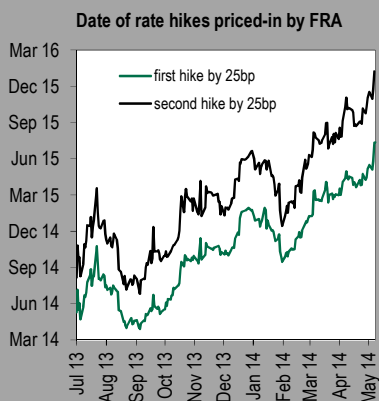
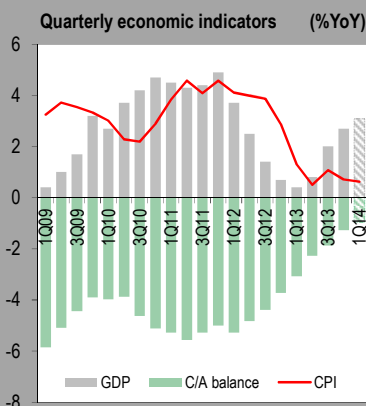


MACROscope

Polish Economy and Financial Markets

May 2014

ECB waits until June, MPC until July



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■ **Recent economic data for Poland was a mixed bag.** Some data came in below expectations (PMI, industrial output, retail sales, exports), while others exceeded forecasts (construction output, employment and wage growth). In our view, most of the negative surprises resulted from one-off disturbances, and the general picture has not changed much – the economy is on a path to a gradual recovery and we still expect GDP growth to accelerate from c3%YoY in 1Q14E to nearly 4%YoY in 4Q14E. The effect of the crisis in Ukraine on Poland's economic growth is not yet visible (although it is negatively affecting companies' moods, as reflected in the PMI survey) and the impact is likely to be relatively small, as long as the growing tension between Russia and the West does not stop the recovery in the Euro zone.

■ **Inflation stays low and should remain subdued for the better part of the year.** The headline CPI number probably touched bottom in 1Q14 and a steady upward move in the coming months is likely to be led mainly by a statistical effect. However, we think CPI growth should start accelerating more strongly in 4Q, as growing domestic demand could put some pressure on retail prices and, on top of that, food prices might bottom out rapidly. The risk for our CPI forecast is still on the downside and comes from external factors, including a Russian embargo or low commodity prices.

■ **Central banks in Poland and in the Euro zone decided to wait for new updates of economic forecasts before making any adjustments to their monetary policies.** In the case of the Polish Monetary Policy Council (MPC) it means staying in dormant mode until July (the moment of possible interest rate hike priced-in by the market is still moving away and was recently was delayed until 2H15 – see margin chart). Meanwhile, the ECB has clearly signalled it may apply additional monetary stimulus already in June as low inflation and a strong euro are increasingly worrying and may derail the economic recovery process.

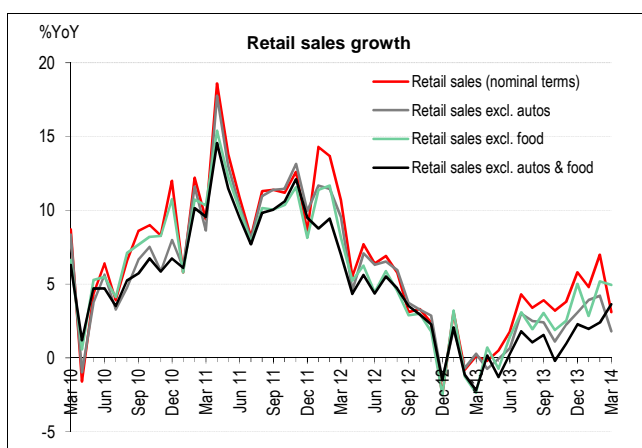
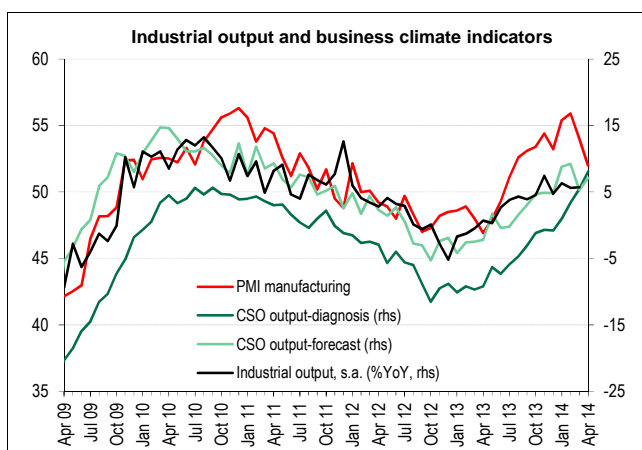
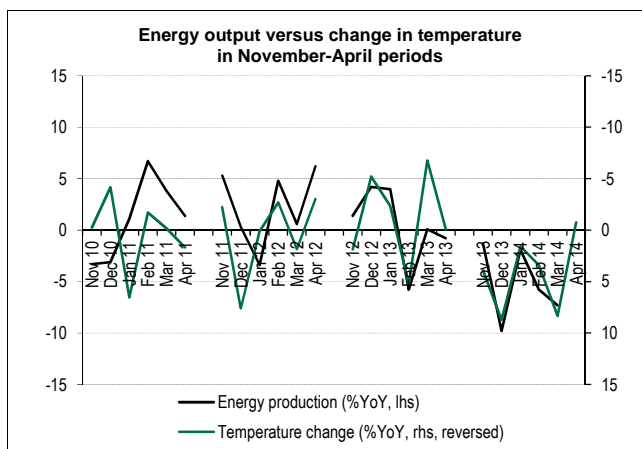
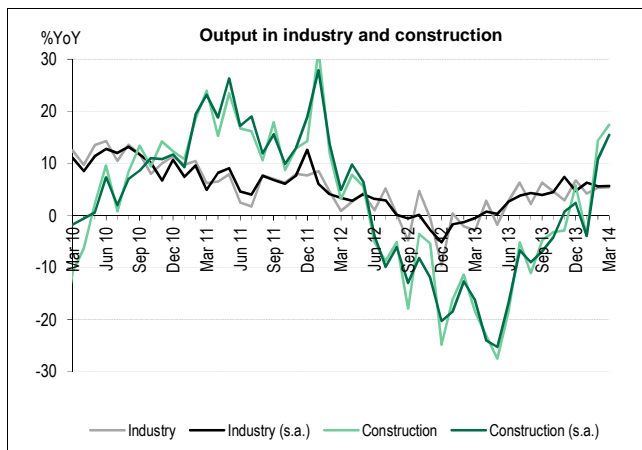
■ **We think ECB policy and the situation in Ukraine are the main factors influencing Polish FX and debt markets.** On one hand, possible ECB actions in June should keep yields low and strengthen the zloty. On the other hand, any escalation of the Ukrainian conflict may cause moves in the opposite direction. In the medium term, we still uphold our scenario of an appreciating zloty and rising yields across the board. However, the increase in yields may be slower than we previously expected and should be more visible only in the last quarter of the year, when economic activity shows more strength and CPI inflation gets closer to the inflation target.

Financial market on 9 May 2014:

NBP deposit rate	1.00	WIBOR 3M	2.72	EURPLN	4.1787
NBP reference rate	2.50	Yield on 2-year T-bond	2.85	USDPLN	3.0247
NBP lombard rate	4.00	Yield on 5-year T-bond	3.45	CHFPLN	3.4292

This report is based on information available until 9.05.2014

Economic update



Source: CSO, Markit, BZ WBK

Weather influenced industry and construction in March

- Growth of industrial output accelerated in March to 5.4%YoY (vs 5.3%YoY in February) and was below forecasts. It seems that this disappointment was again largely due to the weather effect, as weather conditions proved much better than a year ago (it was cold and we had a heavy snowfall in March 2013). Consequently, the output in the energy supply sector plunged substantially for a second month in a row (-7.3%YoY) and weighed on the overall performance of industry. If we only consider manufacturing output data, a strong growth level has been recorded (7.7%YoY, the highest since January 2012) confirming that this sector is still expanding.

- On the other hand, construction and assembly output clearly surprised on the upside (17.4%YoY). In this case, weather conditions provided a visible boost. Nevertheless, the scale of improvement suggests that the activity in construction is actually improving, also probably due to higher investments.

PMI disappoints but CSO indices go up

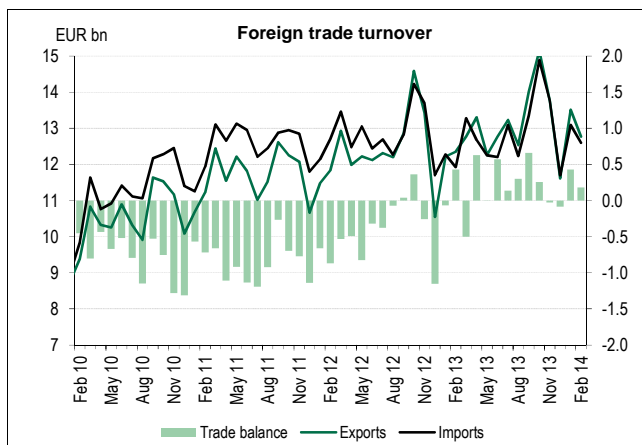
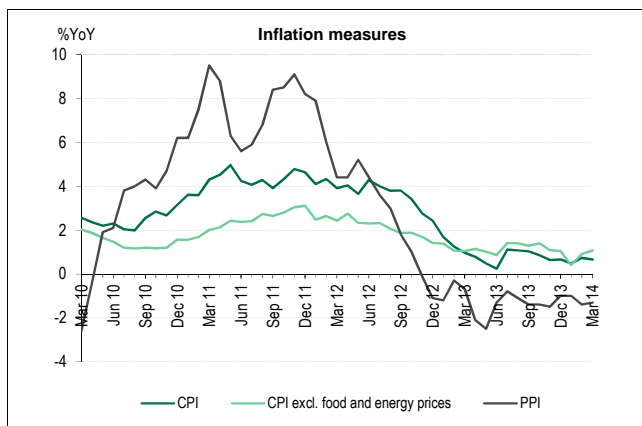
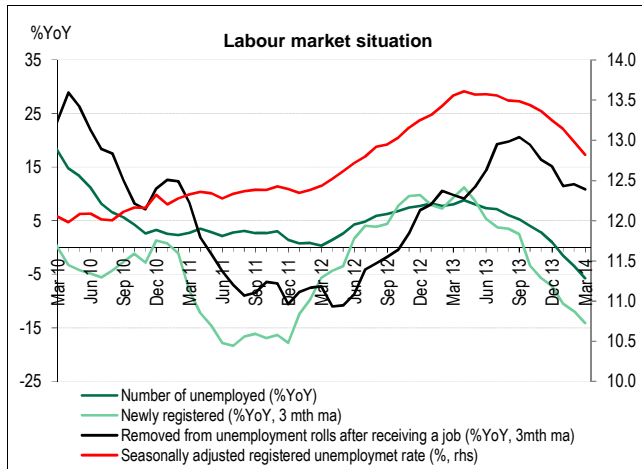
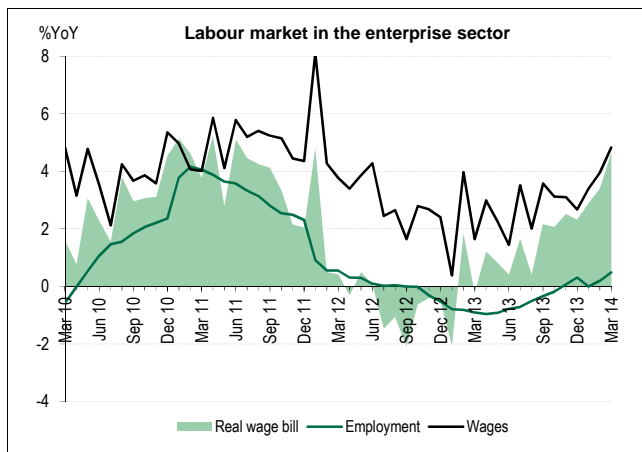
- PMI index for Poland also proved disappointing. In April, it fell to 52pts from 54pts in the previous month. This was the lowest reading since July 2013. Declines were posted by 4 out of 5 PMI sub-indices, which might have partly resulted from negative impact of the uncertain situation in Ukraine on managers' expectations. The Index for new export orders also declined. This is another warning signal indicated by the PMI index about Polish economic prospects. On the other hand, in our view the index was at exaggerated levels in the preceding months and even after the considerable correction in March and April, the current PMI level is still in line with industrial output growth of over 6%YoY. Moreover, business climate indices calculated by the Polish Central Statistical Office (CSO) are still moving in an upward direction – index for manufacturing climbed to 6.6pts, ie, to the highest level since end of 2010. Nevertheless, the upcoming data on economic activity will be observed closely to see if they show any actual signals of weakening output growth.

Cars and Easter distorted retail sales

- March retail sales have fallen clearly below expectations, the pace of growth decelerated to 3.1%YoY (the lowest since June 2013). In our opinion, there have been two sources of this disappointment. First, too optimistic forecasts of automobile sales in the final month of VAT deductions related to purchases of personal cars registered as trucks; and second, underestimation of high base effect impact due to Easter timing, which were celebrated later this year vs 2013. We underscore the fact that due to the latter effect April's reading should be high and even close to a two-digit growth rate.

- Sales of motor vehicles, motorcycles and parts increased by 7%MoM and 12.3%YoY (vs 11.8%MoM and 24.9%YoY in February). Sales of food and non-alcoholic beverages dropped from +6.9%YoY in February to -7.3%YoY in March while other retail sales in non-specialised stores plunged by 3%YoY in March vs a 7.2%YoY increase in the previous month. These two categories are strongly connected to Easter shopping. Thus, retail sales excluding cars and Easter shopping posted acceleration to 4.0%YoY in March from 1.6%YoY in February. That is why we do not think March data deteriorate the outlook for consumption demand. The revival of the labour market is stronger than anticipated and has a positive impact on households' conditions and should support sales in the following months.

Economic update



Source: CSO, NBP, BZ WBK

Labour market data keep surprising on the upside

▪ Average employment in the corporate sector amounted to 5.515mn people and was by 0.5% higher than one year ago. At the same time, average wage growth accelerated to 4.8%YoY, which is the highest growth rate since January 2012, while the registered unemployment rate declined to 13.5% (and to 13.0% in April, the Ministry of Labour estimated). Labour market statistics were again significantly better than expected. It seems that Polish companies are growing more confident as regards economic prospects, and thus are more vigorously hiring new employees and are also gradually offering higher salaries.

▪ The number of jobs in the corporate sector increased by 7k vs February and this was the best March result since 2008. Similarly as in the previous months, this was mainly due to rising employment in the industrial manufacturing sector (+5k). Strengthening demand for jobs is probably due to gradual rise of investment activity.

The seasonally adjusted registered unemployment rate already started to tend downward in July 2013, but recently this figure began to surprise on the downside. Please note that the growth rate in the number of persons finding jobs (and thus exiting unemployment rolls) has stabilised at the high double-digit levels. Furthermore, the growth rate for newly registered jobless claims has continued declining. It suggests a further decrease in the registered unemployment rate in the months ahead. We expect the registered unemployment rate to fall even below 12.0% in 3Q and below 12.5% in December.

▪ Further wage acceleration in March (4.8%YoY) after a surprisingly good result in February (4.0%YoY) is also optimistic. Every month, the flow of labour income to households is growing stronger. Given still low inflation this should enhance households' purchasing power and translate into acceleration of private consumption.

Nothing new regarding inflation (so far)

▪ In March, the CPI inflation remained at 0.7%YoY. Price increases suffered downwards pressure caused by declines in pork prices (-3.2%MoM), probably as effect of Russia's embargo on this kind of meat. Inflation excluding food and energy prices amounted to 1.1%YoY and PPI inflation stood at -1.3%YoY.

▪ Data confirmed that there is no inflationary pressure on the Polish economy. In the upcoming months CPI should remain at low level, below 1%. However, we are expecting it to increase towards 2% at the year-end, among other factors due to higher consumer demand, low base effect and rising food prices. Pork prices began to climb again in April, as shown by data of the Ministry of Agriculture.

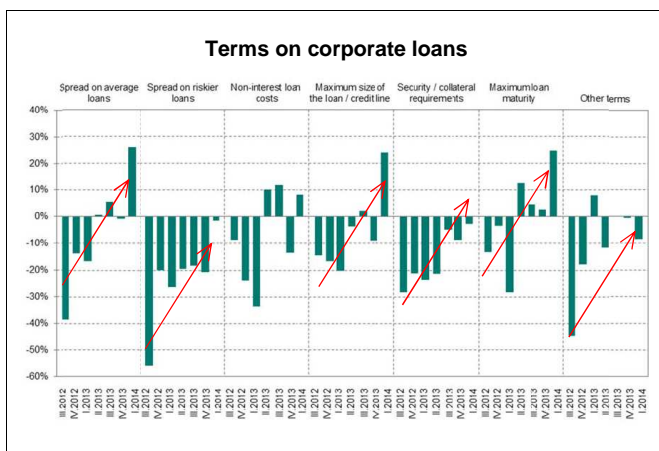
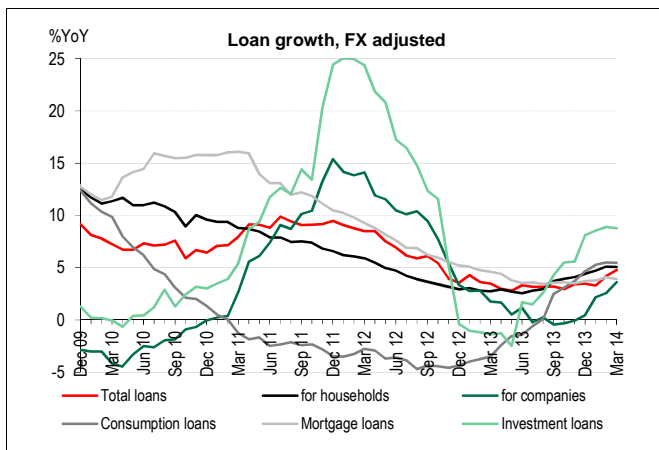
▪ External factors, including the risk of deflation in the euro zone and prolonging Russia-Ukraine conflict are generating risk of lower inflation.

Foreign trade disappointed, but this was probably a one-off

▪ February's current account deficit reached €572mn. The biggest disappointment came from the trade data. Correction in trade volumes (-5.5%MoM in case of exports and -3.8%MoM for imports) seems to be too big to be fully explained by the situation in Ukraine. It is also worth noting a divergence between the pace of export growth and the annual change to industrial output. It may suggest that February's weakening is only a one-off phenomenon rather than a signal of more persistent deterioration in foreign trade. Such an interpretation is also supported by anecdotal evidence from transport companies.

▪ The Polish central bank has revised the January data – the current account deficit was lower than initially released (€-825mn vs €-1135mn). Consequently, the 12-month rolling total current account deficit reached a mere -1.1% of GDP in January and February.

Economic update



Rising demand for loans, mainly from companies

- The loan market recovery is gradually gathering steam. Total loan growth in the Polish banking system accelerated to 4.7% YoY in March, mainly due to an improvement in loans to companies (+3.6%YoY, the highest in 1.5 years). Demand for investment loans is still growing (up c9% YoY) and entrepreneurs' demand for current loans is rising (although still slowly, by 1.1% YoY). Growth in loans to households stabilised at close to 5% YoY. Mortgage loans have expanded by 4% YoY for three quarters (after correction to eliminate FX fluctuations). Consumer loan growth, after an earlier acceleration, is slightly above 5% YoY.

- In 1Q, banks decided to improve the terms of loans to companies, according to the latest NBP survey of the credit market (lower margins, longer credit periods, higher maximum loan values). For the first time in two years, the assessment of portfolio quality contributed to easing credit conditions in this segment. Tightening mortgage credit criteria after the introduction of Recommendation S did not undermine the demand for housing loans. Banks are expecting further easing of credit conditions for short-term loans for companies and some easing of credit policy for households. They are also expecting a considerable increase of demand for corporate loans as well as mortgage and consumer loans in 2Q.

- In our view, the recovery we have seen in the loan market in recent months is likely to continue in the rest of the year, which would support faster economic growth and allow domestic demand to play an increasing role.

Monetary policy watch

Fragments of MPC communiqué after its May meeting

Growth in global economic activity remains moderate, although the economic situation varies across countries. (...) Moderate growth in global economic activity is conducive to maintaining low inflation in many countries.

Domestic economic activity data confirm a continuation of the gradual recovery in Poland. In March, industrial output and retail sales continued to rise, but more slowly than expected. At the same time, construction and assembly output picked up. Business climate indicators – despite some weakening in March – still point to further activity growth in the coming quarters. A gradual acceleration in economic activity is accompanied by moderate lending growth, both to firms and households. (...) The recovery is gradually translating into an improvement of labour market conditions. Employment in the enterprise sector is rising slowly, and unemployment is falling gradually. However, the unemployment rate is still high, which limits wage pressure in the economy.

In March, CPI inflation amounted to 0.7%, still significantly below the NBP's inflation target of 2.5%. Core inflation also remained low and producer prices continued to fall. This was accompanied by low inflation expectations.

In the opinion of the Council, the gradual economic recovery is likely to continue in the coming quarters, but inflationary pressures will remain subdued. Therefore, the Council decided to keep NBP interest rates unchanged. In the Council's assessment, NBP interest rates should be kept unchanged for a longer period of time, i.e. at least until the end of the third quarter of 2014.

Sources: NBP, BZ WBK.

Tone of the statement unchanged until July

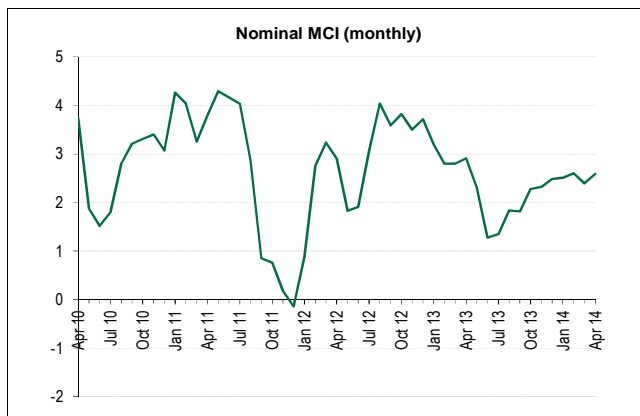
- The Monetary Policy Council (MPC) left the main parameters of monetary policy unchanged again. The reference rate remained at the all-time low of 2.50%, where it has been since July 2013. This decision was in line with expectations.

- The tone of its official statement did not change significantly from the previous one. The statement shows that the monetary authority is expecting a continuation of economic revival amid still low inflation pressures.

- The statement and comments of the MPC members suggest that no crucial changes in the authority's bias are to be expected. NBP governor Marek Belka clearly suggested at the last two press conferences that there is unlikely to be any change in tone until July at the earliest, when new National Bank of Poland (NBP) projections for GDP and CPI will be released. Recent comments suggest that this will be another extension of the forward guidance, until end of this year.

- It is possible that the Council will drop its forward guidance communication before the declared stable-rate period comes to an end, as accelerating economic recovery, driven by the domestic demand could lead to higher inflation in the medium term. Such a decision could be taken, for example, after approval of monetary policy guidelines for 2015 in September, or after the release of the NBP's projections in October. We still think that first rate hikes are likely to be in 1Q15.

Restrictiveness of the Monetary Policy (Council)



MCI returns to a gradual upward trend

- In April the MCI monetary policy restrictiveness index posted a slight increase, in line with our expectations. This change was due to the strengthening of the Polish currency, accompanied by a slight rise in money market rates.
- We are expecting the restrictiveness of monetary policy to increase in the coming months. This is likely to be supported by a rise in money market rates ahead of expected hikes in NBP interest rates and by the strengthening of the zloty on the back of improving economic prospects. However, market expectations about the date of the first hike are becoming more distant, while conflict between Russia and Ukraine could put pressure on CEE currencies. Thus, we see a risk of stabilisation or a decline of the index.



Rzońca (1.44)

Winiński (1.45)

Bratkowski (0.58)

Kaźmierczak (1.41)

Hausner (1.03)

Belka (0.96)

Zielińska-Głębocka (0.81)

Głapiński (1.38)

Chojna-Duch (0.73)

Osiatyński



Index is between 0 and 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights, more distant – lower.

Numbers directly by the name are values of the index for period since the beginning of current term of office of the current MPC and NBP governor.

Direction of the restrictiveness axis reflects our expectations regarding direction of interest rate changes in the nearest 12 months.

As there was no vote on the rate change for a long time, the positioning of MPC members on the axis is based mainly on our assessment, as we took into account comments of MPC members in recent period.

June conference likely to be “not very exciting” again

At the end of the press conference after the MPC meeting in May, NBP president Marek Belka said that June's conference is also likely to be “not very exciting”. Thus, he confirmed the scenario that we predicted in April's MACROscope. In April Belka hinted quite clearly that the change in the MPC's communication would be no earlier than July, after the release of new NBP projections on economic growth and inflation. This month he repeated this declaration, adding that even though current communication strategy seems effective, the MPC will not stick to this strategy forever and, at some point, the Council will want to change its forward guidance approach. Still, this is unlikely to happen soon. In Belka's opinion, making a long-term pledge on monetary policy would become risky and unreliable if the situation turned less stable and less predictable. That said, in July the MPC is likely to communicate with the market in the same way as currently.

Hawks not dead

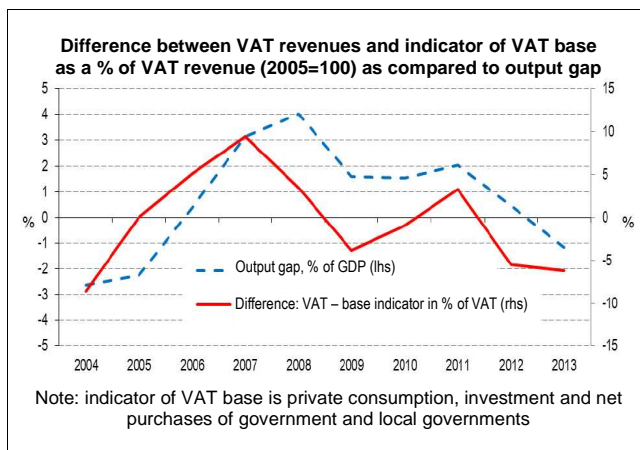
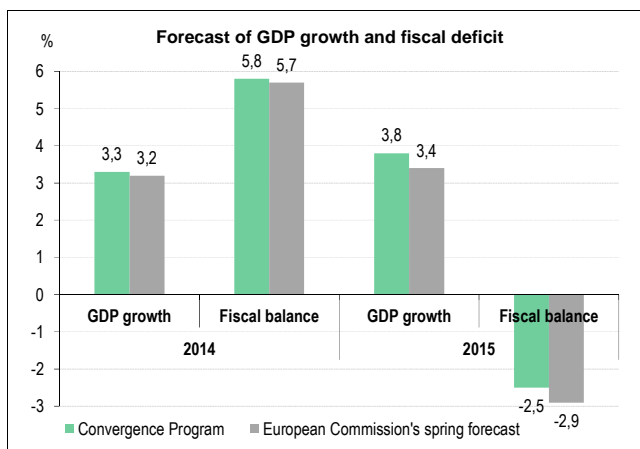
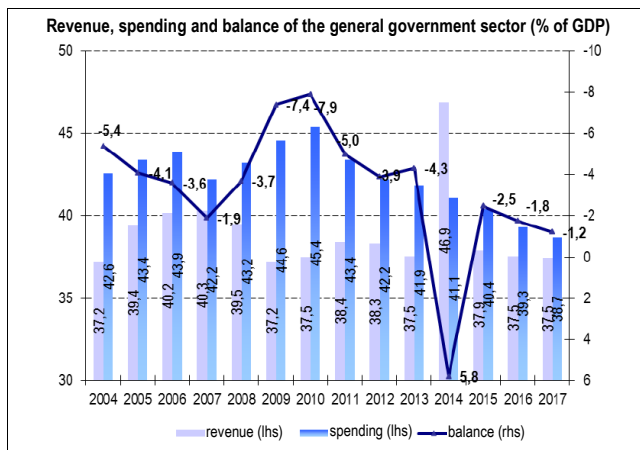
While vast majority of comments from MPC members in recent weeks were quite dovish, suggesting quite clearly that it is very likely (or even “practically certain”) that the MPC's forward guidance will be extended in July until the end of 4Q, two central bank hawks reminded us that their view is slightly different. Andrzej Rzońca and Andrzej Bratkowski did not rule a rate hike in 2014 and both pointed to GDP growth of more than 3.5% as one of conditions for such a decision (Bratkowski also mentioned faster wage growth). Still, these voices seem to be quite isolated (with the possible exception of Jan Winiński who probably has a similar opinion).

Interestingly, Marek Belka said after the last MPC meeting that there is a “very far-reaching consensus in the MPC as regards monetary policy”, and while there are some differences in views and opinions among members, these are very tiny discrepancies when it comes to policy decisions or, for example, the anticipated path of future interest rates.

Central bank sees higher growth, lower inflation

MPC members are quite optimistic as regards GDP growth forecasts. Most of them predict 3.5% or higher average growth in 2014, approaching 4% at the year-end. Marek Belka said at the post-meeting conference that the last NBP GDP projection (one of the highest in the market at 3.6% growth in 2014 and 3.7% in 2015) was not overly optimistic and that the forecasts of central bank experts, updated regularly every month, show a similar expansion rate. At the same time, those experts' forecasts suggest that inflation may be lower in the coming months than the last NBP's projection suggests. It seems to us that inflation will be the key factor behind the Monetary Policy Council's attitude in the following months and quarters. If CPI growth starts accelerating at the end of 4Q, in line with our predictions, and looks like breaking the 2.5% inflation target in 2015, then the Council will start mulling monetary policy tightening and the first rate hikes may indeed take place at the start of 2015.

Fiscal policy watch



	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	9.05	change since 10.04.14	change since 31.12.13	9.05	change since 10.04.13	change since 31.12.13
Poland	241	-5	4	71	-1	-7
Czech	30	-20	-28	59	1	-2
Hungary	380	-34	3	205	-27	-51
Greece	466	27	-195	87	7	51
Spain	144	-18	-76	86	-5	-68
Ireland	120	-18	-32	69	-18	-51
Portugal	204	-29	-205	159	-14	-188
Italy	147	-14	-67	110	-4	-59
France	44	-6	-5	46	-1	-8
Germany	-	-	-	21	0	-5

Source: Ministry of Finance, European Commission, CSO, Reuters, BZ WBK

Changes to OFE and GDP growth help fiscal consolidation

- Poland's fiscal consolidation stopped, with the general government deficit increasing to 4.3% of GDP (up from 3.9% of GDP the previous year). The increase came mainly from the unfavourable structure of GDP growth (the increasing role of net exports and the decline in domestic demand) and the low inflation rate.

- Poland's new Convergence Programme update assumes a general government (GG) surplus of 5.8% of GDP in 2014 (according to ESA95) due to the implementation of pension system reforms. It will be only a one-off effect and in the following years the public sector balance is likely to shift to a deficit, reaching -2.5% of GDP in 2015, -1.8% in 2016 and -1.2% in 2017, according to Finance Ministry's plan. At the same time, public debt should fall slightly below 50% of GDP this year and decline gradually in the following years towards 45% in 2017.

- The European Commission's spring forecasts are more cautious about Poland's fiscal consolidation. However, the performance of tax revenues at the start of 2014 suggests that GG balance may be even better than the government's target and we do not rule out Poland exiting the excessive deficit procedure already in 2015.

Risk of lower GDP offset by other factors

- The Convergence Programme Update 2014 is based on economic forecasts, which, in our view, are not unrealistic but are quite ambitious (except for 2014, which we think may be even slightly better than assumed in the programme). The government predicts GDP growth of 3.3% in 2014, 3.8% in 2015 and 4.3% in 2016-17.

- We think the risk to expected growth is more on the downside. The economic recovery in the Euro zone is still uneven and may be easily derailed by a threat of deflation, while the situation in Ukraine and a growing conflict between Russia and the West creates another threat to the economy (even though the direct impact on Poland may not be substantial, it could undermine growth in the Euro zone).

- While lower economic growth would negatively affect public finances, there are at least three reasons to believe that this would not necessarily mean a substantial deviation from the fiscal consolidation path set out in the Convergence Programme:

- First of all, the fiscal effect of pension system reform implemented at the start of this year will largely depend on the number of people opting to stay in open pension funds (OFE). The government's plans are based on the assumption that the opt-in ratio will be around 50%, while recent evidence suggests that the number of people choosing to stay in is very small. If the actual ratio were much smaller, it would have a positive impact on the fiscal balance.

- Secondly, the Convergence Programme assumes a simple linear relation between VAT revenues and GDP growth, while it may be argued that true tax elasticity is, in fact, strongly non-linear (as was evidenced in the recent economic downturn – see chart). That means that if GDP growth is slightly slower than predicted, the scale of tax revenue improvement in the economic recovery may be stronger than the Ministry of Finance assumes.

- A third factor, that may potentially offset negative surprises from GDP growth, is a possible improvement in tax collection in the medium term.

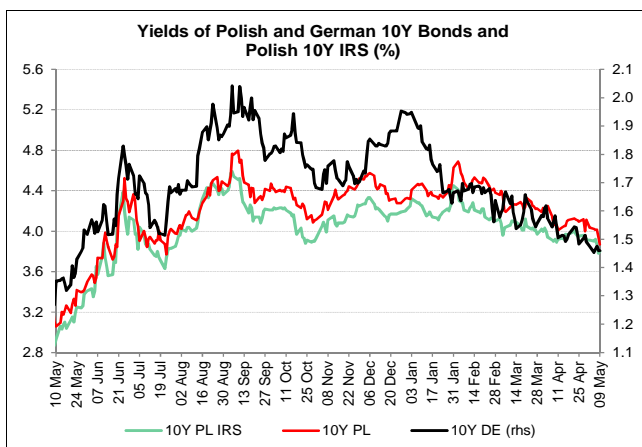
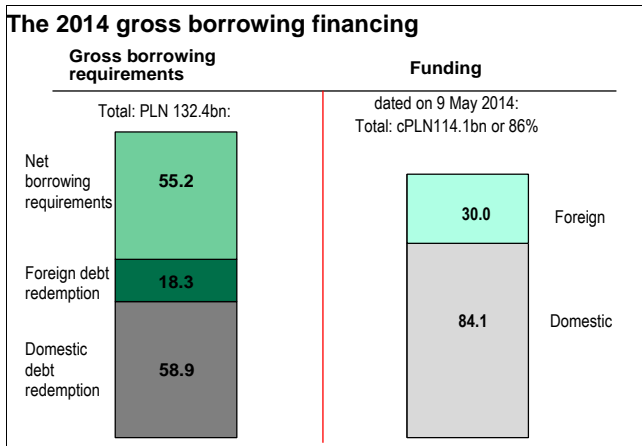
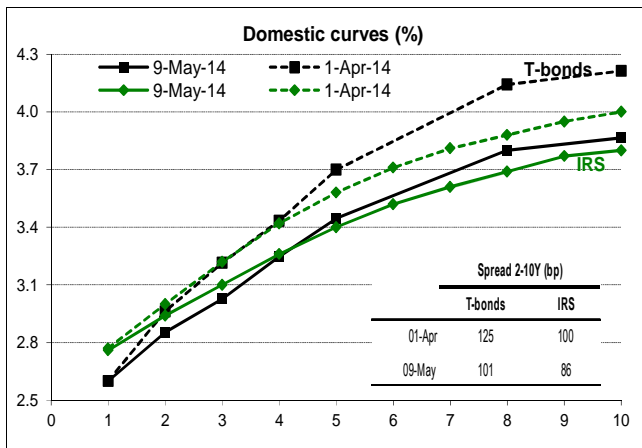
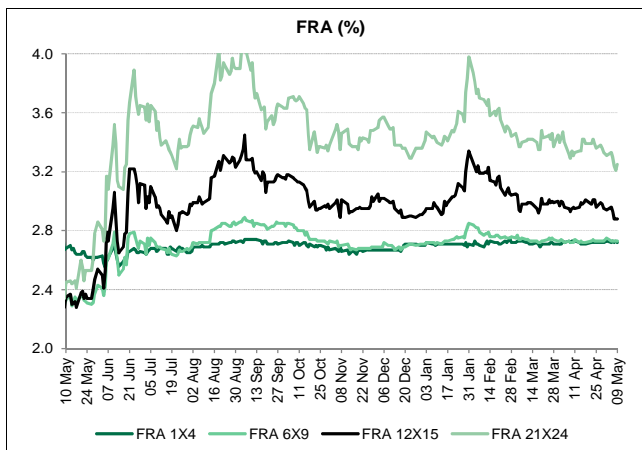
Possible ECB action drove yields down

- The core market continued to strengthen in April and early May. It was supported by expectations that the ECB would act after a lower-than-expected inflation reading, but also by heightened perceptions of risk from the conflict in Ukraine, which shifted capital towards perceived safe haven assets.

- Euro zone peripheral debt rallied substantially during that time, not only because of improving macro fundamentals, but also thanks to strong demand at primary auctions.

- The ECB's declaration that it will act in June should support core market and peripheral debt near current levels. However, we uphold our stance that yields will increase gradually at the end of the year.

Interest rate market



Source: Reuters, BZ WBK

Market revised expectations of rate hikes

- In April and early May, 1M-12M WIBOR rates increased by 1bp. The minor changes were on the back of the MPC's comments (declaration of stable rates until the end of 3Q14 and a strong possibility of that continuing until year-end) and low inflation.
- FRA rates, particularly longer-dated ones, were more volatile. Adjusting to the global situation (possible further easing by ECB in June) as well as the domestic scenario, longer-dated FRAs fell quite considerably. The narrowing of the FRA12x15-WIBOR3M spread to 16bp at the end of the first week of May suggests that investors doubt there will be a rate hike at the end of the first/beginning of the second quarter of 2015 and expect it instead at the beginning of 2H15. What is more, investors expect the 3M rate to increase by c50bp in 21 months' time, as compared to expectations of 75bp at the beginning of April.

- 3M WIBOR should stay near its current level in the coming weeks based on May's MPC outcome and expected macro data releases for April, which should confirm continuation of non-inflationary economic growth.

Strong performance of Polish debt

- T-bonds and IRS rallied quite significantly in April and the decline in yields and IRS rates deepened in the first week of May. This was driven mainly by: (1) expectations of more ECB monetary policy easing, (2) limited supply of debt from the Ministry of Finance, and (3) decent auction results. Consequently, bond yields and IRS rates dropped again and are now at their lowest levels since July 2013. Furthermore, the long ends of the curves shifted down more than the front and consequently, a bullish flattening scenario dominated investor sentiment. As result 2-10Y spreads dropped to c100bp for T-bonds and to 86bp for IRS.

- Favourable auction results also helped. There was strong primary market demand for T-bonds from both domestic and foreign investors. The ministry had covered around 86% of its 2014 borrowing needs after the first auction in May (see chart). The finance minister suggested that after June it might have covered 100%. We think this is quite likely.

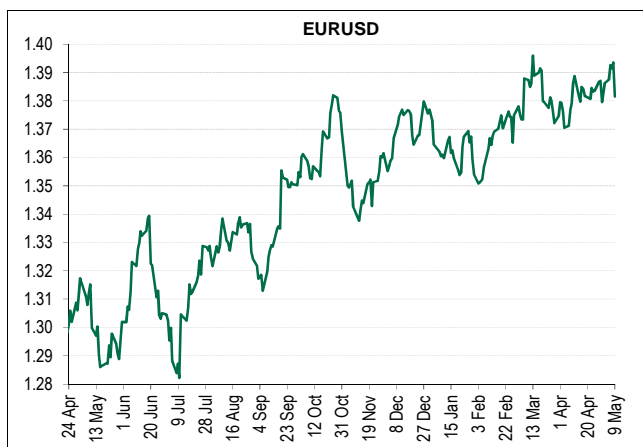
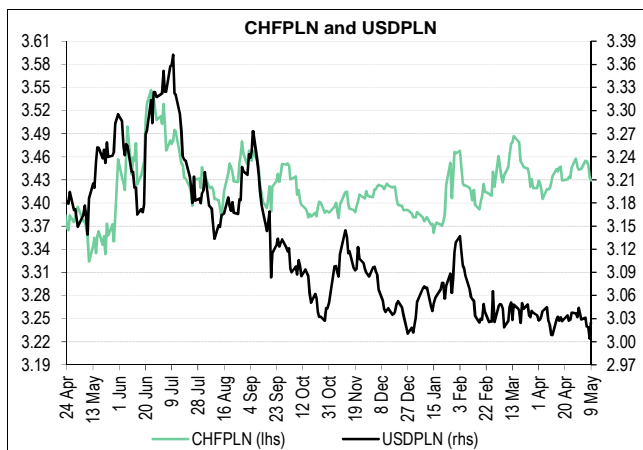
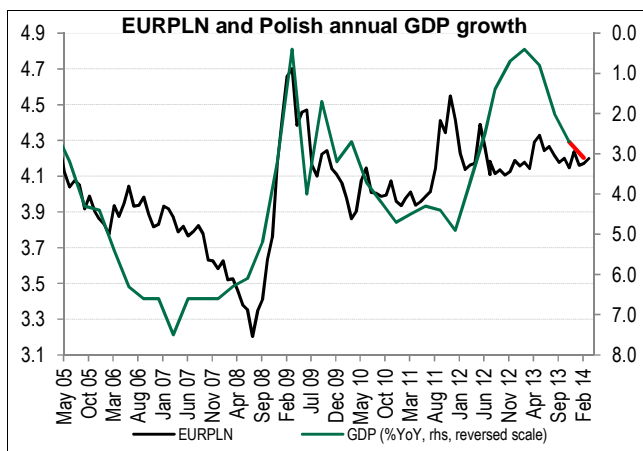
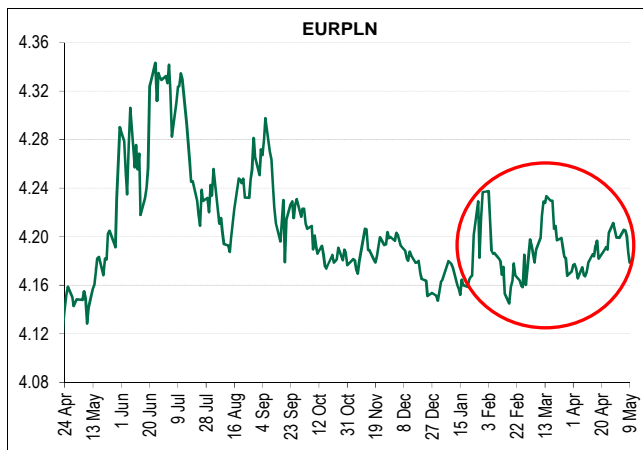
Lower yields than previously expected

- Recent weeks showed a positive correlation of the core market (i.e. German bonds) and the Polish debt market. This means that falling Bund yields drag domestic bonds yields lower. We think this trend should continue in coming weeks. Monthly domestic macro data should be also supportive: a gradual economic recovery and low inflation should not alter the monetary policy outlook.

- We think the ECB policy and situation in Ukraine are the main factors influencing investors' view of the Polish debt market. On one hand, possible ECB action in June should keep yields low. On the other hand, any escalation of the Ukrainian conflict may drive yields up. Taking into account all these factors, we expect yields and IRS rates to stay close to their current lows in the next month. We do not rule out their testing the bottom of the channel (i.e. this year's minimums), but the uncertain situation in Ukraine (a presidential election later this month) may limit their potential to fall further.

- In the medium term, we continue to expect yields to rise across the board. However, this increase is likely to be slower than we previously expected and should be more visible only in the last quarter of the year, when economic activity should be stronger and CPI inflation should be closer to the NBP's inflation target. Consequently, we have slightly reduced our yield forecast for the coming quarters and are expecting an increase in 10Y yield towards 4.30% at the end of the year.

Foreign exchange market



Sources: CSO, Reuters, BZ WBK

Bigger EURPLN move likely

▪ In April we suggested that the situation in the Polish FX market was similar to the changes we saw at the end of January. We said that after two weeks of appreciation vs the euro the zloty could reverse its trend. The next three weeks indeed saw a rebound of EURPLN (from 4.16 to nearly 4.22 – its highest since mid-March). The domestic currency was under pressure from concern over mounting tension in Ukraine. The EURPLN rate at the end of April was slightly above our forecast (4.20 vs. 4.18), but the average monthly rate was in line (4.18).

▪ In early May, the zloty pared over half the losses it had suffered since mid-April (it dropped to nearly 4.17) due to the ECB's rhetoric. The ECB president, Mario Draghi, said that more monetary policy easing may start in June if new inflation forecasts do not show any improvement. Inflation forecasts for the Euro zone released recently by the European Commission and the OCED have been revised downwards and we should expect the same with ECB forecasts due for release next month. Thus, expectations of further easing are likely to remain strong and should continue to support the zloty vs. the euro in the weeks to come.

▪ We think that Polish macro data may also underpin the zloty. Although our forecast for 1Q14 GDP growth is in line with consensus, if the actual release confirms an acceleration (to 3.1%YoY from 2.7% in 4Q13) this may back the domestic currency. Furthermore, our forecast of March's C/A balance is well above market expectations and may also work towards a lower EURPLN.

▪ However, the situation in Ukraine remains an important factor for the Polish FX market. The referendum in the Donetsk region showed that over 89% of voters were in favour of independence for this area. Ukraine, the EU and the US claim the referendum was illegal, but Russia said it respects the results. Consequently, developments beyond Poland's eastern border are likely to play a significant role, as they have in the past few months.

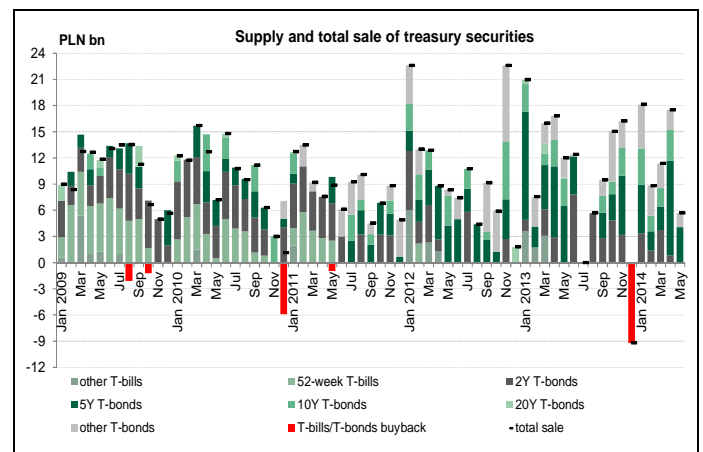
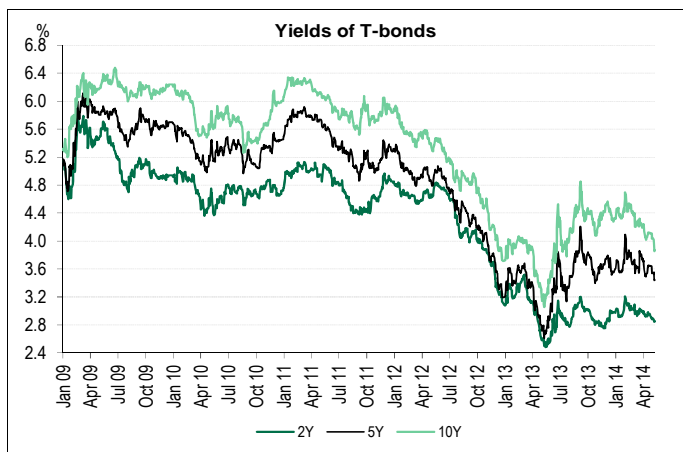
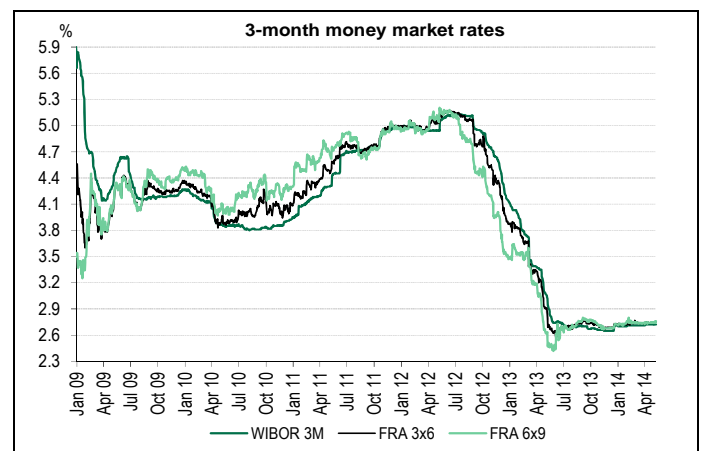
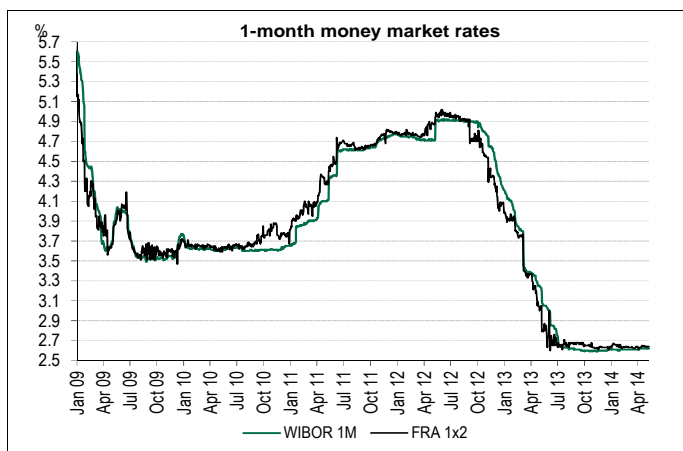
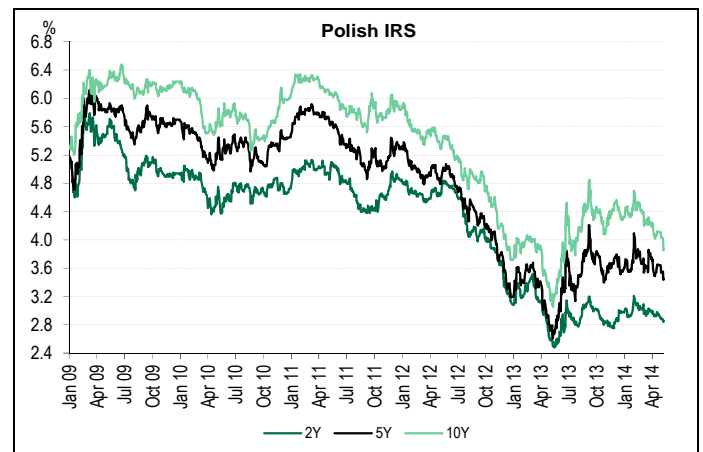
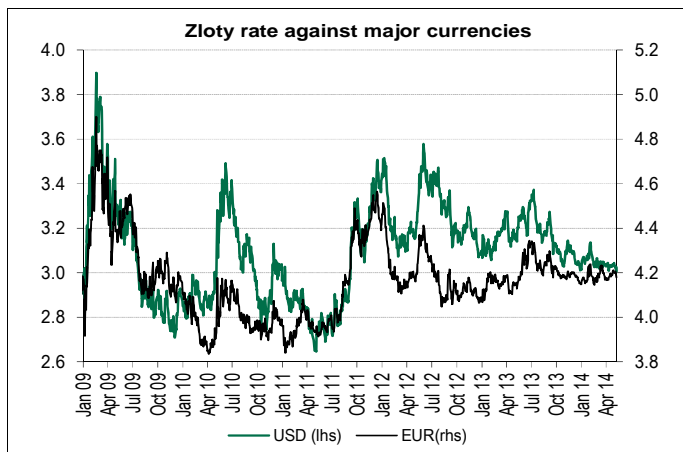
▪ We can see that the EURPLN trading range is narrowing gradually, suggesting that a more visible move may occur in the coming weeks. Before the ECB meeting, the exchange rate was close to the upper boundary of this range. However, it drifted away from this crucial level due to stronger expectations that the ECB will ease monetary policy in June. Thus, the risk of a noticeable depreciation of the zloty vs the euro has faded. Still, we continue to see potential for a significant move in the next two months. It seems that the impulse will come from the ECB or Ukraine. Breaking 4.20 would open the door to a return to this year's peak of 4.26, while falling below 4.15 may lead to the zloty's appreciation to 4.12 per euro. We expect both the average and end-of-period EURPLN levels to be at 4.18 in May.

Euro pressured by ECB rhetoric

▪ After only slight moves in the second half of April, early May saw considerable volatility in the EURUSD, triggered by the ECB rhetoric. A lack of ECB monetary policy easing in May pushed the exchange rate to nearly 1.40, a fresh 2014 peak. However, this move was soon reversed when Draghi suggested that some action may be taken in June. The single currency plunged vs the greenback, dropping to 1.375 in the following few days.

▪ Despite this significant move, EURUSD rate still remains in a 1.37-1.40 range. We see very limited room for a firm rebound of the euro in the coming weeks, but at the same time we think the EURUSD should not fall below this range. One should not forget that monetary policy easing in June is conditional and depends on the inflation trend presented in the ECB forecasts. Secondly, the market has already priced in some easing and, given the uncertainty about what action (if any) will be taken in June, investors' willingness to sell the EURUSD may be limited.

Market monitor



Treasury bond auctions in 2013/2014 (PLN mn)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
May '13	9.05	PS0718	3500-5500	6498.0	16.05	DS/WZ/WS	2000-6000	5505.4	19.06	OK0713/DS1013	
June	6.06	PS0718/WZ0119	3000-5000	4606.5							
July		-	-	-							
August	7.08	OK0116	3000-5000	5695.0							
September	5.09	OK0112/PS0718	5000-7000	5706.8					25.09	DS1013/OK0114	WZ0119/DS1023
October	3.10	PS0718	2500-4500	3008.0	22.10	OK0116/IZ0823/DS1023	6000-12000	12019.9	16.10	EUR20140203**	445.0
November	7.11	OK0116/PS0718	4000-7000	7964.2	13.11	USD20140115**	100	132.2	20.11	OK0114/PS0414	DS1023/WS/WZ/IZ
December									5.12	OK0114/PS0414	PS0416/WZ0119
January '14	9.01	PS0718/WZ0124	3000-5000	6013.0	23.01	OK/PS/WZ/DS	6000-10000	12129.7			
February	6.02	OK0716/WZ0119	2000-4000	4810.0	13.02	PS0718/DS1013	3000-5000	4011.0			
March	6.03	OK0716/WZ0119	2500-5500	6573.0					20.03	PS0414/OK0714	PS0718/DS1023
April	3.04	DS1023/WZ0119	3000-5000	5781.0	23.04	OK0716/PS1016/PS0718	5000-10000	11722.3			
May	8.05	PS0719/WZ0119	3000-5000	5694.2	22.05	IDS1024	1000-2000				

* with supplementary auction, ** buy-back auction, *** demand/sale,

Source: MoF, Reuters, BZ WBK.

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
12 May CZ: CPI (Apr)	13 HU: CPI (Apr) DE: ZEW index (May) US: Retail sales (Apr)	14 PL: CPI (Apr) PL: Money supply (Apr) EZ: Industrial output (Mar)	15 PL: Advance GDP (Q1) PL: Core inflation (Apr) PL: Balance of payments (Mar) GE. CZ. HU. EZ: Advance GDP (Q1) EZ: HICP (Apr) US: CPI (Apr) US: Industrial output (Apr) US: Philly Fed index (May)	16 US: House starts (Apr) US: Building permits (Apr) US: Flash Michigan (May)
19 PL: Wages and employment (Apr)	20 PL: Industrial output (Apr) PL: PPI (Apr)	21 US: FOMC minutes	22 PL: MPC minutes CN: Flash PM – manufacturing (May) DE: Flash PMI – manufacturing (May) EZ: Flash PMI – manufacturing (May) US: Home sales (Apr)	23 GE: GDP (Q1) DE: Ifo index (May) US: New home sales (Apr)
26 PL: Retail sales (Apr) PL: Unemployment rate (Apr)	27 HU: Central bank decision US: Durable goods orders (Apr) US: Consumer confidence index (May)	28	29 US: Preliminary GDP (Q1) US: Pending home sales (Apr)	30 PL: GDP (Q1) PL: Inflation expectations (May) US: Personal income (Apr) US: Consumer spending (Apr) US: Michigan index (May)
2 June PL: PMI – manufacturing (May) CN: PMI – manufacturing (May) DE: PMI – manufacturing (May) EZ: PMI – manufacturing (May) US: ISM – manufacturing (May)	3 PL: MPC decision EZ: Flash HICP (May) US: Industrial orders (Apr)	4 CZ: GDP (Q1) HU: GDP (Q1) EZ: PMI – services (May) DE: PMI – services (May) US: ADP report (May) US: ISM – services (May) US: Fed Beige Book	5 EZ: ECB decision DE: Industrial orders (Apr)	6 DE: Industrial output (Apr) DE: Exports (Apr) CZ: Industrial output (Apr) US: Non-farm payrolls (May) US: Unemployment rate (May)
9 CZ: CPI (May)	10	11 HU: CPI (May)	12 EZ: Industrial output (Apr) US: Retail sales (May)	13 PL: CPI (May) PL: Money supply (May) PL: Balance of payments (Apr) US: Flash Michigan (Jun)

Calendar of MPC meetings and data releases for 2014

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
ECB meeting	8	6	6	3	8	5	3	7	4	2	6	4
MPC meeting	7-8	4-5	4-5	8-9	6-7	2-3	1-2	19	2-3	7-8	4-5	2-3
MPC minutes	23	20	20	17	22	20	-	21	18	23	20	18
Flash GDP*	-	14	-	-	15	-	-	14	-	-	14	-
GDP*	-	28	-	-	30	-	-	29	-	-	28	-
CPI	15	14 ^a	14 ^b	15	14	13	15	13	15	15	13	15
Core inflation	16	-	14	16	15	16	16	14	16	15	17	16
PPI	21	19	19	17	20	18	17	20	17	17	20	17
Industrial output	21	19	19	17	20	18	17	20	17	17	20	17
Retail sales	24	24	25	24	-	-	-	-	-	-	-	-
Gross wages, employment	20	18	18	16	19	17	16	19	16	16	19	16
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	31	-	-	30	-	-	-	-	-	-
Balance of payments	17	12	17	11	15	13	14	13	-	-	-	-
Money supply	14	14	14	14	14	13	14	14	-	-	-	-
Business climate indices	23	21	21	23	22	23	22	22	22	22	21	19

* quarterly data. ^a preliminary data for January. ^b January and February; Source: CSO, NBP, Ministry of Finance, Reuters, Bloomberg.

Economic data and forecasts

Monthly economic indicators

		Apr 13	May 13	Jun 13	Jul 13	Aug 13	Sep 13	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14E	May 14E
PMI	pts	46.9	48.0	49.3	51.1	52.6	53.1	53.4	54.4	53.2	55.4	55.9	54.0	52.0	52.2
Industrial production	% YoY	2.8	-1.8	2.8	6.3	2.2	6.3	4.6	2.9	6.7	4.2	5.3	5.4	6.2	5.9
Construction production	% YoY	-23.1	-27.5	-18.3	-5.2	-11.1	-4.8	-3.2	-2.9	5.8	-3.9	14.4	17.4	24.0	23.8
Retail sales ^a	% YoY	-0.2	0.5	1.8	4.3	3.4	3.9	3.2	3.8	5.8	4.8	7.0	3.1	9.1	4.2
Unemployment rate	%	14.0	13.5	13.2	13.1	13.0	13.0	13.0	13.2	13.4	14.0	13.9	13.5	13.0	12.6
Gross wages in corporate sector	% YoY	3.0	2.3	1.4	3.5	2.0	3.6	3.1	3.1	2.7	3.4	4.0	4.8	4.3	5.8
Employment in corporate sector	% YoY	-1.0	-0.9	-0.8	-0.7	-0.5	-0.3	-0.2	0.1	0.3	0.0	0.2	0.5	0.8	0.9
Exports (€)	% YoY	11.0	0.3	5.4	7.4	2.8	9.0	3.8	2.3	10.1	10.7	3.4	10.3	11.4	11.4
Imports (€)	% YoY	1.6	-6.1	-1.9	3.1	-0.3	4.2	4.6	0.6	0.0	6.6	5.6	4.7	11.0	11.0
Trade balance	EUR mn	630	1	570	137	299	660	259	-25	-85	426	179	200	753	50
Current account balance	EUR mn	569	-176	100	-566	-618	-907	162	-803	-430	-825	-572	283	670	-158
Current account balance	% GDP	-2.8	-2.8	-2.3	-1.9	-1.9	-1.9	-1.7	-1.6	-1.3	-1.1	-1.1	-1.0	-0.9	-0.9
Budget deficit (cumulative)	PLN bn	-31.7	-30.9	-26.0	-25.9	-26.8	-29.6	-39.5	-38.5	-42.2	-2.6	-11.7	-17.5	-27.5	-28.8
Budget deficit (cumulative)	% of FY plan	61.6	60.0	50.4	50.3	51.9	57.4	76.5	74.7	81.8	5.6	24.7	36.8	57.9	60.6
CPI	% YoY	0.8	0.5	0.2	1.1	1.1	1.0	0.8	0.6	0.7	0.5	0.7	0.7	0.7	1.0
CPI excluding food and energy	% YoY	1.1	1.0	0.9	1.4	1.4	1.3	1.4	1.1	1.0	0.4	0.9	1.1	1.0	1.2
PPI	% YoY	-2.1	-2.5	-1.3	-0.8	-1.1	-1.4	-1.4	-1.5	-1.0	-1.0	-1.4	-1.3	-0.8	-0.8
Broad money (M3)	% YoY	7.4	6.5	7.0	6.6	6.1	6.1	5.9	5.7	6.2	5.4	5.2	5.1	5.3	5.1
Deposits	%YoY	7.1	6.0	6.5	5.6	5.8	6.0	5.9	5.2	6.0	4.9	4.7	4.7	5.2	5.3
Loans	%YoY	2.3	1.4	3.5	3.7	3.3	3.7	2.9	3.8	4.0	4.2	4.7	5.3	5.9	5.4
EUR/PLN	PLN	4.14	4.18	4.28	4.28	4.23	4.24	4.19	4.19	4.18	4.18	4.18	4.20	4.18	4.18
USD/PLN	PLN	3.18	3.22	3.25	3.27	3.18	3.17	3.07	3.10	3.05	3.07	3.06	3.04	3.03	3.03
CHF/PLN	PLN	3.39	3.36	3.47	3.46	3.43	3.43	3.40	3.40	3.41	3.39	3.42	3.45	3.43	3.43
Reference rate ^b	%	3.25	3.00	2.75	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
WIBOR 3M	%	3.29	2.86	2.74	2.70	2.70	2.69	2.67	2.65	2.67	2.70	2.71	2.71	2.72	2.72
Yield on 2-year T-bonds	%	2.89	2.55	2.86	2.87	2.98	3.07	2.90	2.80	2.94	2.99	3.06	2.99	2.94	2.90
Yield on 5-year T-bonds	%	3.03	2.80	3.43	3.36	3.67	3.86	3.62	3.64	3.65	3.67	3.79	3.68	3.60	3.55
Yield on 10-year T-bonds	%	3.50	3.28	3.95	3.97	4.31	4.50	4.28	4.38	4.41	4.42	4.47	4.26	4.10	3.95

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; ^a in nominal terms, ^b at the end of the period.

Quarterly and annual economic indicators

		2011	2012	2013	2014E	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14E	3Q14E	4Q14E
GDP	PLN bn	1 528.1	1 596.4	1 635.7	1 708.9	378.4	396.3	405.6	455.5	391.7	414.2	423.6	479.4
GDP	% YoY	4.5	2.0	1.6	3.5	0.4	0.8	2.0	2.7	3.1	3.6	3.6	3.8
Domestic demand	% YoY	3.6	-0.1	0.0	3.1	-1.0	-1.6	0.6	1.8	2.1	3.6	3.0	3.7
Private consumption	% YoY	2.6	1.3	0.8	2.5	0.0	0.1	1.0	2.1	2.4	2.5	2.5	2.6
Fixed investments	% YoY	8.5	-1.6	-0.2	4.6	-2.4	-3.3	0.5	2.0	1.5	2.0	5.0	7.0
Industrial production	% YoY	7.7	1.0	2.3	5.5	-2.0	1.2	5.0	4.5	4.8	5.3	5.2	6.4
Construction production	% YoY	12.3	-1.0	-10.3	17.1	-15.6	-22.9	-7.0	0.0	9.8	22.6	18.7	15.6
Retail sales ^a	% YoY	11.2	6.0	2.6	5.5	0.9	0.8	4.0	4.5	5.1	5.6	4.8	6.4
Unemployment rate ^b	%	12.5	13.4	13.4	12.3	14.3	13.2	13.0	13.4	13.5	12.2	11.9	12.3
Gross wages in national economy ^a	% YoY	5.2	3.7	3.4	5.2	2.6	3.3	4.0	3.6	4.3	5.4	5.5	5.6
Employment in national economy	% YoY	0.6	0.0	-0.8	0.4	-0.7	-1.1	-1.2	-0.1	0.0	0.5	0.6	0.6
Exports (€)	% YoY	12.1	5.9	5.0	10.9	3.2	5.5	6.5	5.0	8.1	11.4	11.8	12.0
Imports (€)	% YoY	12.2	2.3	0.0	9.6	-2.0	-2.2	2.4	1.8	5.6	11.0	10.0	11.5
Trade balance	EUR mn	-10 059	-5 175	2 309	4 584	-139	1 203	1 094	151	805	1 489	1 919	371
Current account balance	EUR mn	-18 519	-14 191	-4 984	-2 614	-2 313	486	-2 086	-1 071	-1 114	424	-1 190	-734
Current account balance	% GDP	-5.0	-3.7	-1.3	-0.6	-3.1	-2.3	-1.9	-1.3	-1.0	-1.0	-0.7	-0.6
General government balance	% GDP	-5.1	-3.9	-4.3	5.7	-	-	-	-	-	-	-	-
CPI	% YoY	4.3	3.7	0.9	1.0	1.3	0.5	1.1	0.7	0.6	0.9	0.9	1.7
CPI ^b	% YoY	4.6	2.4	0.7	1.9	1.0	0.2	1.0	0.7	0.7	1.2	1.3	1.9
CPI excluding food and energy	% YoY	2.4	2.2	1.2	1.1	1.2	1.0	1.4	1.2	0.8	1.2	1.1	1.5
PPI	% YoY	7.6	3.4	-1.3	-1.4	-0.7	-2.0	-1.1	-1.3	-1.2	-1.1	-2.0	-1.4
Broad money (M3) ^b	% oY	12.5	4.5	6.2	7.4	6.6	7.0	6.1	6.2	5.1	4.7	6.3	7.4
Deposits ^b	%YoY	11.7	20.6	9.8	9.1	6.6	6.5	6.0	6.0	4.7	4.8	6.1	7.1
Loans ^b	%YoY	14.4	36.6	8.7	8.8	3.5	3.5	3.7	4.0	5.3	4.2	4.3	4.8
EUR/PLN	PLN	4.12	4.19	4.20	4.12	4.16	4.20	4.25	4.19	4.19	4.17	4.10	4.01
USD/PLN	PLN	2.96	3.26	3.16	2.98	3.15	3.22	3.21	3.08	3.06	3.02	2.97	2.88
CHF/PLN	PLN	3.34	3.47	3.41	3.34	3.38	3.41	3.44	3.40	3.42	3.42	3.33	3.18
Reference rate ^b	%	4.50	4.25	2.50	2.50	3.25	2.75	2.50	2.50	2.50	2.50	2.50	2.50
WIBOR 3M	%	4.54	4.91	3.02	2.74	3.77	2.96	2.70	2.66	2.71	2.72	2.74	2.78
Yield on 2-year T-bonds	%	4.81	4.30	2.98	2.96	3.29	2.77	2.98	2.88	3.01	2.91	2.93	2.98
Yield on 5-year T-bonds	%	5.44	4.53	3.46	3.63	3.49	3.09	3.63	3.64	3.71	3.55	3.57	3.70
Yield on 10-year T-bonds	%	5.98	5.02	4.04	4.15	3.95	3.58	4.26	4.36	4.38	4.00	4.02	4.22

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates;

^a in nominal terms, ^b at the end of period.

This analysis is based on information available until 09.05.2014 has been prepared by:

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EXPLANATION OF THE RECOMMENDATION SYSTEM

DIRECTIONAL RECOMMENDATIONS IN BONDS		DIRECTIONAL RECOMMENDATIONS IN SWAPS	
	Definition		Definition
Long / Buy	Buy the bond for an expected average return of at least 10bp in 3 months (decline in the yield rate), assuming a directional risk.	Long / Receive fixed rate	Enter a swap receiving the fixed rate for an expected average return of at least 10bp in 3 months (decline in the swap rate), assuming a directional risk.
Short / Sell	Sell the bond for an expected average return of at least 10bp in 3 months (increase in the yield rate), assuming a directional risk.	Short / Pay fixed rate	Enter a swap paying the fixed rate for an expected average return of at least 10bp in 3 months (increase in the swap rate), assuming a directional risk.

RELATIVE VALUE RECOMMENDATIONS

	Definition
Long a spread / Play steepeners	Enter a long position in a given instrument vs a short position in another instrument (with a longer maturity for steepeners) for an expected average return of at least 5bp in 3 months (increase in the spread between both rates).
Short a spread / Play flatteners	Enter a long position in given an instrument vs a short position in other instrument (with a shorter maturity for flatteners) for an expected average return of at least 5bp in 3 months (decline in the spread between both rates).

FX RECOMMENDATIONS

	Definition
Long / Buy	Appreciation of a given currency with an expected return of at least 5% in 3 months.
Short / Sell	Depreciation of a given currency with an expected return of at least 5% in 3 months.

NOTE: Given the recent volatility seen in the financial markets, the recommendation definitions are only indicative until further notice.

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