WEEKLY ECONOMIC UPDATE

27 July – 2 August 2015

The past week's macro calendar was very light for Europe and the U.S. and so there have been no breaking changes in the FX and FI markets. EURPLN and USDPLN stayed in their horizontal trends, while the Polish yields and IRS remained close to the previous week's closing levels. The euro gained slightly vs. the dollar thanks to more positive news on Greece (further reforms approved by the parliament, new bridge financing rumored to be discussed by the EU) and despite the positive U.S. data. The Polish labour market data was rather mixed. The June unemployment rate dropped more than expected, but detailed data confirmed that some mismatch on the labour market could generate an upside risk for wage pressure in the coming months.

FOMC decision and the statement will be in the spotlight this week. We and the market do not expect a rate change already this week, so the statement should be key. We think it is worth bearing in mind that crucial U.S. data are due between now and mid-September (when the market expects the first rate hike), including the 1st and 2nd estimates of 2Q15 GDP and two monthly non-farm payroll reports. Having such important data on the horizon, we do not think the FOMC will allow itself to convey a very straightforward message to the market in the post-meeting statement. In our view, its tone will rather be cautious, leaving the decision on rates very data-dependent. This, in turn, could support the EM currencies, including the zloty, and the other risky assets, like Polish bonds. At the same time, a not too hawkish of a statement might hit the dollar in the global market. Poland's Ministry of Finance will announce this week its issuance plan for August. Given the current level of financing of the 2015 borrowing needs, we expect a flexible approach to the offer. We do not expect any significant changes in the supply, initially planned at PLN1-2bn.

Economic calendar

CZAS W-WA	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 July)					
10:00	DE	Ifo index	Jul	pts	107.5	-	107.4
14:30	US	Durable goods orders	Jun	%MoM	3.0	-	-2.2
		TUESDAY (28 July)					
16:00	US	Consumer confidence index	Jul	pts	100	-	101.4
		WEDNESDAY (29 July)					
16:00	US	Pending home sales	Jun	%MoM	1.1	-	0.9
20:00	US	FOMC decision		%	0.0-0.25	-	0.0-0.25
		THURSDAY (30 July)					
14:30	US	Advance GDP	Q2	%QoQ	2.5	-	-0.2
14:30	US	Initial jobless claims	week	k	-	-	281
		FRIDAY (31 July)					
11:00	EZ	Flash HICP	Jul	%YoY	0.2	-	0.2
14:00	**PL**	**Inflation expectations**	**Jul**	**%YoY**	**-**	**-**	**0.2**
16:00	US	Michigan index	Jul	pts	94.0	-	96.1

Source: BZ WBK, Reuters, Bloomberg

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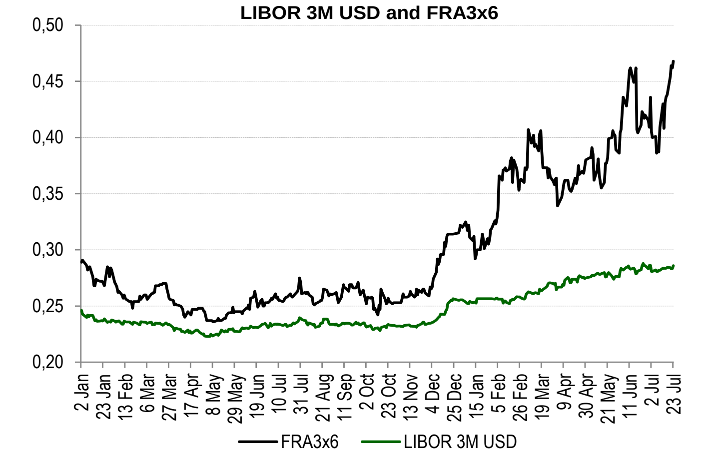
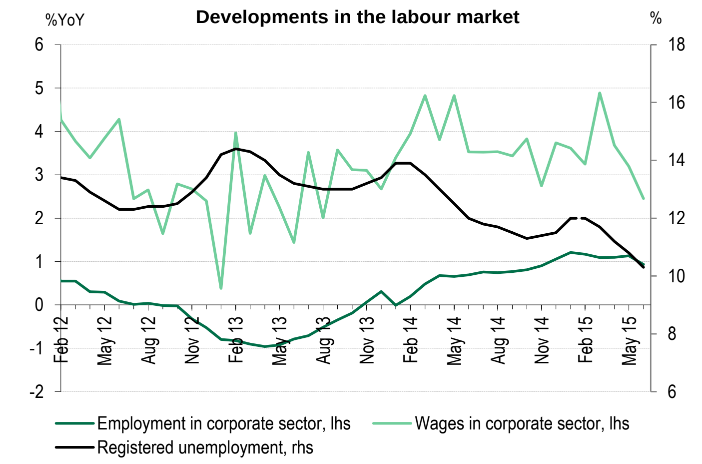
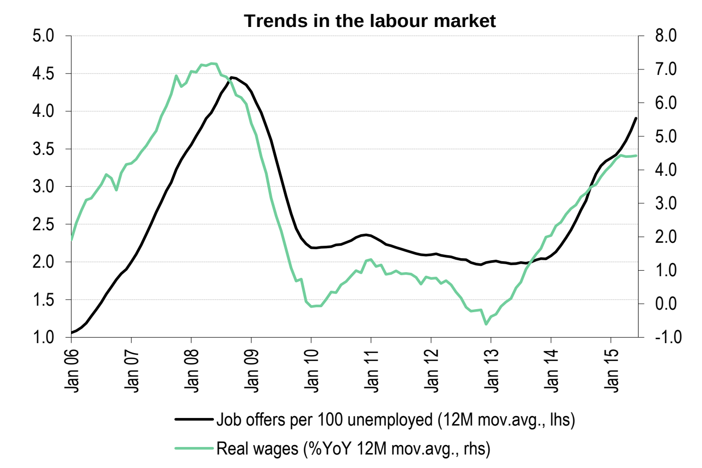
What's hot this week – FOMC decision in focus



- The FOMC meeting is this week's main event. There seems to be a consensus that rates will remain unchanged this month as Janet Yellen once said that it would be good to have a press conference after the rate hike to elaborate on the decision (the next conference is in September).
- The U.S. money market rates have clearly been on the rise already since late 2014 and the FRA3x6 indicates that the 3M U.S. LIBOR (currently at 0.30%) will be at c0.50% in October. According to Bloomberg, the vast majority of analysts expect at least a 25bp hike in September.
- This month the Council's statement is likely to prepare the market for the possible change in rates at the next meeting. As investors seem to have already priced in a September hike, the post-meeting statement could impact the market only if it sounds less hawkish than expected.

Last week in the economy – Mixed signals from the labour market





- The June unemployment rate dropped to 10.3% from 10.8%. We and the Labour Ministry had expected a smaller improvement (10.4%). But it turned out that nearly 80k people found a job last month and this was the best result for June since 2007. At the same time, the number of the unemployed was the lowest since December 2008.
- Recall, however, that the June data on corporate sector employment was disappointing, growing only 0.9% YoY, the weakest pace so far this year. Detailed data showed that employment in the industrial sector grew 1.3% YoY (with a 2.4% YoY increase in manufacturing and a nearly 7% YoY decline in mining) and that the decelerating trend continued (in 1Q the pace of growth was at 1.7% YoY). As for the remaining sectors, there seems to be no worrying signals for now.
- We have been suggesting already for some time that the pace of improvement in the labour market was fading with the employers having trouble finding a qualified workforce (and this may lead to an upward wage pressure). In June, the average number of job offers was c.2.5k lower than in May (119.9k vs. 122.3), but it was still well above the long-term average (well below 100k). At the same time, the number of people removed from the unemployment statistics due to finding a job fell nearly 6k MoM.
- June's wage growth in the corporate sector was well below the consensus (2.5% YoY vs. 4.1% YoY). This stemmed from the significant deceleration in wage growth in the industrial sector (to 0.8% YoY from 2.4%YoY) due to contracting wages in mining (by c11% YoY). In general, wage growth in corporates slowed in the entire 2Q15 to c3%YoY from nearly 4%YoY in 1Q15. The pace of the wage bill growth also slowed in both nominal and real terms. Notwithstanding, in our view, private consumption has stabilised slightly above 3% in 2Q15.

Quote of the week – Further rate cuts could be dangerous

Marek Belka, the NBP governor, 22.07.2015, Poland's parliament

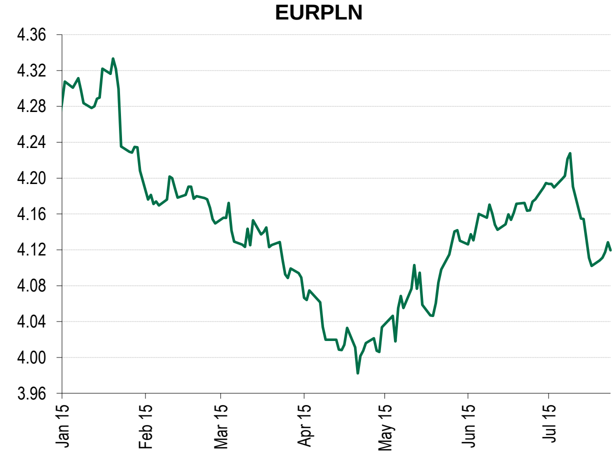
I think that our monetary policy supported economic growth, increased confidence in the zloty and we avoided imbalances and instability. […]

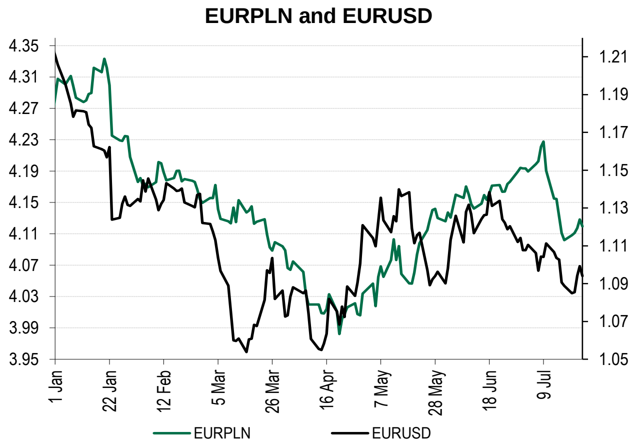
If lower rates could have delivered inflation closer to target, yet further cuts could have been dangerous for the behavior of bank depositors. Lower rates would reduce government borrowing costs, but wouldn't likely bear the same punch on private sector lending. […]

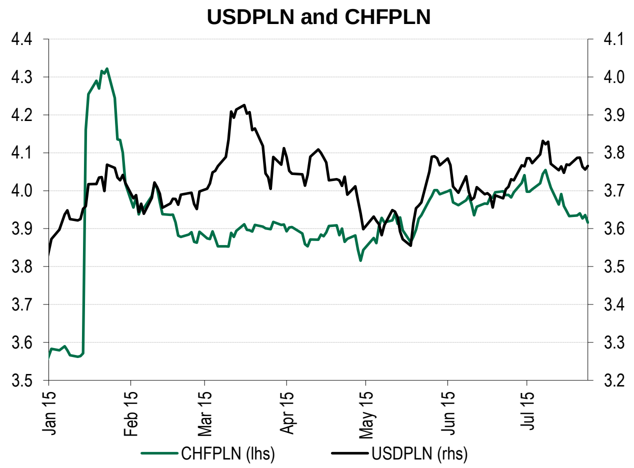
Falling prices would generate worries of a deflationary spiral if wages were coming down in turn, but wages have "started to rise notably" from last year.

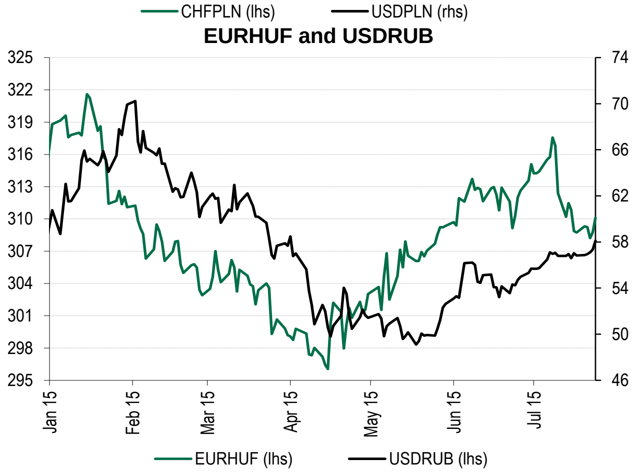
NBP governor Marek Belka pointed out in his testimony to the Sejm that Poland's interest rates should not be reduced further. Even though inflation was still far from the NBP's target (2.5% +/- 1pp), lower rates could be dangerous for the economy, he said. Belka highlighted that that the MPC needed a balanced approached to interest rates in order to prevent bigger deposit outflows. He added that the Council was currently unanimous that rates in Poland should remain stable in the coming quarters. However, the market has started to price in a re-launch of easing, supported by a slower inflation pickup, an IMF report suggesting more easing may be needed and the opposition's (PiS) call for a more supportive central bank. Such risk exists, but we believe that a longer period of stable rates seems to be the more likely scenario.

Foreign exchange market – FOMC rhetoric crucial









FOMC could support EM currencies

- EURPLN snapped a two-week long decline and the zloty depreciated marginally vs. the euro. The domestic currency was hit by a profit-taking mode, but then recovered slightly thanks to the forint's appreciation vs. the euro (more details on this below). All in all, EURPLN stayed within the 4.10-4.14 range for the last five days and, when compared to levels seen at the end of the past week, the zloty was the 3rd best performing currency vs. the dollar and the euro (after the Ukrainian hryvnia and Czech koruna).
- The second chart shows that EURPLN and EURUSD have been moving in the same direction so far this year. However, we think that this correlation could fade in the coming days with the FOMC decision in the spotlight. We and the market do not expect a rate change already this week, so the statement should be key. We think it is worth bearing in mind that crucial U.S. data are due between now and mid-September (when the market expects the first rate hike), including the 1st and 2nd estimates of 2Q15 GDP and two monthly non-farm payroll reports. Having such important data on the horizon, we do not think the FOMC will allow itself to convey a very straightforward message to the market in the post-meeting statement. In our view, its tone will rather be cautious, leaving the decision on rates very data-dependent. This, in turn, could support the EM currencies, including the zloty. At the same time, a not too hawkish of a statement might hit the dollar in the global market. Should our scenario materialise, EURPLN and USDPLN could test their local lows at c4.10 and 3.71, respectively.

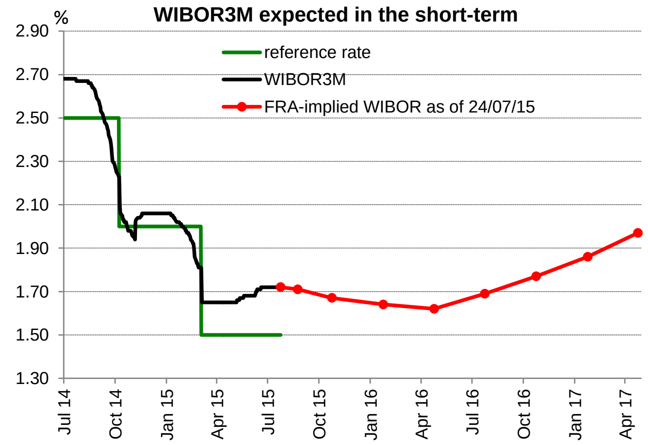
Dollar could lose vs. euro

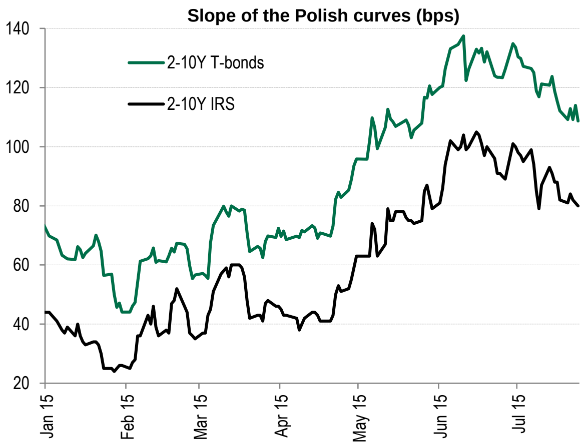
- EURUSD rose marginally last week to 1.10 from 1.08 on the back of more positive news on Greece (further reforms approved by the parliament, new bridge financing rumoured to be discussed by the EU) and despite the positive U.S. data.
- The outcome of the FOMC meeting is likely be in the spotlight this week. Just like we already wrote in the PLN section, we do not expect the post-meeting statement to be excessively hawkish and this could be somewhat disappointing to the market. Thus, we would rather expect the dollar to depreciate vs. the euro this week. Still, the scale of a EURUSD upside move is likely to be limited by the still unresolved Greek case.
- The first resistance is at 1.11, then at 1.14. Support levels are at 1.08 and 1.05.

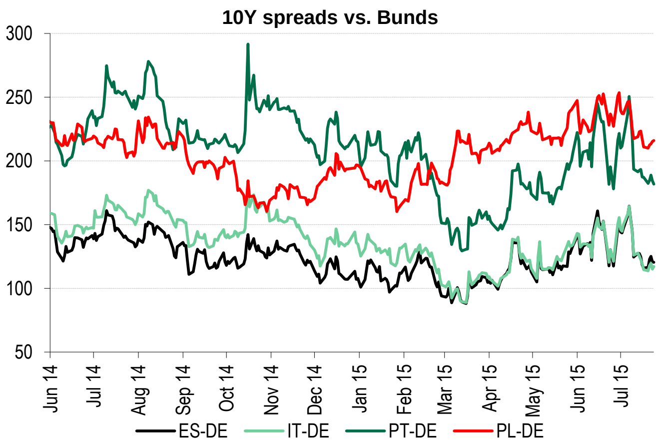
MNB ends easing cycle, EURCZK close to 27.0

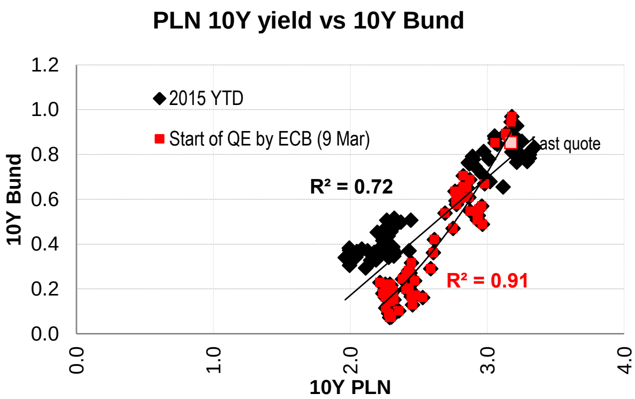
- The Hungarian central bank (MNB) surprised the market by cutting interest rates by 15bp (the main rate to 1.35%), more than expected. Still, the statement read out by the MNB governor at the extraordinary press conference was more important than the rate cut itself. Governor Matolcsy said that this was the end of the easing cycle and that interest rates would remain low for some time. The closing of the rate cuts cycle had a positive impact on the forint — EURHUF plunged to 307, its lowest level since late May. However, the Hungarian currency did not manage to stay this strong and the exchange rate rebounded to 310 at the end of the week.
- At the same time, EURCZK is still flirting with the 27 floor. The Czech central bank has already intervened once in July and we think more activity is likely in the next days.
- The falling price of crude in the global market continued to have a negative impact on the ruble. The Russian currency depreciated to more than 58 per dollar, its weakest since early March. The past week was already the 5th week in a row of a rising USDRUB and we think there is still more upside potential.

Interest rate market – Holiday period may add to market volatility









Money market mixed, yields in horizontal trend

- The situation on the money market was mixed the past week. WIBORs stayed unchanged, while FRAs, up to 12 months, continued their gradual decline. The current levels of FRA6x9 and FRA9x12 imply that the 3M WIBOR might fall c10bp in 6-9 months' time.
- At the same time, the T-bond yields and IRS rates were vulnerable, reacting strongly to changes on the core and peripheral markets. Yields fell quite visibly at the beginning of the week, supported by the gaining core markets. But they rose in mid-week ahead of the regular auction. Despite the favourable auction results, the 10Y benchmark rose slightly above 2.90% just to recover again at the end of the week. Poland's bonds underperformed the Bunds and, as a consequence, the spread over the Bunds slightly widened (to 215bp), though still stayed well below its maximum level reached at the end of June (253bp).
- Changes in yields and the IRS rates were muted over the past week. The long end of the curve performed better than the front, which caused a gradual flattening of the curves echoing the global trend.
- The last regular auction of this month was successful. The Ministry of Finance sold PLN5.85bn of PS0420 and DS0725 bonds (with PLN3-6bn on offer). Demand stood at PLN7.56bn, with yields reaching 2.355% and 2.891%, respectively (close to bids on the secondary market). Demand was supported by inflows from the OK0715 redemption and interest rate payments worth cPLN11bn in total. After the auction, this year's borrowing need are now covered in c78%.

Global factors still in spotlight

- This week's domestic macro calendar is nearly empty – only inflationary expectations will be released, but their impact on the market is very limited. It will, therefore, be global factors that will play the main role, determining market trends in the upcoming days. The FOMC meeting will be the main event. It is broadly expected that the Fed's fund rates will remain unchanged this month, but expectations for a hike in September have increased after strong U.S. macro data. In our view, the Fed will be cautious in its announcement of the monetary tightening launch, with the post-meeting statement roughly similar to June's. This should support the domestic assets' valuation near their current levels. However, after the meeting, the U.S. GDP data for 2Q15 will be released. A strong outcome of the first GDP reading might cause some profit taking.
- Recent weeks confirmed there was a strong positive correlation between the Polish and German 10Y yields. This is why higher yields on the core markets will translate into higher yields of the Polish T-bonds in the medium to long term. In the short term, we expect a horizontal trend in both yields and the IRS rates. However, the holiday period and the resulting low liquidity could add to market volatility in the upcoming weeks.
- The Ministry of Finance will announce this week its issuance plan for August. Initially, the Ministry had planned only one regular auction next month worth PLN1-2bn. Given the current level of financing of the 2015 borrowing needs, we expect a flexible approach to the offer. A variety of bond series is possible, but we think that the current market situation still favours fixed-rate instruments rather than floaters, though the later could appear at the special request of investors. We do not expect any significant changes in the supply.

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