also supportive, the levels seen at the IRS and bond markets at the end of the week are clearly showing that markets are concerned about political situation. Our forecast of May's retail sales – just like in the case of industrial output – is below market consensus and in normal circumstances it would probably support expectations for monetary easing in Poland. However, given recent events investors may be more careful when pricing in such option.
- Flash PMI data for Germany and euro zone, and German Ifo index may be potentially supportive for Polish fixed income market. If they show lower than expected readings, expectations for further ECB actions may be reinforced, which could potentially offset to some extent the negative impact of domestic political factors on Polish debt.

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