WEEKLY ECONOMIC UPDATE

6 – 12 July 2015

The summer holiday season started on a very nervous note, with the situation in Greece becoming increasingly tense. Instead of continuing the talks, the Greek PM announced a referendum to ask Greeks whether they were in favour of the bailout package proposed by the creditors. A referendum would have been a good idea and would have enabled the Greek government to 'save face' – had it been held a few weeks/months earlier. The Eurogroup's reaction to the news was obvious: the bailout package cannot be extended. The ECB also decided to freeze liquidity assistance (ELA) for Greek banks, so the government decided to close them and impose capital controls. What is more, Greece did not pay its IMF tranche that was due on June 30. The market's reaction has, however, been muted so far as some investors still hope that an agreement between Greece and its creditors is possible, which would lower the risk of Greece leaving the euro zone.

Theoretically, all doors remain open. It is possible that talks will be resumed if the Greeks vote "yes" in the referendum, but even in this scenario uncertainty would likely remain high as there would still be many hurdles for Greece to overcome. A change of government may in this situation also be needed and the new cabinet would probably have no majority in parliament, making the credibility of its pledges doubtful. And time will be running out before July 20 when Greece is scheduled to pay €3.5bn to the ECB. A "no" vote would increase the odds of Greece leaving the euro zone, with a strong negative impact on the global risk aversion, at least in the short run.

The last MPC meeting before the summer break will be the only major domestic event this week, with no change in rates expected, even though NBP's new projections are likely to show slightly higher CPI and GDP paths.

Economic calendar

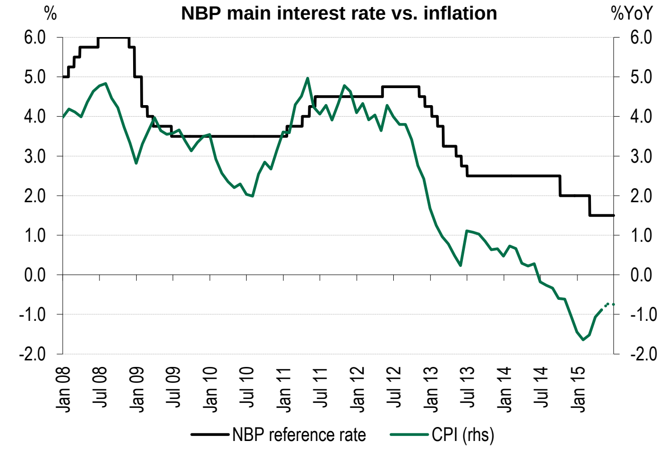
CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (6 July)					
8:00	DE	Factory orders	May	%MoM	-0.1	-	1.4
16:00	US	ISM services	Jun	pts	56.4	-	55.7
		TUESDAY (7 July)					
8:00	DE	Industrial production	May	%MoM	0.1	-	0.9
14:30	US	Trade balance	May	$bn	-42.75	-	-40.9
		WEDNESDAY (8 July)					
	PL	**MPC decision**		**%**	**1.5**	**1.5**	**1.5**
9:00	HU	CPI	Jun	%YoY	0.6	-	0.5
20:00	US	FOMC minutes	Jun		-	-	-
		THURSDAY (9 July)					
9:00	CZ	CPI	Jun	%YoY	0.9	-	0.7
11:30	**PL**	**Bond auction**			**-**	**-**	**-**
14:30	US	Initial jobless claims	Week	k	277	-	281
		FRIDAY (10 July)					
16:00	US	Wholesale inventories	May	%MoM	0.3	-	0.4

Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

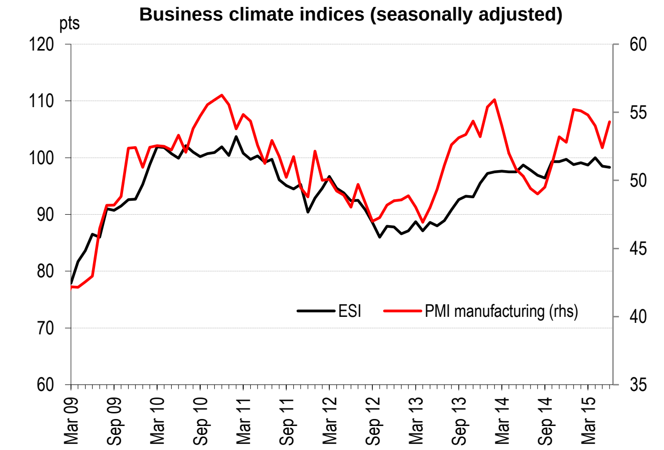
TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

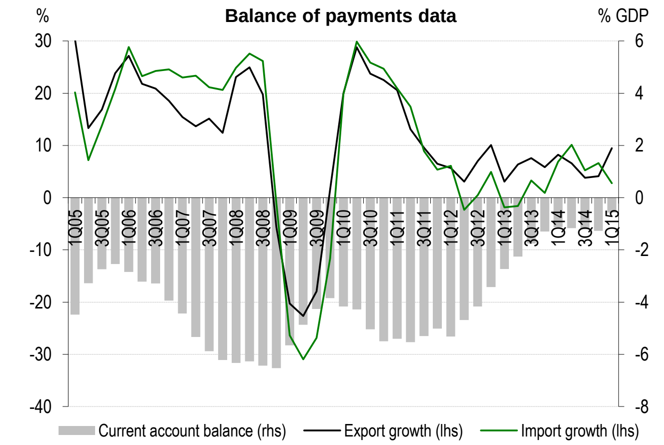
What's hot this week – Polish MPC unlikely to surprise



- We expect the Monetary Policy Council to leave interest rates unchanged (reference rate at 1.50%) at its last meeting before the summer break (the next meeting is scheduled for September).
- The MPC will become acquainted with the central bank's new GDP and inflation projections. We think they will show higher inflation and economic growth paths compared to March, but not to an extent that would require change in the Council's monetary policy stance. We stick to our view that the first hike will be delivered in late 2016.
- The press conference is likely to focus on the potential repercussions of the Greek referendum. In the event of extreme market volatility, the central bank's governor may repeat his warning that NBP may use FX interventions to smooth the currency's fluctuations.

Last week in the economy – PMI up, but ESI down





- The PMI Index for the Polish manufacturing sector rebounded in June to 54.3 from 52.4 in May following four months of declines. We had expected an upward move, but of a smaller scale, as we were afraid that uncertainty over Greece continued to weigh on business sentiment. But it seems that Polish companies had shrugged off the deepening crisis and the growth rates of output, new orders and purchasing accelerated. Employment growth remained at a solid, yet a bit slower pace. New export orders rose only slightly and the improvement in new orders was generally driven by a stronger domestic demand. We think that the continuing economic recovery in the euro area will also trigger a revival, also in export orders in the following months. The PMI reading supports our forecast of strong industrial production growth in June (7.9% YoY).
- On the other hand, the European Commission's Economic Sentiment Index (ESI) declined in June to 98.3 from 98.5 in May. This indicator is a slightly better predictor of GDP than PMI. Still, the average ESI in Q2 was the same as in Q1 (98.9), pointing to a stable GDP growth rate.
- Poland's quarterly balance of payments showed a lower-than-expected current account surplus in Q1: €1676mn versus expectations at €2200mn. The revision mostly applied to exports, which went down by €527mn. This was the first quarterly current account surplus since comparable data are available. Our estimate of 1Y rolling C/A is equal to -0.6% of GDP.
- The LFS seasonally adjusted unemployment rate remained flat at 7.8% in June. Still, the number of jobseekers declined by 9k to 1350k, the lowest level since mid-2009. We expect further falls in the unemployment rate in the following months.

Quote of the week – No need (yet) to intervene on the FX market

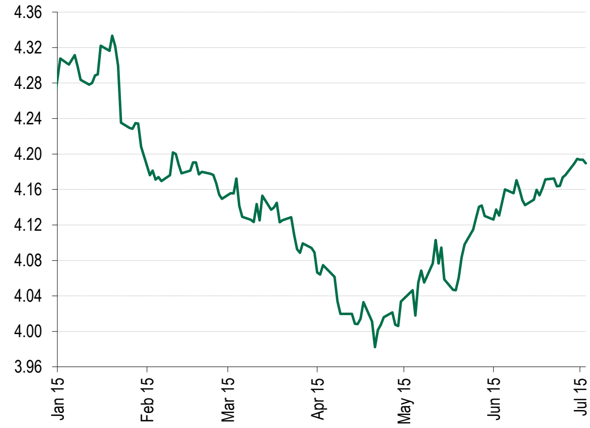
Andrzej Raczko, NBP's deputy president, PAP, 02.07.2015

We currently see EURPLN near to 4.18-4.19 or even 4.20 and this is not a range, which can considerably affect the real economy (…) Let me remind you that the central bank has intervened very rarely over the last few years. I currently see no need to think about it.

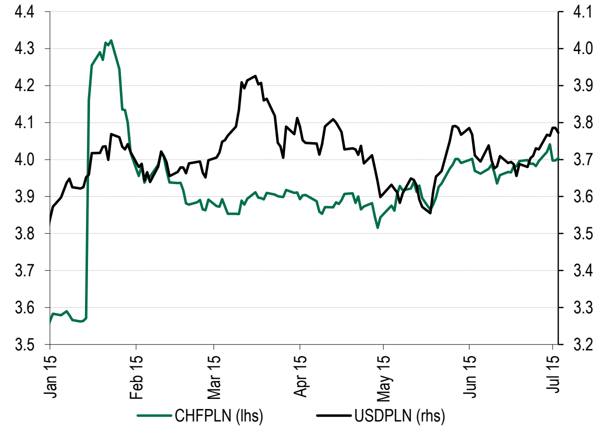
Given the uncertainty over Greece, we expect questions about NBP's possible interventions during the upcoming MPC press conference. Let us keep in mind that some officials (including the NBP president) have recently said that Poland was safe in case of a Grexit and that it held high amounts of reserve assets. This may have been interpreted as a suggestion that interventions could not be ruled out. The zloty's recent depreciation, due to the bad news about negotiations between Greece and its creditors, was not very significant, so there was surely no need to intervene. However, FX interventions are part of the NBP toolbox and, in our view, the NBP board is likely to use them if necessary. What is more, state-own bank BGK may sell euros on the market.

Foreign exchange market – Greek YES or NO may determine market direction

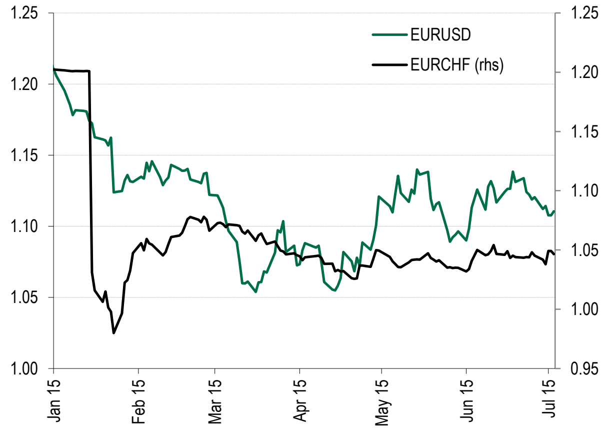
EURPLN



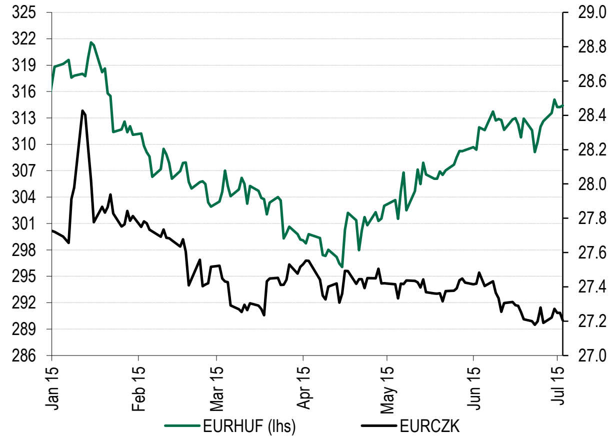
USDPLN and CHFPLN



EURUSD and EURCHF



EURHUF and EURCZK



Patiently awaiting the referendum

- Last week opened with zloty and other currencies in the region weaker, in reaction to surprising decision of Greek government to hold a referendum on bailout conditions proposed by creditors. However, after the initial spike, the currencies remained surprisingly stable in the following days, patiently awaiting the referendum and its potential consequences.
- The EURPLN, after rising on Monday to nearly 4.20, the highest level since February, stabilised in a narrow range 4.185-4.195 for the better part of the week. The USDPLN was a bit more volatile, due to EURUSD moves – after a jump to 3.82 on Monday, the rate slid to 3.72, only to return towards 3.80 later in the week.
- The focus remains on Greece. We see higher odds for a “yes” vote in the weekend referendum on accepting the terms of the bailout extension, which should imply some strengthening of the zloty. However, we think the scope for a short-term PLN rebound is relatively small as, even with such an outcome, there will be many hurdles for Greece to overcome. It seems likely that in such scenario creditors will return to talks with Greece, but a change of government will be probably needed, and time will be running out before next payments against international creditors will come due. It implies more days or even weeks of uncertainty about how the situation in Greece evolves.
- A “no” vote in the Greek referendum would probably imply Greece leaving the Euro zone, with a strong negative impact on global risk aversion, at least in the short run. That would be very likely to send the EUR/PLN higher. However, the scale of the move will be limited, in our view, by central banks’ activity (more ECB’s QE, Fed’s rate hike probably delayed) and limited contagion in the euro zone peripheries. If EURPLN goes above 4.30, a risk of NBP / BGK interventions will increase.

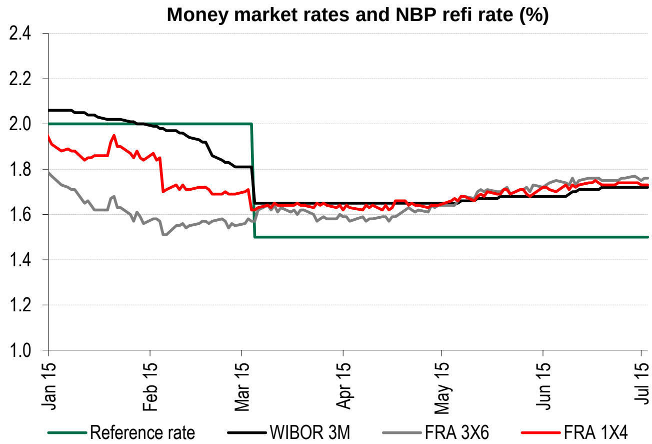
Ambiguous impact of Greek events on EUR

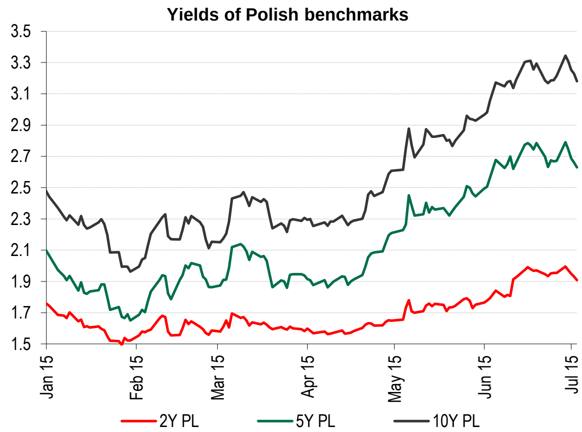
- The euro initially lost versus the dollar, in reaction to news about Greek referendum, but soon regained ground and fluctuated in the following days, reacting to news about quickly-changing situation in Greece.
- We believe that Greece’s impact on the EUR is more ambiguous than it might seem.
- A “yes” vote could provide some limited euro support. However, much will depend on the details of the following compromise deal. The revised bailout plan could imply an internalizing of Greek risk within the Eurozone and, ironically, undermine the EUR, as it could keep the Fed on course to hike rates.
- A “no” vote in the referendum would probably imply Greece leaving the EUR, which is likely to push EUR/USD lower in short run. However, the single currency could rebound quickly if the global uncertainty this should imply encourages a response from other global policymakers, in particular prompting the FOMC to delay a US rate hike.

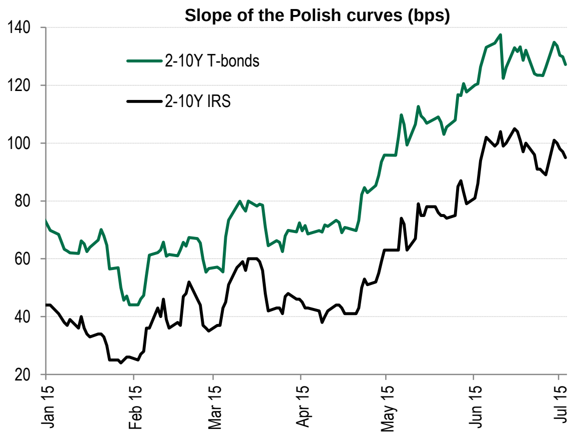
Forint and koruna also stable before the referendum

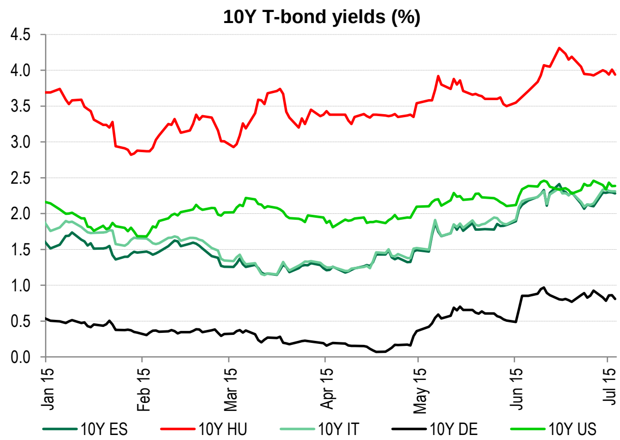
- The Hungarian forint moved in a similar pattern to the zloty – after an initial weakening to 316 on Monday, EURHUF hovered in the following days in a horizontal trend near 314-315.
- The koruna was stable for the better part of the week, but gained on Friday to its strongest level in 19 months versus the euro on the release of the central bank’s minutes, which suggested that the bank’s rate-setters saw a lower likelihood of changing the koruna cap since as the economy is likely to accelerate.

Interest rate market – Little room for yields to fall









Stable money market

- WIBOR rates were unchanged last week and the FRA market was also stable amid a lack of impulses that could change expectations of the monetary policy outlook.
- We expect no significant changes in the money market in the nearest days or even weeks. The Monetary Policy Council's meeting (the last one before the summer break) should be unexciting again, with interest rates on hold and the official statement reaffirming the Council's wait-and-see mode. The central bank's new inflation and GDP projections are unlikely to change much compared with March to justify any change of view. We still think that the Monetary Policy Council will keep the main interest rate on hold until the last quarter of 2016.

Uncertainty about Greece affecting bond markets

- Polish bonds weakened at the start of the week in reaction to the Greek government's decision to hold a referendum on whether it should accept the creditors' bailout proposals. The 10Y bond yield soared temporarily to 3.36%, its highest in 12 months. In the following days, the Polish debt market was gradually regaining strength with the peripheral spreads in the euro zone tightening on rising investor hopes that an agreement between Greece and its creditors was still possible. News of a limited T-bond supply for next two months was also supportive for the market. Market activity in the second part of the week was very small with investors awaiting the Greek referendum.
- The Finance Ministry presented its T-bond supply plan for July-August only due to high uncertainty connected to the situation in Greece. Three standard auctions are planned for these months with the offer at PLN4-12bn. The WZ0120/WZ0124 floaters, worth PLN4-12bn, will be offered at the first auction in July. The Ministry does not rule out foreign issues.
- We see limited room for the short-end yield curve's strengthening in the coming weeks, with Poland's inflation trending up and the next economic data releases likely to confirm, in our view, that GDP growth is strong and robust. The central bank's new inflation and GDP projections, to be revealed after MPC's July meeting, should be higher than those released in March, but not enough to change the monetary policy stance.
- Risk aversion may decrease slightly if Greece votes "yes" in the referendum. However, reaching a compromise agreement may still take time and uncertainty may remain high for weeks. Also, in this scenario, the Fed would probably stay on track to raise rates in September. Therefore, we think that long-term yields are likely to remain close to their current levels in the next few weeks.
- A "Grexit" scenario would likely trigger a surge in risk aversion, driving the non-core yields higher. However, the scale of the sell-off on the Polish debt market should be limited by the fact that such a scenario would probably trigger a response from the global policymakers, in particular prompt the FOMC to delay its rate hike. Also, Polish debt supply would probably be trimmed during the summer in the event of market turbulence since the government has a large liquidity cushion that could help limit a spike in yields.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, Al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.