

# WEEKLY ECONOMIC UPDATE

## 13 – 19 July 2015

Despite the “NO” vote in the Greek referendum, it seems the odds for an agreement have increased after the Greek government proposed a list of reforms similar to those suggested by the creditors two weeks ago in exchange for a new bailout and some debt relief. The result of this weekend’s talks of the Eurogroup and the EU summit will be decisive. In case of a happy-end solution, the relief at the start of the week may be limited, however, as it seems the market has already partly priced-in an agreement. Numerous data releases scheduled this week should be quite positive, in our view, confirming the ongoing economic recovery in Poland and abroad. Still, the global situation may be more important than local macro publications, given that the elevated volatility last week was not caused only by the situation in Greece, but also (or above all) by developments on the Chinese stock market.

### Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (13 July)</b>						
9:00	PL	Release of NBP's Inflation report				
<b>TUESDAY (14 July)</b>						
11:00	EZ	Industrial output	May	%MoM	0.2	- 0.1
11:00	DE	ZEW index	Jul	pts	60.5	- 62.9
14:00	PL	Current account	May	€m	482	404 1138
14:00	PL	Exports	May	€m	13976	13870 14 485
14:00	PL	Imports	May	€m	14100	13724 14 358
14:00	PL	Money supply	Jun	%YoY	7.6	8.1 7.7
14:30	US	Retail sales	Jun	%MoM	0.3	- 1.2
<b>WEDNESDAY (15 July)</b>						
14:00	PL	CPI	Jun	%YoY	-0.8	-0.7 -0.9
15:15	US	Industrial output	Jun	%MoM	0.2	- -0.2
20:00	US	Fed Beige Book				
<b>THURSDAY (16 July)</b>						
11:00	EZ	HICP	Jun	%YoY	0.2	- 0.2
13:45	EZ	ECB decision		%	0.05	- 0.05
14:00	PL	Wages in corporate sector	Jun	%YoY	4.5	3.9 3.2
14:00	PL	Employment in corporate sector	Jun	%YoY	1.1	1.1 1.1
14:00	PL	Core inflation	Jun	%YoY	0.3	0.3 0.4
14:30	US	Initial jobless claims	week	k	-	- -
16:00	US	Philly Fed index	Jul	pts	12.0	- 15.2
<b>FRIDAY (17 July)</b>						
14:00	PL	Industrial output	Jun	%YoY	6.9	7.9 2.8
14:00	PL	Construction and assembly output	Jun	%YoY	3.6	3.1 1.3
14:00	PL	Retail sales	Jun	%YoY	6.3	6.9 1.8
14:00	PL	PPI	Jun	%YoY	-1.9	-1.9 -2.2
14:30	US	CPI	Jun	%MoM	0.3	- 0.4
14:30	US	House starts	Jun	k	1100	- 1036
14:30	US	Building permits	Jun	k	1110	- 1250
16:00	US	Flash Michigan	Jul	pts	96.5	- 96.1

Source: BZ WBK, Reuters, Bloomberg

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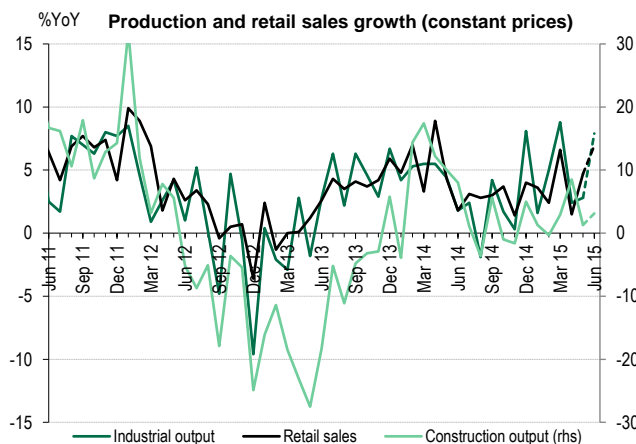
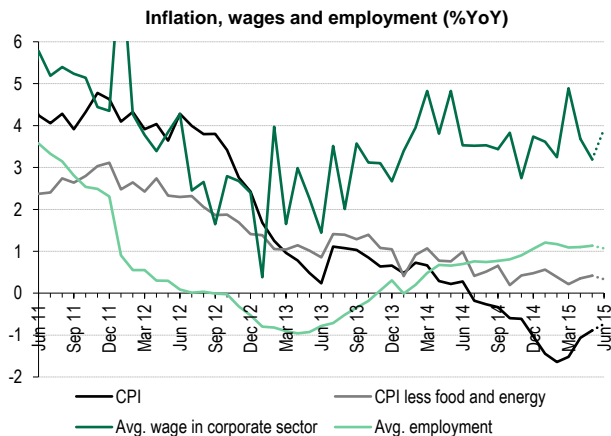
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## What's hot this week – Bunch of important data releases



- June's CPI most probably went up, in line with the recently observed trend. Our forecast is slightly above the market consensus because we see some rebound in the food prices, driven mostly by the low base effect from 2014. At the same time, core inflation excluding food and energy prices fell, in our view. There is still no upward pressure on prices, but the strengthening private consumption should finally lead an inflation pickup. It is also possible that food prices will go up soon due to draughts and the relatively weak zloty. We expect CPI inflation to stay negative until November and reach 0.7% at the year-end.

- Labour market statistics will likely continue to be positive, with stable employment growth and wage growth acceleration (after one-off factors dragged it down in recent months). We expect no significant acceleration of employment growth in the months to come because of the scarcity of a skilled labour force. The good labour market situation will be supportive of consumption growth.

- We expect a strong acceleration of industrial output growth in June, mainly due to the working-day effect. Still, the underlying trend remains quite positive and the strong PMI reading for June supports this view. Our forecast of retail sales is also strong and we see them rising by 6.9%YoY in real terms, the highest pace in more than a year.

- On the other hand, our construction output forecast is rather low, as May's data proved disappointing and undermined our forecasts for the following months.

- May's statistics on foreign trade should be a bit weaker than in April, but the trade and current account balances will most likely remain in surplus. Economic recovery in the euro zone will be supportive for the Polish exports in the upcoming months.

## Last week in the economy – Interest rates on hold, GDP and CPI projections up

### Inflation and GDP projections in the subsequent Inflation reports

	GDP growth			
	Jul 14	Nov 14	Mar 15	Jul 15
2015	2.6+4.5	2.0+3.7	2.7+4.2	3.0+4.3
2016	2.3+4.5	1.9+4.2	2.2+4.4	2.3+4.5
2017	-	-	2.4+4.6	2.5+4.7
	CPI inflation			
	Jul 14	Nov 14	Mar 15	Jul 15
2015	0.5+2.1	0.4+1.7	-1.0+0.0	-1.1+/-0.4
2016	1.3+3.1	0.6+2.3	-0.1+1.8	0.7+2.5
2017	-	-	0.1+2.2	0.5+2.2

- The Monetary Policy Council caused no surprises and kept interest rates on hold at its July meeting, with the reference rate remaining at 1.50%.

- The MPC presented the main conclusions of the NBP's newest staff projection. Both the inflation and GDP paths went up. As regards the GDP, changes were mostly for 2015 (with the average growth at 3.7%). The bank's inflation path was shown on a decline in 2015 (deeper deflation), only to rise in the following two years. If this scenario materialised, it could lead to a fall in the real interest rate to zero and increase the chances of an interest rate hike in the second half of 2016, in our view. This is consistent with our scenario.

- Still, there is high uncertainty regarding the line-up of the new MPC, which will determine the central bank's monetary policy in 2016. But this uncertainty will disappear in a couple of months' time.

## Quote of the week – Market expectations more or less accurate

### Marek Belka, NBP governor, 08.07.2015, press conference

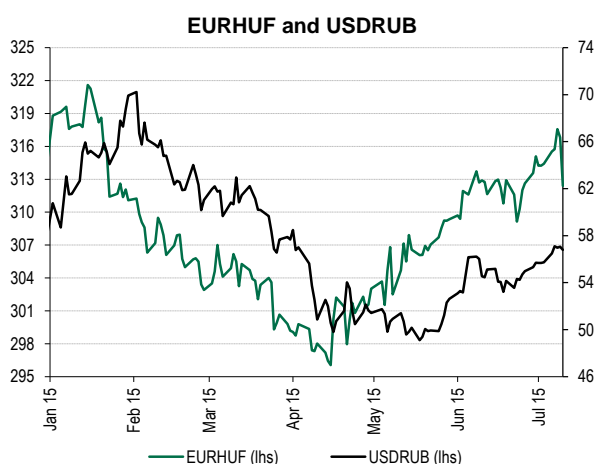
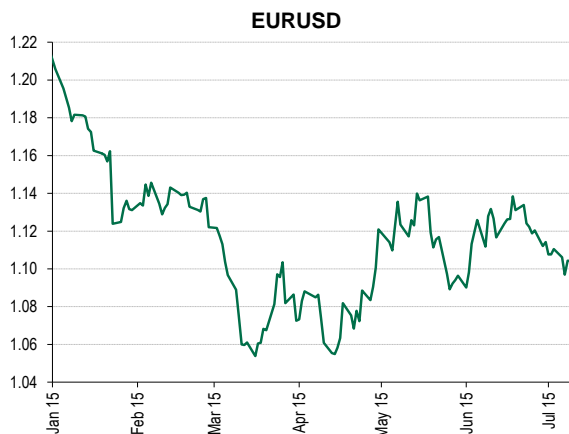
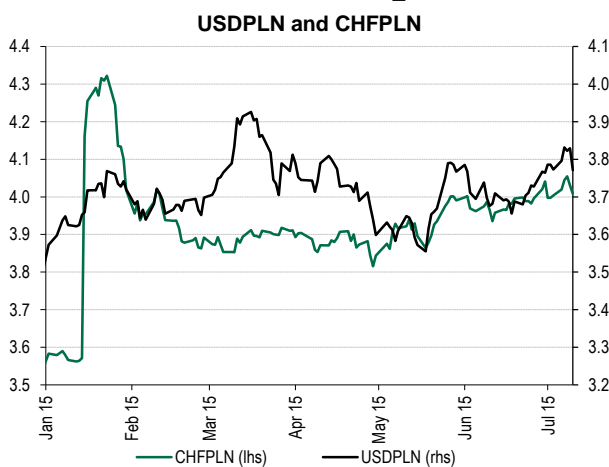
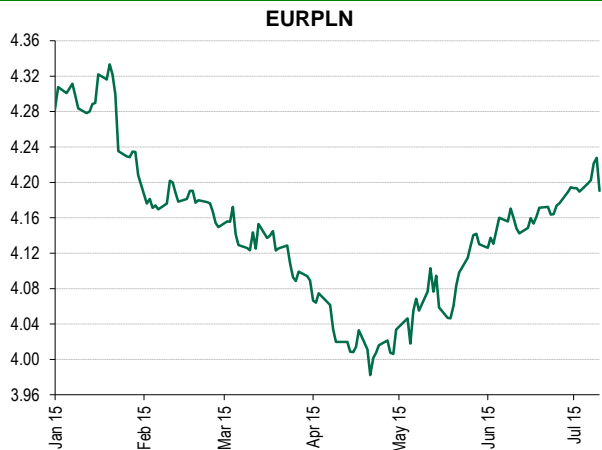
The projection does not take into account the events in Greece. A negative scenario, taking these events into account, would be visible in the inflation report, but the GDP and CPI paths would not change much. (...) There could be side-effects [of a Grexit], but we would know what to do in such a case. (...) We do not expect further acceleration, but rather stabilization of growth (...) I do not expect it [a return to rate cuts] (...) Market expectations are more or less accurate, but the Council has made no pledge to keep the monetary policy unchanged [till the end of its term].

### Beata Szydło, PiS candidate for Prime Minister, 09.07.2015, DGP

The central bank should be active in supporting credit action for SMEs, like the LTRO of the ECB.

As we had expected, Grexit was one of the topics during the Q&A session with Governor Belka. It turned out that NBP's staff had estimated this scenario in the projection, which is due for release on Monday. According to Belka, this does not affect the Polish macroeconomic variables strongly and this is in line with our expectations. Belka also suggested that the NBP was ready to intervene on the FX market, should it be necessary (side-effects of Grexit). The NBP governor said that the market was more or less right in expecting the first hike in late 2016. However, let us keep in mind that the line-up of the MPC is to change in early 2016. Beata Szydło's comments clearly show that PiS, which is likely to win the election, will prefer dovish candidates, who may prefer to delay hikes.

## Foreign exchange market – Another crucial weekend



### Volatile week ahead

▪ The Greek “NO” in the referendum to reforms and no conclusion reached at the EU summit on Tuesday hit the Polish currency in the first part of the past week. EURPLN surged from 4.18 to 4.24, the highest level since late January, on the back of the rising odds of a “Grexit”. However, the zloty recovered all these losses and even gained slightly at the end of the week as it appeared that the new reforms presented by the Greeks ahead of the EU’s Sunday summit resemble very much those propositions that were rejected in the referendum. In the market’s view, this raises the odds for a final deal on Sunday.

▪ Already for a couple of weeks, the market’s main focus has been on Greece and just like in several of our previous reports, this time we again have to say that the weekend’s events could be decisive for the euro zone and the markets. If a final agreement on the Greek bailout programme is reached, the zloty could continue its appreciation trend from the beginning of the new week. Also, our forecasts for the Polish industrial output and retail sales are above the consensus and this could also back the currency. Still, room for EURPLN falls could be limited since the market has been pricing in a positive final of the Greek talks already at the end of the past week, with the exchange rate plunging to 4.17 from 4.22.

▪ The EU’s Sunday summit was announced as the “ultimate deadline” by many of the European leaders, so if no solutions are decided on, risk aversion could dominate the global markets at the beginning of the week. However, we think that worries about the impact of a “Grexit” may be somewhat tamed by hopes for coordinated and extensive measures launched by the central banks to stabilise the global market. However, the beginning of the week could be quite volatile, if there is no agreement on the Greek bailout package.

### Greece and U.S. data in the spotlight

▪ The euro gained vs. the dollar last week despite “NO” in the Greek referendum and market turmoil in China. EURUSD rose to 1.12 from 1.09 also on the back of the somewhat less hawkish than expected minutes from the last FOMC meeting

▪ The outcome of the EU summit could also be important for EURUSD. In our view, volatility could be particularly high, if the European politicians failed to reach an agreement, as it seems that a positive final to the talks has already been priced in (at least partly) on Friday.

▪ When a solution is reached, we think investors could shift their attention to the numerous U.S. data releases scheduled for this week. The FOMC minutes showed that the Committee may need more signals confirming that the U.S. economy is on track before it raises rates. Plenty of crucial data are due in the coming days and may influence market expectations as regards the timing of the first U.S. rate hike and, as such, trigger some noticeable changes in the EURUSD market

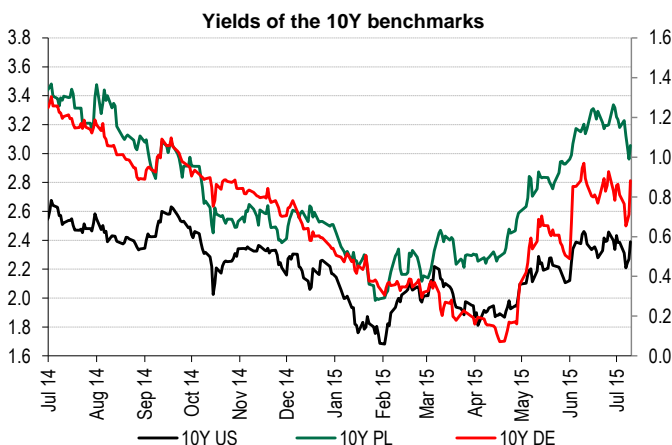
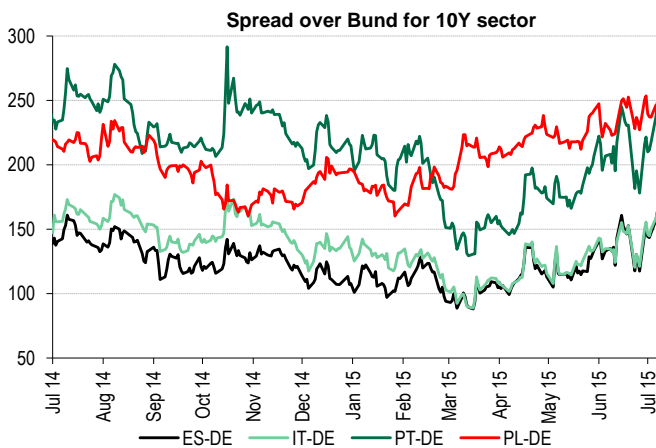
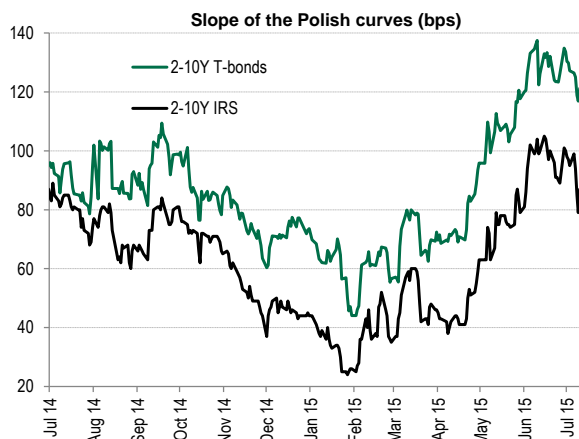
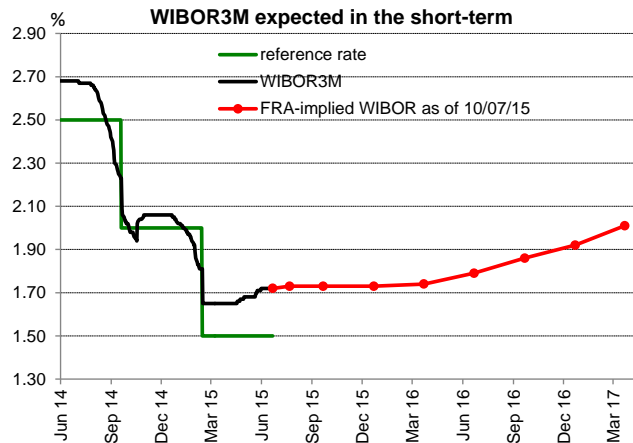
▪ Important levels for EURUSD at 1.09 and 1.14.

### Volatile forint, weaker ruble

▪ Global market sentiment and Greece were the forint’s main drivers last week. The Hungarian currency depreciated to 318 per euro (highest level since mid-January), but then recovered sharply to 310 at the end of the week. This week, global market sentiment is likely to continue to be main factor influencing the forint.

▪ The Russian ruble lost vs. the dollar for the third week in a row. The currency was under pressure, like its CEE peers, but gained less than them at the end of the week.

## Interest rate market – Under the influence of global factors



### Market shifts rate hike expectations forward

- WIBORs stayed unchanged last week, while FRAs fell visibly (by 3-22 bp across the board) due to the significant rebound on the IRS. The FRA curve flattened considerably, suggesting that the first rate hike could take place no earlier than in 2017 vs. the 15 months' time expected at the beginning of July (FRA21x24 is at 2.01%).

- The recent market changes clearly show that investors have shifted their expectations on the start of monetary tightening forward. In our view, the rising inflation rate and economic growth revival could allow the MPC to raise rates in 4Q16. However, changes to the MPC's line-up in early 2016 generate the risk of a longer period of looser monetary policy. Macroeconomic data due this week (industrial production, retail sales), confirming the upward path of economic activity, could result in some profit taking on FRAs after the significant strengthening in recent days.

### Rebound on bond and IRS markets

- Last week brought a significant rebound on Poland's bond and IRS markets. On a weekly basis, the bond curve shifted down by 6-16 bp, while the IRS curve went down by 5-18 bp, with the biggest fall on the belly and long-end of the curve. This was caused by global trends on both the core and peripheral debt markets, which firmed considerably despite the "no" vote in the Greek referendum, mainly due to the market turmoil in China. Consequently, the 10Y benchmark yield fell temporarily below 3%, for the first time since the beginning of June. However, the end of the week brought some profit taking.

- Both curves flattened over the past week, with the 2-10Y spread narrowing to 121 bp for the T-bonds and 87 bp for the IRS, the lowest levels since May. What is more, the spread over Bunds tightened visibly, reaching 217bp for the 10Y sector, the lowest since May.

- Poland's Finance Ministry successfully launched floaters at its first regular tender in July. It sold WZ0120 and WZ0124 worth PLN2.43bn in total (with the total demand at PLN4.64bn at both the regular and top-up auctions). In our opinion, the offer mainly attracted domestic interest. After the auction, the ministry has covered c74% of the 2015 gross borrowing needs.

### Fragile investor sentiment to weigh on domestic curves

- This week's domestic macro calendar is heavy with important releases, including CPI, industrial output and retail sales. In our view, these data should reaffirm the healthy growth of Poland's economy and the gradual rebound in the inflation rate. In our view, signals of further improvement of the economic outlook could adversely affect the domestic fixed-income market, in particular the long-end of the curves.

- Investors are likely to continue to focus on external factors, including the EU summit on Greece and macro data releases for both the European and the U.S. economies. In our view, proposals sent by Greece increase the chances of an agreement during the weekend. If this proves true, then the risk of a Grexit would fall considerably, at least for some time, which could lead to improved sentiment and a fall in risk aversion. As a consequence, we could see Poland's assets firming again, but this would likely only be short-lived as investor focus would shift onto other external factors (China, Fed), weighing on the domestic curves.

- As regards other key events, investors will focus on the ECB meeting and macro data releases, especially from the U.S. The ECB could mainly concentrate on Greece and any decisions about further liquidity assistance would be closely monitored. What is more, further strengthening of the U.S. economy might uphold expectations of rate hikes this year, weighing on the long-end of the curves' valuation.

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