WEEKLY ECONOMIC UPDATE

22 – 28 June 2015

Last week both Greece and FOMC meeting were on the headlines, closely monitored by investors. The Eurogroup meeting ended with no agreement on Greek aid, which weighed on investors' mood, in particular after information that the ECB may be forced to enlarge its liquidity programme for Greek banks due to accelerating deposit flight. This partly overshadowed sentiment improvement after Fed's meeting. The market interpreted results of FOMC meeting as less hawkish than feared despite that both the statement and forecasts show that the first hike is likely in September. As regards domestic data releases, the headline CPI showed slower rebound than we expected, increasing in May to -0.9% YoY from -1.1% YoY in April. At the same time data from real economy (wages and employment, industrial output, retail sales) showed mixed picture of economic activity. However, we still think that economic growth in likely to accelerate further, towards 4%YoY at the end of this year. All in all, the zloty and bonds have remained under pressure last week.

This week Greece will remain in the focus of attention as the emergency summit of the euro zone leaders on Monday seems to be the last chance for a deal to avoid the country's default. While the last-minute agreement with creditors allowing for disbursement of some extra cash for Greece before end of June would certainly improve market sentiment, such scenario is still far from certain. Apart from Greece, investors will focus on macro data from the euro zone (flash PMI, German Ifo) and from the U.S. economy. The latter could influence expectations on the start of Fed's monetary tightening. Poland's unemployment rate due on Wednesday is likely to be market-neutral.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 June)					
16:00	US	Home sales	May	mn	5.28	-	5.04
		TUESDAY (23 June)					
3:45	CN	Flash PMI – manufacturing	Jun	pts	49.4	-	49.2
9:30	DE	Flash PMI – manufacturing	Jun	pts	51.5	-	51.1
10:00	EZ	Flash PMI – manufacturing	Jun	pts	52.0	-	52.2
14:00	HU	Central bank decision		%	1.50	-	1.65
14:30	US	Durable goods orders	May	%MoM	-0.5	-	-0.5
16:00	US	New home sales	May	k	520	-	517
		WEDNESDAY (24 June)					
10:00	**PL**	**Unemployment rate**	**May**	**%**	**10.8**	**10.8**	**11.2**
10:00	DE	Ifo index	Jun	pts	108.0	-	108.5
14:30	US	GDP	Q1	%QoQ	-0.2	-	2.2
		THURSDAY (25 June)					
11:00	**PL**	**Bond switch auction**					
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Personal income	May	%MoM	0.5	-	0.4
14:30	US	Consumer spending	May	%MoM	0.7	-	0.0
14:30	US	Initial jobless claims	week	k	-	-	267
		FRIDAY (26 June)					
16:00	US	Michigan index	Jun	pts	94.6	-	90.7

Source: BZ WBK, Reuters, Bloomberg

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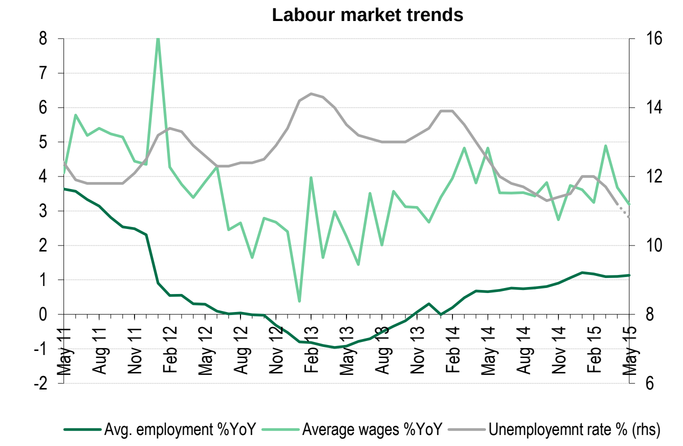
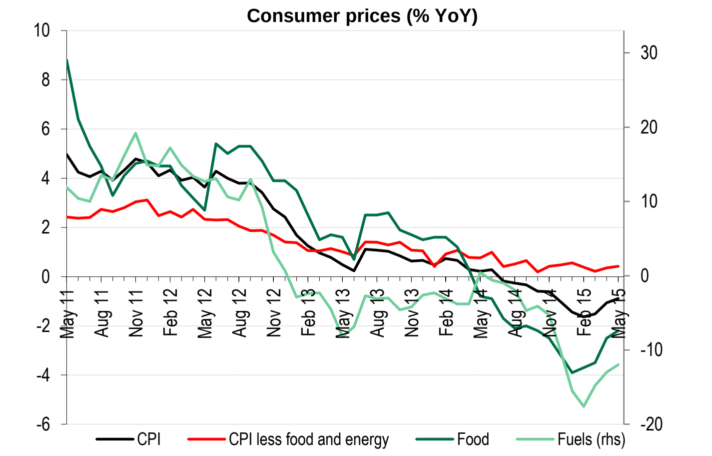
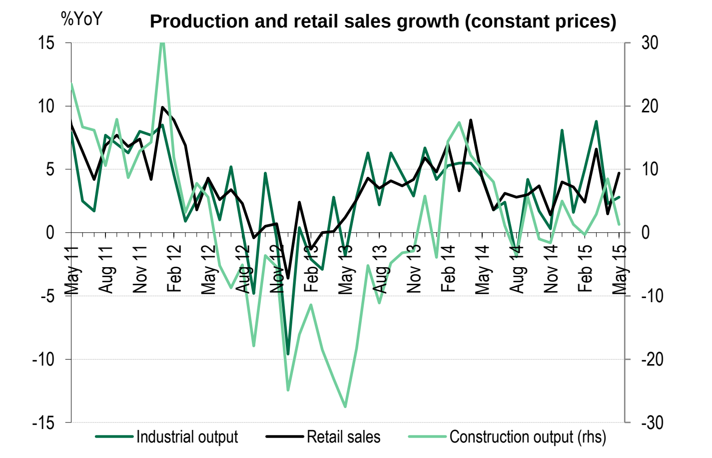
What's hot this week – Unemployment rate to keep falling



- Our estimate of May's registered unemployment rate is at 10.8%, in line with numbers shown by the Labour Ministry. Unemployment is still falling, but not as fast as in 2014 and in our view the pace of decline of this measure will be slowing down, as supply of workers with adequate skills is drying up. Still, the labour market is in very good situation, actually the best since the world economic crisis, and this should be supportive for the domestic demand in the coming quarters.

Last week in the economy – Disappointing wages and production, decent retail sales





- Inflation rate increased in May to -0.9%YoY from -1.1%YoY in April. This was below our forecast and market consensus. Surprise was mostly due to a decline in food prices. Core inflation excluding food and energy prices stayed unchanged in May at 0.4% YoY. The annual CPI is likely to stay negative until the end of 3Q15 and should reach c.0.7% at the end of the year.
- April's current account balance showed surplus of €1.1bn. The 12-month cumulated current account amounted to -€1.5bn and the current account to GDP ratio fell, according to our estimates, to 0.4%, the lowest level since the mid-90's. Export growth was strong, reflecting the recovery in demand from the European Union. We expect solid exports and imports also in the coming months.
- In May pace of wage growth in the corporate sector decelerated to 3.2% YoY from 3.7% YoY in April, mainly due to negative working-day effect, in our view. Meanwhile, employment rose 1.1% YoY, the same pace for the third consecutive month. In the short run, we expect a moderate growth in wages and stabilization in employment dynamics.
- Pace of industrial output growth disappointed for the second consecutive month, reaching 2.8%YoY in May. While in April this was mainly due to the timing of Easter that dragged food output down, the main culprit in May seems to have been the negative impact of the working days effect. Construction output decelerated significantly (to 1.3%YoY) after two strong months suggesting a recovery in this sector. Should the coming months do not bring a clear improvement in output and construction, we will start worrying about the recovery in the Polish economy. Some consolation was provided by the retail sales data (4.7%YoY growth in constant prices) that was in line with our forecast and above the market consensus, suggesting good performance of the private consumption.

Quote of the week – Unemployment below the equilibrium level

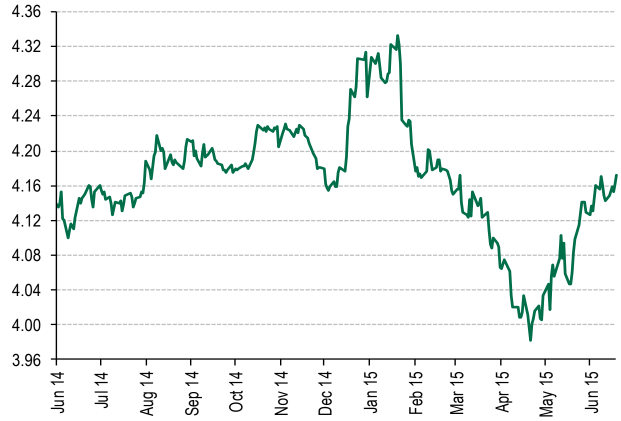
Minutes from the June's MPC meeting, NBP

Certain Council members indicated, however, that in their opinion the unemployment rate was currently already below the equilibrium unemployment rate, which might be conducive to a rise in wage growth in the future. Other Council members expressed an opinion that the wage level in Poland was low. According to these members, faster productivity growth could lead to higher wages in Poland provided that it was brought about by more innovation in the Polish economy.

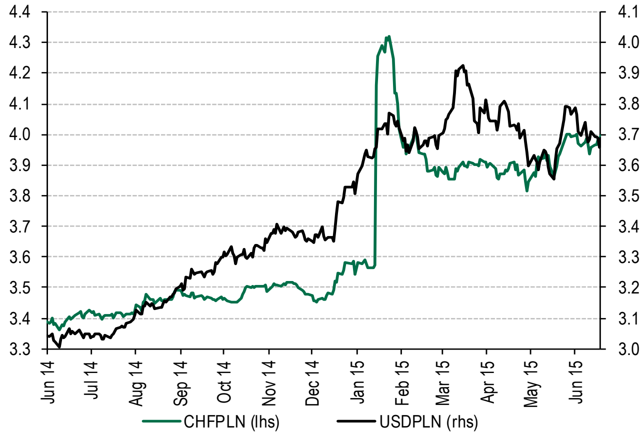
Minutes from the June's MPC meeting show that the Polish central bankers see a gradual recovery in the Polish and euro zone economy coupled with very favourable situation of the labour market, which will slowly move the inflation rate towards target. Yet, the output gap remains negative, indicating no inflation pressure. Thus, there is no need to change rates and this is of course the same conclusion as earlier. We do see however an interesting element in the minutes: certain MPC members claim that the unemployment rate is below the equilibrium level, which may translate into higher wage pressure. This is in line with our interpretation of the labour market situation.

Foreign exchange market – Greece remains the most important market driver

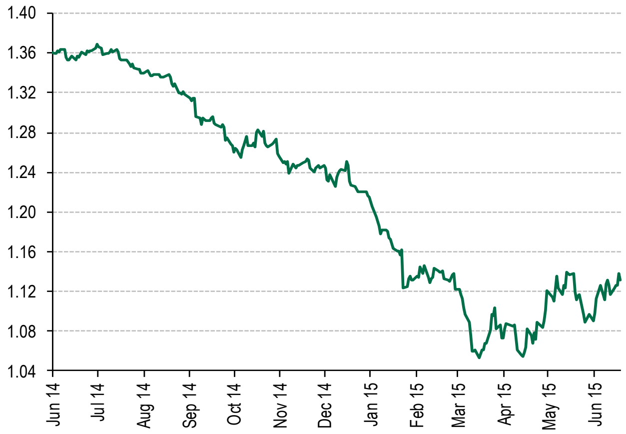
EURPLN



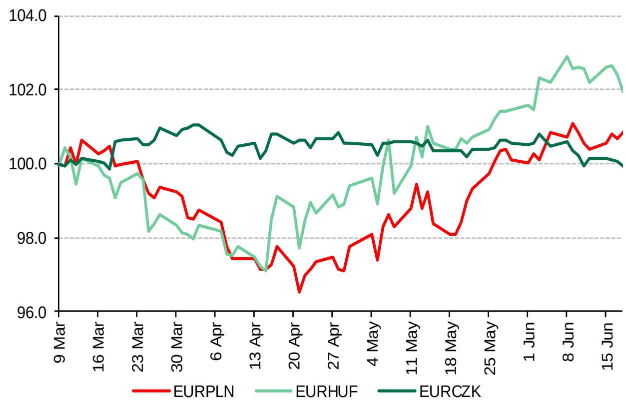
USDPLN and CHFPLN



EURUSD



Zloty and CEE currencies (9 March = 100)



Zloty under pressure of unsolved Greek problem

- The Polish zloty as other emerging market currencies stayed under pressure of global factors, in particular uncertain situation in Greece. Prolonged disagreement between Greece and its creditors overshadowed less hawkish statement of FOMC and the zloty did not benefit from sentiment improvement. At the same time domestic macro data (lower than expected C/A surplus and weaker industrial output) were not supportive for the currency. As a result EUR/PLN increased temporarily towards 4.176. In the meantime zloty gained quite visibly against the US dollar, amid significant increase of EUR/USD, which pushed USD/PLN down to slightly below 3.65. At the end of the week the rate increased gradually towards 3.69.
- Situation on EUR/PLN chart did not change significantly over the past week. News about progress in talks with Greece will be key for investors' sentiment and will determine the market direction for upcoming days/weeks. Global macro data releases may also have some impact, in particular US publications affecting expected timing of Fed rate hike, while domestic macro calendar is very light this week. In our view, EUR/PLN could head even towards 4.20 (this month's high) unless there is a breakthrough on financial aid for Greece.

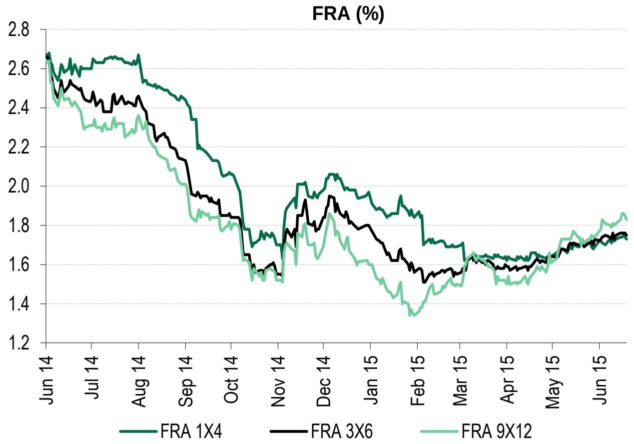
Euro rebounded after FOMC

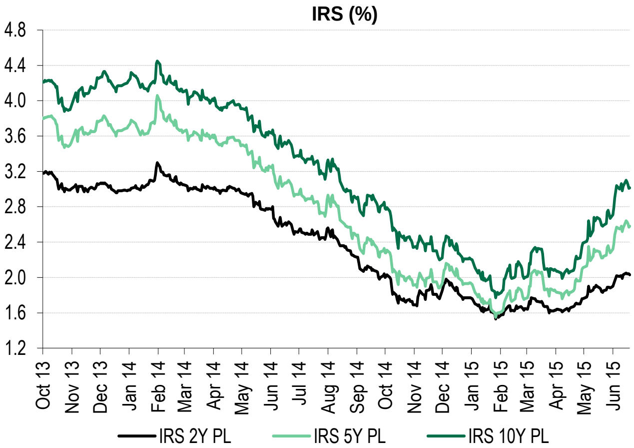
- EUR/USD moved sideways (between 1.119 and 1.133) in the first part of the week, waiting for June's Fed outcome. The European currency was also under negative pressure of the mixed macro data from Germany. Later, EUR/USD peaked as high as 1.1436 helped by less hawkish than expected FOMC statement, a somewhat weaker US inflation number and talks that Greece may be nearing a deal after all. However, end of the week brought some profit taking due to news that the ECB plans to hold an emergency session of its Governing Council to discuss the deteriorating liquidity situation of Greek banks. As a result EUR/USD declined towards 1.13 at the end of the week.
- This week investors will mainly focus on the outcome of the emergency summit of the euro zone leaders on Monday, but also on macro data releases. A positive finale of the Greek saga before 30 June would be supportive for the euro, in particular if the US macro data confirm that Fed could postpone the start of the monetary tightening. The problem is that odds for such scenario do not look particularly high.

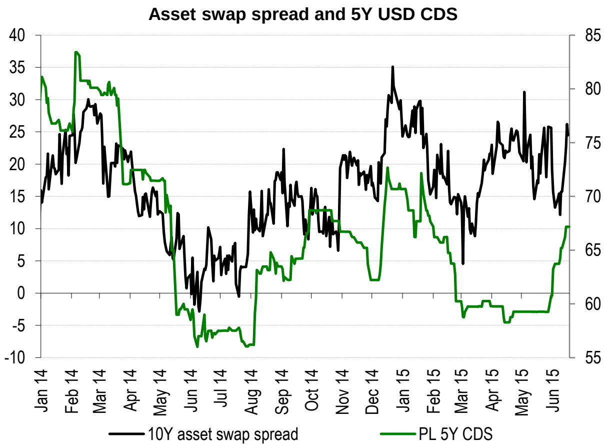
HUF and CZK ahead of central bank meetings

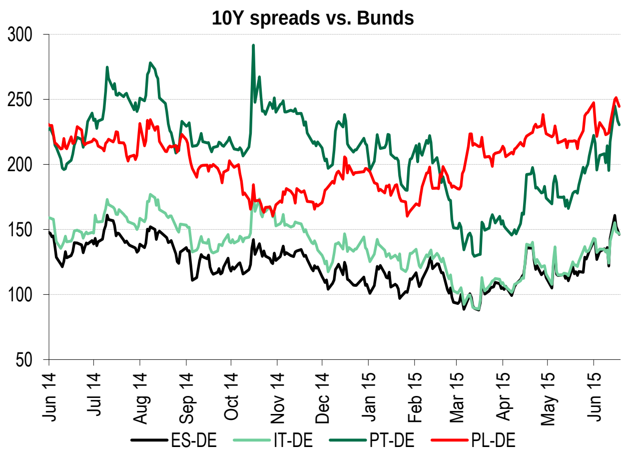
- The Hungarian forint, in tandem with the Polish zloty, stayed at elevated level due to uncertainty about aid package for Greece. EUR/HUF oscillated between 310 and 313. At the same time, the Czech koruna was quite immune to global risk aversion. EUR/CZK was traded with a moderate gap to the floor at 27.00.
- This week not only global factors, but also domestic ones will play the main role. Investors will focus on central bank meetings in both Hungary and the Czech Republic. It is broadly expected that the Czech central bank will keep monetary conditions unchanged, while the Hungarian central bank will cut interest rates by 15 pb, trimming the base rate to a fresh low 1.50%. Theses decision would be in the shadow of news flow from Greece. Reaching an agreement before the end of the month would help the market to relieve.

Interest rate market – External factors still key









Rates rise again as Greek agreement seems remote

- Bond yields added several basis points to the recent upward wave and so the 10Y benchmark broke 3.30% temporarily and 5Y rose noticeably above 2.70%. In the case of IRS, there has been some volatility, but rates did not change significantly on weekly basis. The 10Y IRS rate remained slightly above 3% and 5Y near 2.60%. The asset swap spreads widened and this was accompanied by the rising Polish 5Y USD CDS (above 67 from c65). The main driver for the recent debt weakening were of course serious concerns over Greece as the negotiations on extending financial aid appeared to be a “Sisyphean task” and brought no real progress. The Polish data did not too look strong and perhaps that is why the IRS curve remained roughly unchanged.
- FRA rates rose 1-4bp and the market still expects first 25bp rate hike in 12 months. Our forecast remains unchanged and we expect the tightening cycle to start in 4Q16.

External factor still key

- Greek case remains unsolved and so we do not expect yields and IRS to drop noticeably and sustainably without the final agreement. Talks are expected to continue during the weekend and on Monday so the beginning of the week could be volatile in the global and Polish market.
- Later in the week several U.S. data is on the agenda. Last week the Polish interest rate market reacted positively to the outcome of the FOMC meeting and pared part of earlier losses. As the Fed’s “dot chart” showed that the pace and the total scale of future rate hikes in the U.S. could be lower than initially expected, yields and the IRS plunged sharply across the global FI market. The very weak performance of the US economy during the first three months of the year was likely the main reason for the downward revision of the Fed GDP estimates for 2015 and probably for the less aggressive predicted rate hikes in the coming years. The real estate market and consumer incomes/spending data may be in the centre of investors’ attention this week. Should the US data do not surprise to the upside, Polish IRS and bond yields could continue the down move triggered by the FOMC.
- We do not expect Polish data to have any significant impact on the market. At the same time, the 2Q is getting to the end and so the “window dressing” activity of the portfolio managers could take place on the market and provide some support for bonds (that look more attractive after the recent sell-off).
- Polish Finance Ministry holds a switch auction on Thursday. According to the earlier information, bonds issued this week should not be the same that were sold two weeks ago (OK0717 and WZ0120). We think that now the Ministry could focus on the sale in the belly and long end of the curve. At the last two auctions the Ministry was selling bonds that were held mainly by the Polish investors and this might have been due to the poor global market sentiment. Should the same rule be applied also this time, we think the Ministry could issue the 5Y benchmark PS0420 (domestic investors held 78% of this bond outstanding at the end of April) and the long-term floater, like WZ0124 that at the end of April was in 99% held by the Polish investors.

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