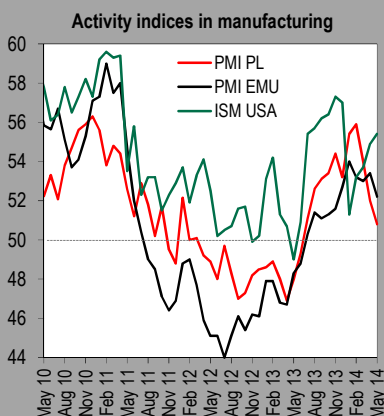
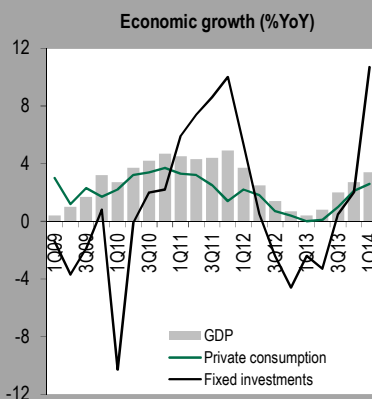


# MACROscope

Polish Economy and Financial Markets

June 2014

## Rate cuts look neither necessary nor likely



### In this issue:

Economic update	2
Monetary policy watch	4
Fiscal policy watch	6
Interest rate market	7
Foreign exchange market	8
Market monitor	9
Economic calendar	10
Economic data & forecasts	11

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■ **The Polish economy accelerated more than expected at the start of the year, mainly due to a strong revival of domestic demand. However, the recent decline in the leading indicators has triggered worries that the pace of the recovery may start to wane, while inflation has fallen to a new ultra-low level.** We maintain our forecast for GDP growth this year unchanged at 3.5% YoY. On one hand, the stronger recovery of domestic demand should fuel further optimism, but, on the other, the uncertainty about economic growth abroad makes us a bit more cautious. Economic expansion could accelerate if the coming months bring no softening of the recovery in the euro zone. We think the risk of deflation in Poland is low, given the revival of domestic demand. However, CPI growth may remain very low until the autumn and a negative reading in July cannot be ruled out. Consequently, it is likely to take longer than expected for inflation to return to the central bank's 2.5% target.

**The Monetary Policy Council (MPC) kept official interest rates on hold in June, but its comments turned more dovish.** A much lower-than-expected April inflation reading, combined with a more dovish MPC statement and the ECB's decision on further policy easing have triggered a significant change in investors' expectations about monetary policy in Poland. The market has started pricing-in a rate cut before the end of this year. We think the MPC is now concerned about the economic outlook and inflation staying ultra-low for longer, but is undecided about how to act. The Council may consider exiting the current forward guidance framework in July, which would give a strong signal to the market that the chances of a rate cut in September are rising. However, we think it will wait for further data on economic activity to decide whether to cut rates after the summer months or not. If our forecasts of accelerating economic growth and rising domestic demand are confirmed by then, rate cuts will be neither necessary nor likely.

■ **ECB and MPC monetary policy were the main factors affecting the Polish financial market in recent weeks, while the Ukraine crisis faded into the background.** After the recent rally, an interest rate cut before year-end is already priced-in, so an additional impulse would be needed for the downward trend in domestic yields to continue. Disappointing macro data later this month and an MPC decision to abandon forward guidance in July could provide the necessary combination. In the medium term, we still expect higher yields. As regards the zloty, we do not rule out short-term profit-taking after recent gains but our year-end target for the EURPLN remains 4.00.

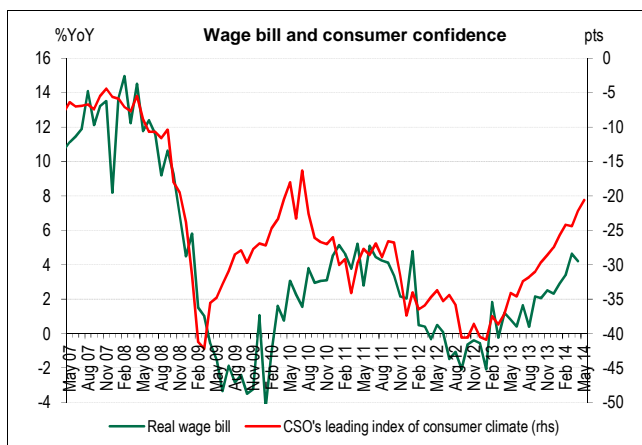
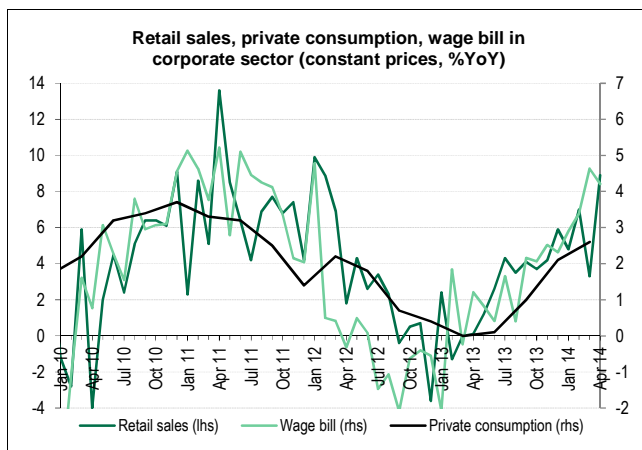
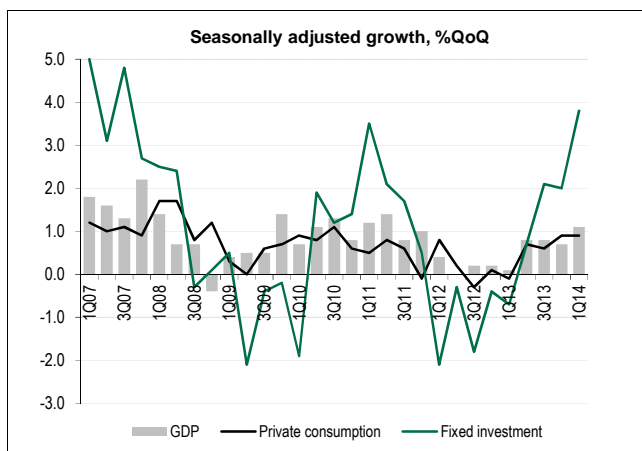
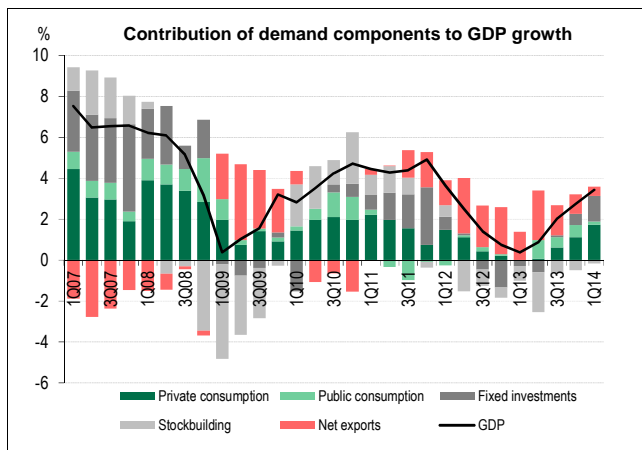
### Financial market on 11 June 2014:

NBP deposit rate	1.00	WIBOR 3M	2.68	EURPLN	4.1096
NBP reference rate	2.50	Yield on 2-year T-bond	2.52	USDPLN	3.0374
NBP lombard rate	4.00	Yield on 5-year T-bond	3.14	CHFPLN	3.3736

This report is based on information available until 11.06.2014.

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## Economic update



Source: CSO, BZ WBK

**GDP growth accelerated, boosted by domestic demand**

- Poland recorded the fastest quarterly GDP growth in the EU in 1Q14 in seasonally-adjusted terms: 1.1% QoQ (on a par with Hungary). In annual terms GDP grew 3.4%, beating expectations.
- The biggest surprise was a surge of 10.7% YoY in fixed investment (the fastest growth since mid-2008). Private consumption growth accelerated to 2.6% YoY and overall domestic demand growth rose to 3.0% YoY, highest level in three years. Export growth also posted solid growth (7.6% YoY), even though the contribution of net exports to GDP growth dropped to 0.5pp, the lowest since 2Q11, due to the acceleration of imports (6.9%).

**How persistent is the investment rebound?**

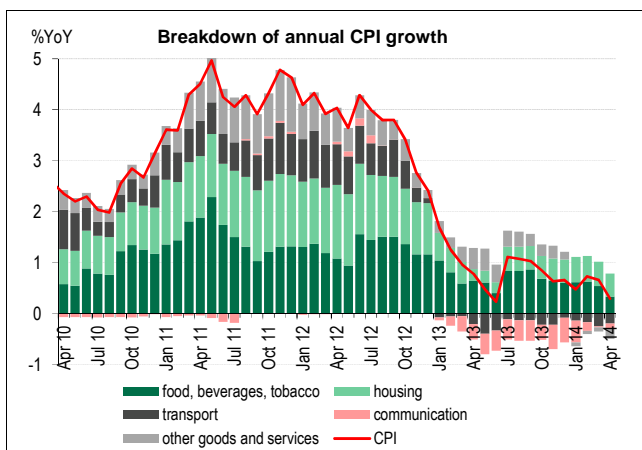
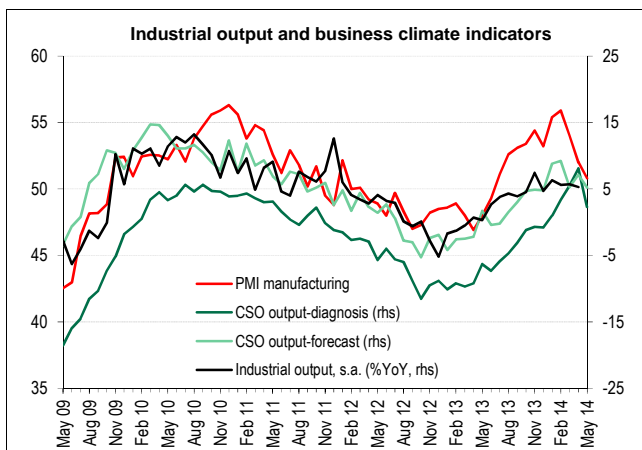
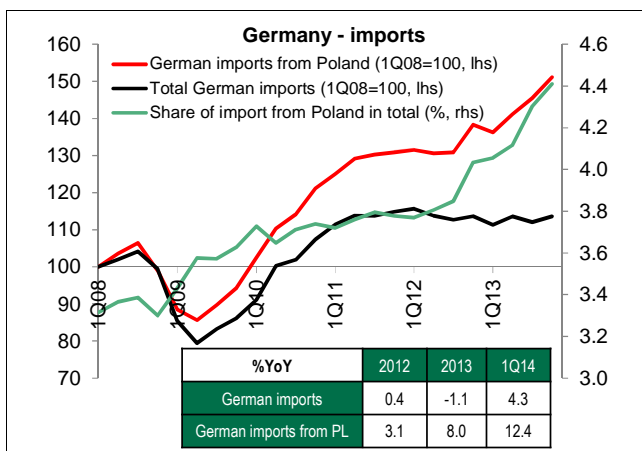
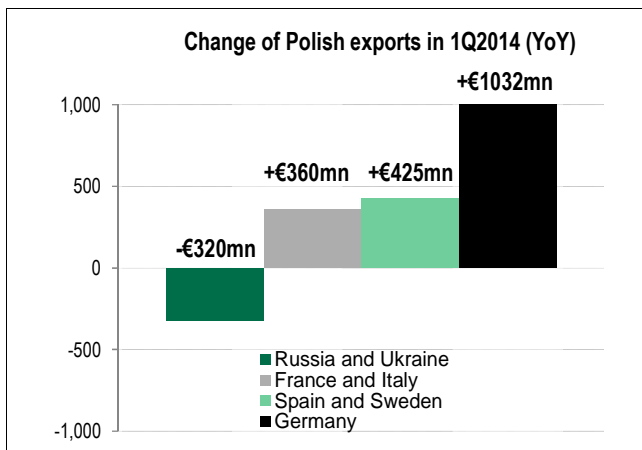
- While, to some extent, the jump in investments was probably boosted by one-off effects (such as the weather being much better than in 1Q13 and a temporary tax allowance encouraging car purchases), we think we are facing an underlying trend of a clear investment revival, which should continue in the following quarters. There are a number of factors behind this. First, average capacity utilisation in Polish firms is rising and has already returned to pre-crisis level (81.3% in 1Q14 according to the central bank's survey: the highest since 3Q08), which, in the past, has been consistent with solid investment growth. Secondly, corporate demand for investment loans is strong (c. 9% YoY in January-April) and the statistical data show that spending on machinery and tools (the biggest part of total fixed investment outlays) rose in 1Q14 by a healthy 9.9% YoY (the fastest since 1Q12). This type of investment was not affected by weather or tax allowances, which seems to confirm that one-off effects were not the only drivers of the surprisingly-strong 1Q14 investment data. Also, a look at the seasonally-adjusted data shows that, even before the unusual spike in 1Q14 (3.8% QoQ), we had already had two quarters of reasonably rapid expansion (2% QoQ in 3Q and 4Q13).

- We think that investment growth will slow to c4% YoY in 2Q14 (the weather effect and the tax allowance for cars will not be repeated), but will keep accelerating in the following quarters. In the second half, public sector investment should recover gradually and add to private sector demand. The Finance Ministry assumes in its convergence programme that public sector investment will start rising this year (with growth of more than 5% YoY), after two years of sharp contraction.

**Private consumption is backed by an improving labour market**

- Private consumption growth in 1Q14 (2.6%YoY) was, in our view, roughly consistent with the recovery seen in the labour market and trends observed in monthly retail sales data.
- Labour market trends were still very positive at the beginning of 2Q14. Employment is gradually picking up (in April average employment in the corporate sector rose 0.7% YoY, but the Labour Force Survey show the number of employed rising by more than 2% YoY). Wage growth is also solid – we think that after a temporary slowdown in April to 3.8% YoY, due to base effects, the coming months will see a further acceleration of wages. As household personal income growth remains decent (especially in real terms, as inflation is low), it should, in our view, continue to support consumer spending.
- Indicators of consumer confidence have also improved rapidly in recent months (in May the leading index reached a four-year high), showing that consumers are more willing to spend money.
- We expect private consumption growth to accelerate gently in the coming quarters, supporting the economy. However, we think it is unlikely to exceed 3%YoY, which is a long way from its pre-crisis levels of 5%-6%YoY or higher.

# Economic update



Source: CSO, Eurostat, Markit, BZ WBK.

## Polish foreign trade is still doing very well . . .

- While domestic demand seems to have gained strength at the beginning of the year, external demand still remained an important growth driver for Poland. Exports expanded by c.9.1% YoY in 1Q14 and nearly 11% YoY in March in euro terms, according to the National Bank of Poland's (NBP) balance of payments data.
- Data from the Central Statistical Office show quite clearly that the weakness of trade with eastern markets (which is due to the conflict between Russia and Ukraine and deteriorating economic growth in those countries) was offset at the start of the year by rapidly-improving exports to Central and Western Europe. This implies Polish entrepreneurs are proving flexible in a changing external macroeconomic environment and trying to benefit from the economic revival in the Euro zone, so far with some success.

## . . . and is gaining market share in a recovering Euro zone

- Detailed data from Euro zone countries show that their imports of Polish products grew quickly, even during the prolonged recession.
- Polish products are attractive to European consumers (thanks to the substitution effect) and the weakness of domestic demand in Poland in the last two years has prompted Polish firms to look extensively for export opportunities. As a result, the Euro zone's imports from Poland have risen much faster than its total imports in the last few years and Polish companies have managed to increase their market shares significantly in countries such as Germany.

## Are leading indicators signalling a slowdown ahead?

- Even though available foreign trade data still paint a fairly bright picture of external demand, the most recent leading indicators introduced some uncertainty for the coming months. The manufacturing PMI index for Poland fell in May for the third time in a row and by much more than expected, dropping from an impressive 55.9 in February to just 50.8 points, as all components deteriorated, including new export orders. CSO business climate indices also dropped in May, reversing an earlier sharp rise.
- While we argued in previous months that Poland's PMI was too high for the pace of its economic recovery, it is worrying that the indicator is now close to the neutral 50 mark. The current level is still more or less in line with industrial output expanding by c. 5% YoY, but a continuation of the downward trend in coming months would suggest that the recovery is weakening.
- In our view, the next few months will be crucial as they will show whether we are dealing with a downward trend in activity or only a temporary deterioration of mood, probably caused by the crisis in Ukraine (which was suggested by respondents).
- As we have suggested in previous reports, it seems the impact of tensions to the east should be quite limited, as long as the Euro zone recovery remains on track. We are still quite optimistic about the outlook for Polish exports (double-digit growth is possible in the coming quarters, in euro terms), as we predict a further acceleration of GDP growth in the Euro zone and continuing 2%-plus growth in Germany.

## CPI low, but not heading for deflation

- Inflation plunged unexpectedly in April to 0.3% YoY, well below expectations. The biggest surprise came from lower food prices, but core inflation excluding food and energy prices also declined, to 0.8% YoY, with two other core inflation gauges close to zero and at all-time lows. This indicates a continuation of the non-inflationary economic recovery. It now looks as if inflation may take longer than we had assumed to reach the NBP target.
- We think deflation is not a real threat in Poland, as domestic demand is gathering steam. Even if the CPI stays close to zero until the autumn (a negative reading in July cannot be ruled out), price growth should start to accelerate before the end of the year.

## Monetary policy watch

### Excerpts from the MPC's communiqué after its June meeting (with main changes vs May's statement highlighted)

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 Poland, GDP growth in the first quarter of 2014 accelerated to 3.4% y/y, close to the March projection (...) driven by faster investment growth and a slight acceleration in consumer demand.

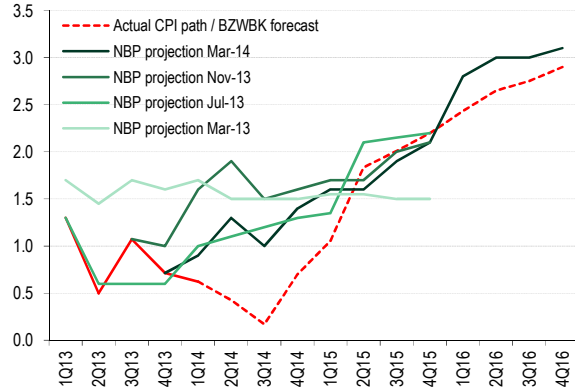
The recovery has been translating into an improvement of labour market conditions. (...) This was conducive to a decline in unemployment, yet it remains elevated. Heightened unemployment restricts wage pressure in the economy.

In April, CPI inflation **fell substantially below the March projection**, to 0.3%, i.e. markedly below the NBP inflation target of 2.5%.

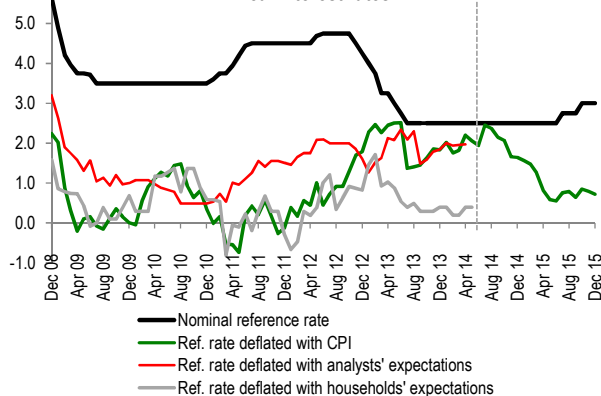
In the opinion of the Council, a gradual economic recovery is likely to continue in the coming quarters, while inflationary pressure will remain **subdued very low**. The Council decided to keep NBP interest rates unchanged. The Council maintains its assessment that NBP interest rates should be kept unchanged **for a longer period of time, i.e. at least until the end of the third quarter of 2014. A more comprehensive assessment of monetary policy perspectives and potential adjustment of interest rates will be possible after the Council gets acquainted with incoming information, including the July NBP projection.**

~~In the opinion of the Council, lowering interest rates in the first half of 2013 and keeping them unchanged in subsequent quarters supports the recovery of the domestic economy, a gradual return of inflation to the target and a stabilisation in the financial markets.~~

Inflation path vs NBP projections



Real interest rates



Sources: NBP, CPI, BZ WBK.

### Cuts cannot be ruled out, but they look unlikely

Poland's Monetary Policy Council kept monetary conditions unchanged at its June meeting, in line with expectations – the reference rate has remained at its record low level of 2.50% since July 2013. However, the press conference after the meeting was not as dull as the NBP's governor Marek Belka suggested it would be a month ago.

The tone of the final MPC statement changed noticeably – in the last paragraph the Council said it would keep official rates unchanged until the end of the third quarter of 2014 (previously it was “for a longer period of time, i.e. at least until the end of the third quarter of 2014”) and announced that a full assessment of the monetary policy outlook and possible rate adjustment would be available after the release of new NBP projections. At the same time, the Council emphasised more strongly than previously that inflation pressure will be very low in the coming quarters (last month it said prices “will remain subdued”) and noted it was substantially below the last projection (see chart on left).

Investors interpreted the differences in the MPC's statement as a suggestion that interest rates could change as soon as 4Q14 and that the change could actually be a cut. The NBP's governor Marek Belka said during the post-meeting press conference that an interest rate cut cannot be ruled out given the current circumstances, especially beyond the end of 3Q. On the other hand, Belka said the Council is currently not planning any cuts and policy easing is neither a baseline scenario nor a probable one, so the change in the statement should not be viewed as a suggestion of rate reductions.

In a post-meeting interview, Marek Belka explained that the MPC's view of the monetary policy outlook changed to “more balanced” after recent data. While previously it thought that a rate hike was the only possible next decision, now a downward move cannot be ruled out, which still does not mean that it is likely. Belka added that the ECB's decision to ease monetary policy did not affect the probability of rate cuts in Poland, particularly when the Polish FX market had reacted less than might have been expected.

### Forward guidance may be dropped in July

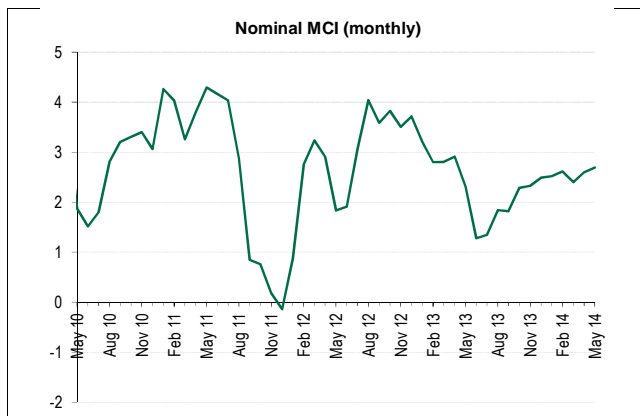
Belka suggested in recent interview that an “earlier resignation” from the current forward guidance framework is possible as he thinks this strategy in its current form has lost its usefulness. The results of the new NBP projection will be an important factor in this decision, in his opinion. The MPC's Andrzej Bratkowski and Jerzy Hausner also suggested recently that a change in the MPC's communication framework is possible in July.

We should not forget that the NBP president signalled in April and May that the MPC may consider a change in its communication in July, after receiving the new NBP projections. Until recently we thought this implied an extension of the forward guidance horizon until the end of the year, but recent comments suggest that the Council is considering leaving the forward guidance framework, which no longer suits the changing economic environment and has too many limitations.

Abandoning forward guidance at this particular moment would probably be interpreted by the market as an additional strong signal of a change in the MPC's attitude and would fuel expectations of a rate cut in September. We suspect we may be returning to a situation in which the market has considerable difficulty in correctly interpreting the MPC's signals.

In our view, even if the MPC drops forward guidance in July, it would wait until the economic activity data to decide whether to cut rates after the summer months or not. At its September meeting, the MPC will have 2Q GDP numbers and the first 3Q monthly releases available. If our forecasts of accelerating economic growth and rising domestic demand are confirmed by then, rate cuts will be neither necessary nor likely.

## Monetary policy restrictiveness



### MCI continues its upward trend

- In line with our expectations, the index of monetary policy restrictiveness (MCI) increased somewhat in May, due to a strengthening of the Polish currency and an increase in money market rates.
- We are expecting the index to increase further in the coming months. Stronger expectations of interest rate cuts, which dragged money market rates lower, may put downward pressure on the index. However, this effect will probably be offset by the stronger domestic currency, supported by the European Central Bank's action last week. A reversal of the trend is possible, should expectations of rate cuts strengthen enough to cause a weakening of the zloty. However, this is not our baseline scenario, as we are expecting the zloty to slide towards 4.00 per euro at the year-end.



Rzońca (1.44)

Winiecki (1.45)

Bratkowski (0.58)

Kaźmierczak (1.41)

Hausner (1.03)

Belka (0.96)

Zielińska-Głębocka (0.81)

Glapiński (1.38)

Chojna-Duch (0.73)

Osiatyński



Index runs from 0 to 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. The value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights and older ones lower weights.

The numbers directly alongside the names are the index values for period since the beginning of current term of office of the current MPC and NBP governor.

The direction of the restrictiveness axis reflects our expectations for the direction of interest rate changes in the next 12 months.

As there has been no vote on a rate change for a long time, the positioning of MPC members on the axis is based mainly on our assessment, taking into account their recent comments.

### The June conference proved surprisingly exciting

The MPC's June conference proved far more interesting than we had expected, with considerable changes in the statement and quite clear suggestions that interest rate cuts are also an option. At the press conference in May, NBP governor Marek Belka said he expected June's meeting to be "not very exciting". Moreover, he said something that clearly suggested no important changes in the MPC's stance should be expected until July: "July's projection is a good moment to consider a change in communication. That is when you should expect us to reveal our plans for interest rate policy." However, Belka also said: "But if it turns out we are not sure if the future is foreseeable (...) then promising something for a longer period is risky and not very credible. It seems that the Council recently saw something that made it reconsider its opinion about the economic outlook."

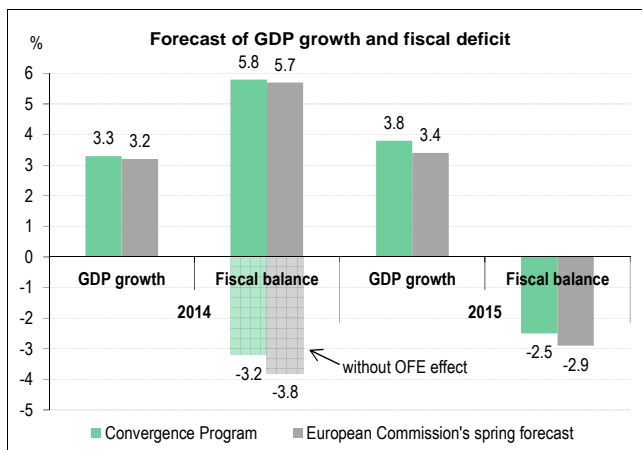
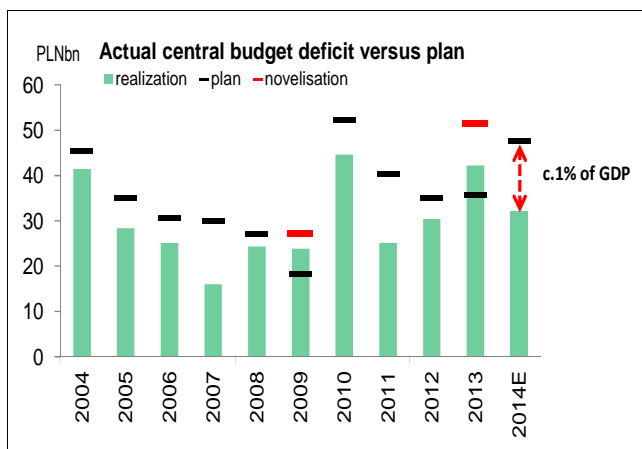
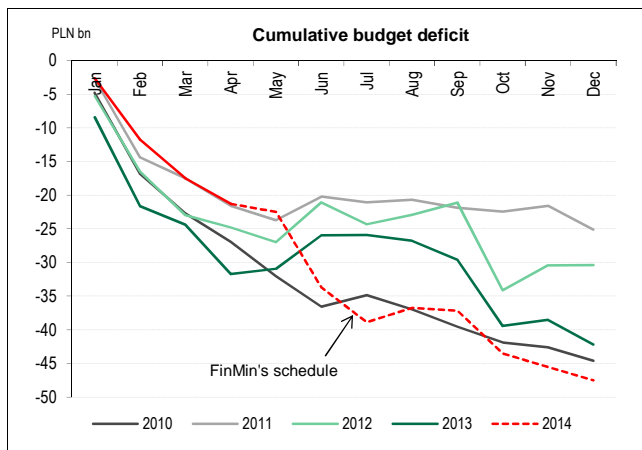
### Was it because of low inflation?

We do not think it was the 1Q14 GDP report that unsettled the MPC as growth proved higher than expected, with a surprising surge in growth rate of fixed investments. Therefore, it may have been the April inflation rate, which dropped to 0.3%YoY (the second-lowest reading ever). Marek Belka said in May that "short-term forecasts show that the inflation path may be lower than projected", but it seems the scale of the CPI decline caught the MPC by surprise. Belka, who said in March that a rate cut in the context of an economic recovery would be a pro-cyclical action and a "mortal sin", said in June that "inflation is surprising, so the mortality of this sin seems a bit lower".

### Or was it because of the deteriorating growth outlook?

However, we think that concern about the GDP outlook also contributed to the change in MPC's tone. Even though Polish 1Q14 GDP was a positive surprise, a strong decline in the PMI index and concerns about a possible slowdown in economic growth abroad have probably made the MPC more uncertain about the future. If this is the case, then probably the MPC's Andrzej Bratkowski was right when he said in a recent interview that GDP forecasts, not inflation forecasts, will be crucial for monetary policy in the coming quarters. We note that Jerzy Osiatyński (one of the most dovish MPC members, in our view) put a lot of emphasis on economic growth data during the Council's last press conference. He said that the structure of GDP growth (in particular the strength of the investment revival) was a big surprise for the board members and, if it does not prove to be a temporary swing, it may mean that "we are living in a different world that we had thought". We share the view that data about economic activity in the coming months may prove crucial for the next monetary policy decisions in Poland.

## Fiscal policy watch



	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	11.06	change since 9.05.14	change since 31.12.13	11.06	change since 9.05.13	change since 31.12.13
Poland	220	-21	-18	56	-15	-23
Czech	17	-14	-42	52	-7	-8
Hungary	313	-67	-64	180	-25	-76
Greece	433	-33	-227	99	12	63
Spain	126	-19	-95	61	-25	-154
Ireland	106	-14	-46	45	-24	-75
Portugal	196	-8	-214	139	-20	-207
Italy	141	-7	-74	81	-29	-88
France	36	-8	-13	35	-11	-19
Germany	-	-	-	20	-1	-6

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

### The central budget deficit may be lower than expected

- Poland's central budget deficit reached PLN21.3bn in January-April, or 44.8% of the forecast for the year as a whole. On the revenue side, indirect taxes amounted to cPLN63.8bn (or 35.6% of this year's target), up 15.6% YoY on the back of a 21.1% YoY rise in VAT collections.

- The Ministry of Finance estimates that at the end of May the budget deficit was PLN22.5bn, well below the Ministry's earlier assumptions of PLN28.8bn. The Ministry said that budget revenues were in line with expectations, with VAT receipts close to plan.

- We have said repeatedly that we think the government's economic assumptions for the 2014 budget were rather conservative, with GDP growth forecast at 2.5%. The economic recovery is likely to boost tax income and limit central budget spending. Thus, we expect the central budget deficit to be considerably lower than planned. We estimate tax income could be PLN10bn above forecast (mainly thanks to VAT revenues). Spending may be cPLN5bn lower, which would reduce the deficit by PLN15bn (c1% of GDP).

- A lower central budget deficit means lower gross borrowing requirements this year. After June's regular auction, Poland has financed over 90% of its planned 2014 borrowing needs. We do not rule out 2014 financing being complete at the end of June (after a switch tender) or at the end of July at the latest. We note that, at the end of May, the Ministry announced low supply for the holiday period (with only one regular auction in July). What is more, it plans to pre-finance its 2015 gross borrowing requirements chiefly with switching auctions, which is seen as "the most adequate form". Switching tenders are more neutral for the level of debt and for the secondary market. Summing up, we think that a lower state deficit will mean greater financial resources at the end of 2014.

### The European Commission suspends the EDP for Poland

- At the beginning of June, the European Commission (EC) issued its opinion on Poland's 2014 convergence programme, saying Poland had taken effective steps towards meeting the recommendation of a sustainable reduction in the budget deficit to below 3% of GDP in 2015. As a result, the ECB decided to suspend the Excessive Deficit Procedure (EDP) for Poland.

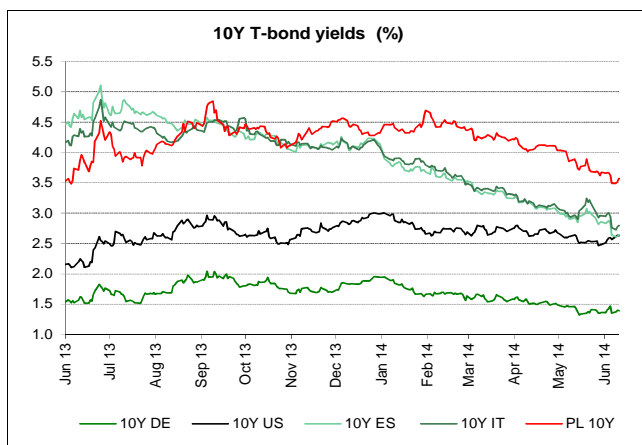
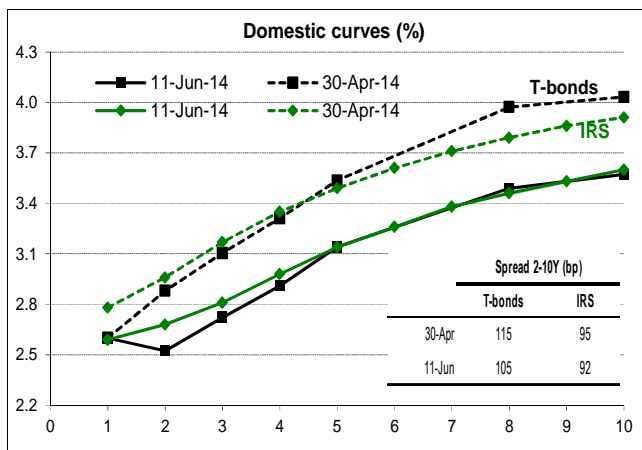
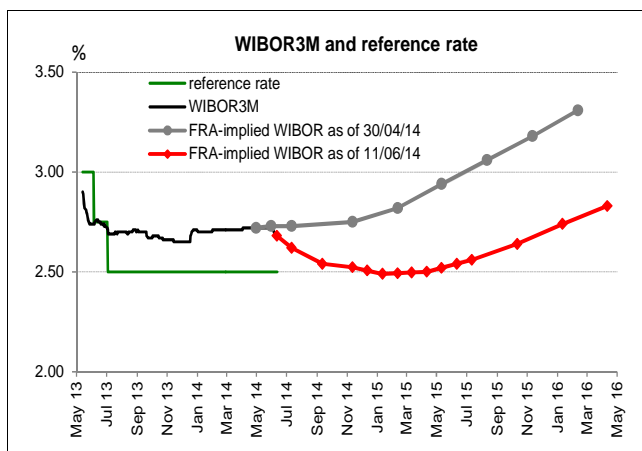
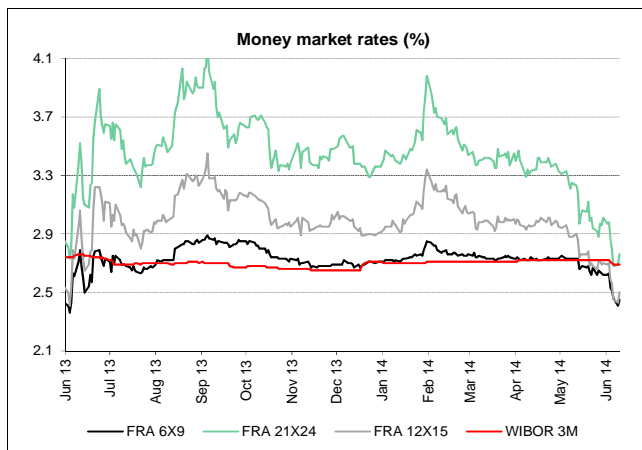
- The prospects for 2014 are favourable. Flash information suggests that local governments also performed well in 1Q (with a surplus of PLN9.6bn versus a planned deficit of PLN12.5bn). However, they could be holding spending back until local government elections in the autumn. As we also foresee a lower central budget deficit, we think that there is a chance that the general government deficit (excluding the OFE effect) will already be below 3% of GDP (ESA2010) in 2014. Therefore, it seems that Poland is on track to exit the EDP in 2015, or 2016 at the latest.

### Sharp decline in yields after the ECB's decision

- In May both core and peripheral markets strengthened quite considerably due to expectations of ECB action in June. The ECB fulfilled market expectations, introducing a number of easing measures, in which it cut the refi and deposit rates, putting the latter in negative territory, and offering abundant liquidity (TLTRO). This action resulted in further sharp decline in yields, in particular peripheral ones. We noted a significant improvement in credit risk measures across CEE and peripheral markets, with spreads narrowing vs Bunds and declines in credit default swaps.

- We expect both German and peripheral debt to outperform US Treasuries due to differences in central bank action. In the short term we do not rule out a gradual decline in yields. However, going forward we could see some steepening of the curves, as the front ends should be well anchored by the ECB's decision, while the long-ends should move higher as economic growth and (probably) inflation expectations are expected to increase.

## Interest rate market



Source: Reuters, BZ WBK.

**The market is not ruling out a rate cut before year end**

▪ June's MPC meeting proved to be a turning point for the money market after relative stability in May. The Council not only changed the tone of its statement to more dovish, but also did not rule out a rate cut in future. Expectations of MPC policy easing strengthened after the ECB's move (including rate cuts and an offer of abundant liquidity to banks). As a result, in the first ten days of June, WIBOR 1M-12M declined by 1-5bp, with the biggest drop in the 12M rate.

▪ FRA market investors quickly adjusted their expectations. Both a low CPI reading and the NBP president's statement, not ruling out deflation, caused a substantial FRA decline in May. Consequently, FRA12x15 declined below WIBOR3M for the first time since June 2013, when the MPC cut rates by 25bp. This trend strengthened in the first ten days of June as the MPC did not rule out the possibility of rate cuts.

▪ Currently, the market is pricing-in a 25bp cut in interest rates in the next six months and rates remaining there until this time next year, after which they could rise, but would not exceed current levels at least until the start of 2016. New data will be crucial for rates in the short term. We foresee rates increasing gradually as we get closer to year-end, when domestic demand is likely to accelerate further and inflation should rise.

**Strong rally in T-bonds and IRS**

▪ In May both IRS and T-bonds rallied strongly as investors paid less attention to the Ukrainian crisis and switched their focus back to monetary policy. Expectations of further ECB stimulus, a strengthening of German Bunds and surprisingly-low Polish inflation pushed the yields of domestic T-bonds and IRS rates to fresh 2014 lows. The rally continued as the MPC rhetoric was more dovish and the Council did not rule out further easing. The ECB decision also boosted demand for higher-yielding assets, including Polish ones. Both T-bond yields and IRS rates reached their lowest levels in one year in the first ten days of June. The 10Y benchmark yield fell briefly below 3.50%.

▪ A bullish flattener has been developing on both T-bonds and IRS markets as mid- and long-term rates benefited the most. The 2-10Y spread narrowed to 105bp for T-bonds (down from 115bp at the end of April) and to 92bp for IRS (from 95bp). The spread vs. German bonds for all tenors has also narrowed, with the 10Y dropping to 213bp, its lowest since June 2013. The asset swap spread for 5Y and 10Y also narrowed and shifted to negative territory.

▪ T-bonds offered on the primary market attracted solid demand from both domestic and foreign investors; the latter picked up the pace of their accumulation of Polish bonds in May. In May-June the Ministry of Finance launched T-bonds worth PLN28.2bn in total and it has now financed over 90% of this year's gross borrowing needs.

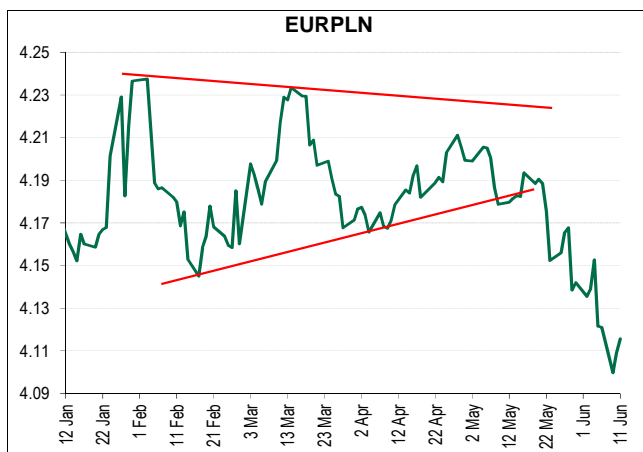
**Moderate growth in yields and IRS rates in the medium term**

▪ After the recent rally, an interest rate cut is already priced-in, so an additional impulse will be necessary for the downward trend in domestic curves to continue. This could come from domestic data (readings below market expectations) or from core markets (a further decline in Bund yields), or even more from the MPC's decision (to drop its forward guidance in July).

▪ The supply of T-bonds in 2H14 will be very limited as the Ministry announced only one standard auction in July. Moreover, pre-financing 2015 borrowing needs will be done through switch tenders. Therefore, the prospect of lower debt supply will support debt as well.

▪ However, in the medium term we still expect higher domestic yields as, in our view, the market will realise that speculation about rate cuts and deflation in Poland was unfounded and macro data will confirm the recovery is continuing. The gradual upward trend should also be supported by an increase in yields on the core debt markets as the Fed approaches the end of its QE programme and starts to consider monetary tightening.

## Foreign exchange market



### EURPLN lowest since April 2013

▪ Last month we suggested that a bigger move of the EURPLN was likely in the following weeks and that the situation in Ukraine or the ECB could be the triggers. Despite continued fighting in Eastern Ukraine, risky assets – including the zloty – have been gaining, as investors were hoping that the ECB would deliver the monetary policy easing it suggested very clearly in early May. The 1Q14 GDP data in Poland also surprised on the upside and this has contributed to the zloty's significant appreciation. At the turn of May/June, the EURPLN broke the lower boundary of the narrowing trading range and the exchange rate dropped to 4.09, its lowest since April 2013. The USDPLN broke 3.0 temporarily and touched its lowest level since late 2013.

▪ Since late April, when the recent appreciation started, the zloty has gained c2.4% vs. the euro, but this was not an impressive result when compared to the 4% appreciation of the Turkish lira, 4.5% for the Indian rupee, 5% for the Colombian peso or over 6.5% for the Russian rouble. The performance vs. the dollar was also unremarkable when compared with other EM currencies – the USDPLN is roughly flat since late April while three strongest currencies gained 2.3%-4.3%. Still, zloty's appreciation vs. the euro should not be played down as the EURPLN has been falling for three consecutive weeks.

▪ Recent sudden strengthening obviously raises a question of whether this momentum will be continued. The main driver of the appreciation trend – expectations of monetary policy easing in the Euro zone – has disappeared. Instead, speculation of rate cuts in Poland has intensified after the surprisingly low inflation and PMI data, suggesting a slowdown in economic growth. From the four-year peak established in February (at 55.9 points), the PMI index has plunged to 50.8 points in May, which was the biggest three-month drop since December 2008. A similar deceleration was shown by the indices for Germany, France and Euro zone as a whole. We maintain that the zloty is a cyclical currency and it usually gains during an economic revival. Recent signs of slower growth and market expectations of rate cuts in Poland may trigger some profit-taking. Additionally, according to Bloomberg, the options market indicates a c50% chance of the EURPLN hitting 4.15 and a 33% probability of it falling to 4.05 in the coming month. There are also some technical signals that suggest the exchange rate may actually rebound slightly in the short run after the recent plunge. At the same time, we are keeping our medium-term forecasts unchanged and expect the EURPLN to be close to 4.0 at year-end.

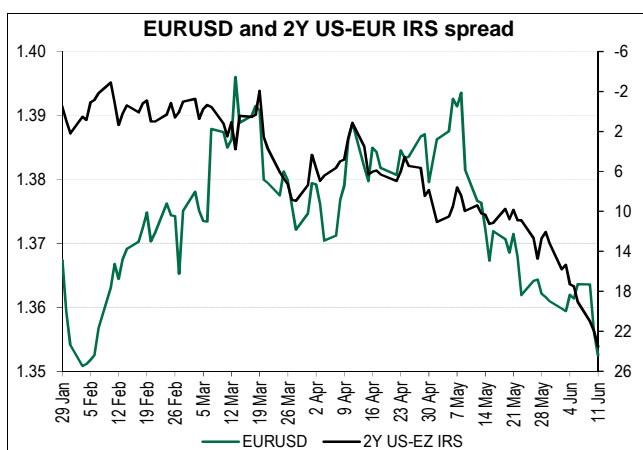
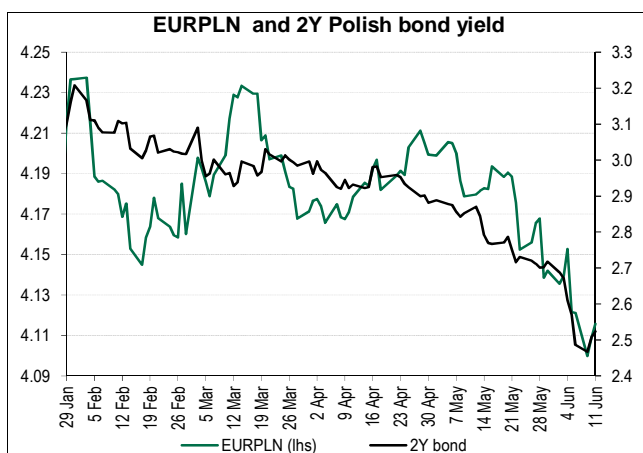
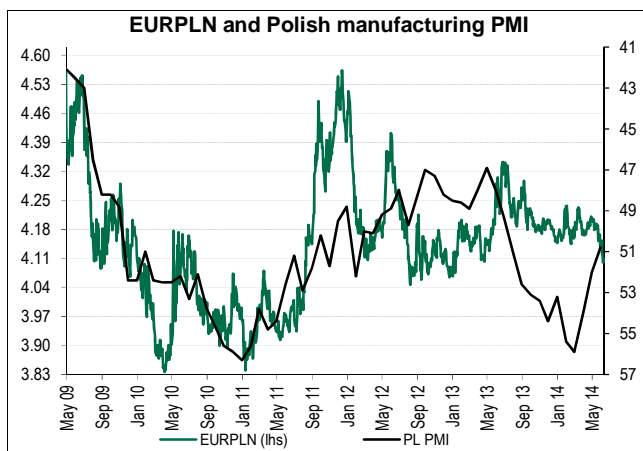
### Euro under pressure

▪ The single currency continued to depreciate in May after the ECB governor suggested that monetary policy easing was likely in June. Expectations of standard and non-standard action were supported by comments of other ECB officials. Consequently, just before the central bank decision the exchange rate was close to 1.36 and dipped to 1.35 after a deposit rate cut was announced.

▪ The ECB has introduced several other measures aimed at fighting the risk of deflation, but so far this has failed to push the EURUSD further down. Now the central bank is likely to refrain from further action until it sees the effect of recent decisions, so the room for further euro depreciation may be limited in the short run and investors may decide to take profits from the swing seen in May (from 1.39 to 1.35).

▪ On the other hand, recent activity indicators (PMI, the German ZEW and Ifo) showed a deceleration in pace of the economic recovery. This may fuel expectations that inflation will not rebound as the ECB hopes and there may be a chance of more easing (the central bank said it was working on an ABS purchase programme and may take further action if needed).

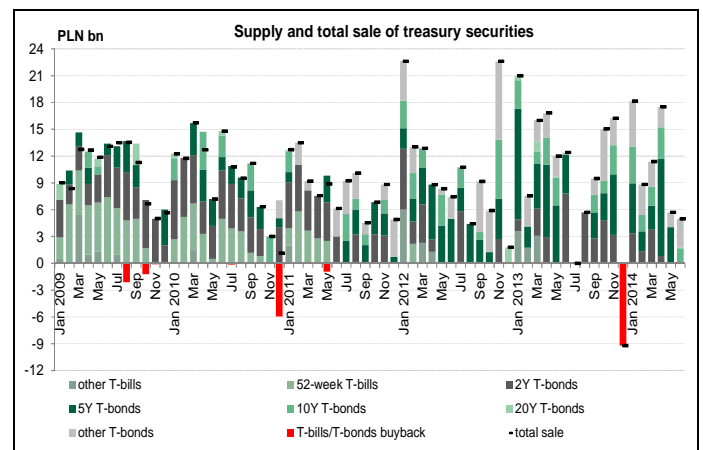
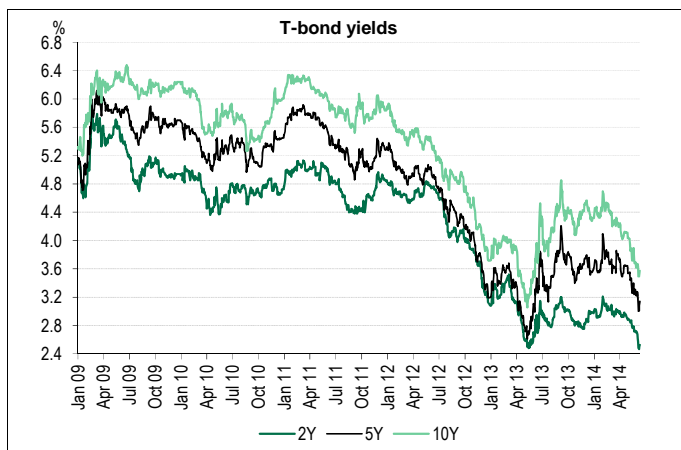
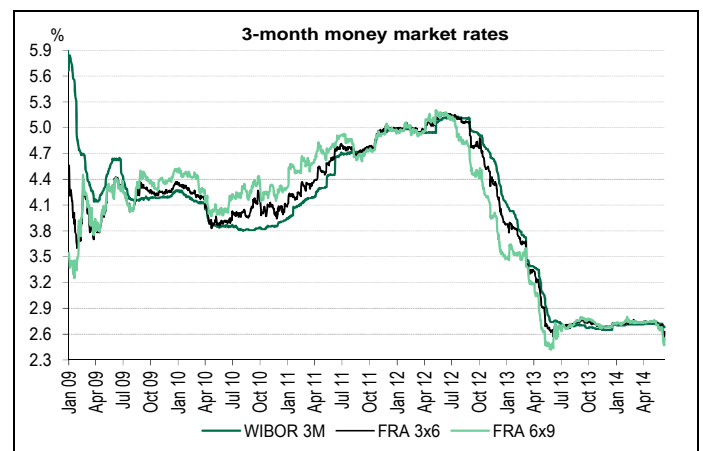
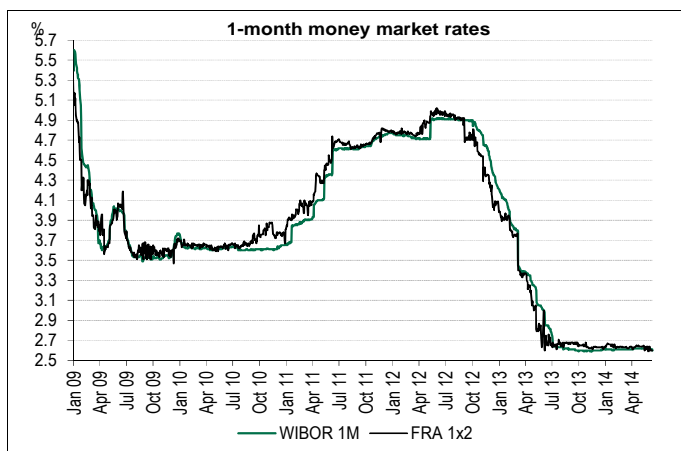
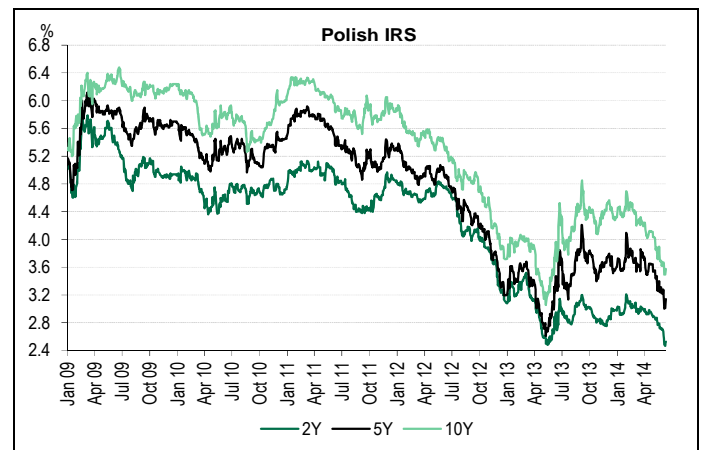
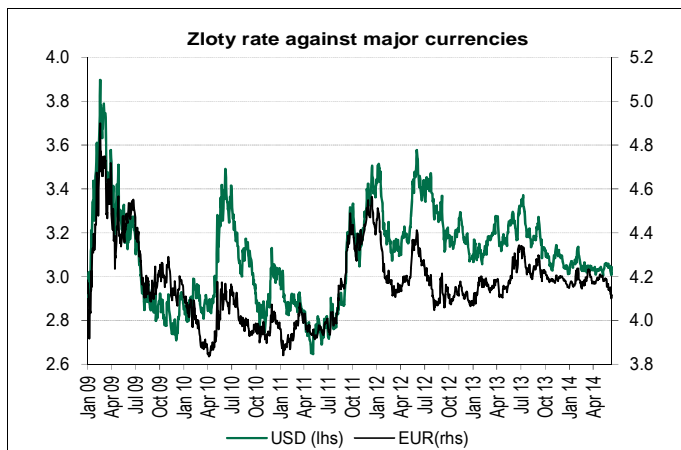
▪ 1.35 is first crucial support for EURUSD, next one is at 1.335.



Sources: CSO, Reuters, BZ WBK.



# Market monitor



## Treasury bond auctions in 2013/2014 (PLN mn)

month	First auction				Second auction			Switch auction			
	date	T-bonds	offer	offer	date	T-bonds	offer	date	T-bonds	offer	
June '13	6.06	PS0718/WZ0119	3000-5000	4606.5				19.06	OK0713/DS1013		
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							
April	3.04	DS1023/WZ0119	3000-5000	5781.0	23.04	OK0716/PS1016/PS0718	5000-10000	11722.3	20.03	PS0414/OK0714	PS0718/DS1023
May	8.05	PS0719/WZ0119	3000-5000	5694.2	22.05	IDS1024	1000-2000	1270.0			
June	5.06	DS/WS/WZ	3000-5000	4989.7					18.06	OK0714/WZ0115	

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

Source: MoF, Reuters, BZ WBK.

## Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
<b>9 June</b> CZ: CPI (May)	<b>10</b>	<b>11</b> HU: CPI (May)	<b>12</b> EZ: Industrial output (Apr) US: Retail sales (May)	<b>13</b> <b>PL: CPI (May)</b> <b>PL: Money supply (May)</b> <b>PL: Balance of payments (Apr)</b> US: Flash Michigan (Jun)
<b>16</b> <b>PL: Core inflation (May)</b> EZ: HICP (May) US: Industrial output (May)	<b>17</b> <b>PL: Wages and employment (May)</b> DE: ZEW index (Jun) US: CPI (May) US: Housing starts (May) US: Building permits (May)	<b>18</b> <b>PL: Industrial output (May)</b> <b>PL: PPI (May)</b> US: FOMC	<b>19</b> US: Philly Fed index (Jun)	<b>20</b> <b>PL: MPC minutes</b>
<b>23</b> CN: Flash PMI – manufacturing (Jun) DE: Flash PMI – manufacturing (Jun) EZ: Flash PMI – manufacturing (Jun) US: Home sales (May)	<b>24</b> DE: Ifo index (Jun) HU: Central bank decision. US: Consumer confidence index (Jun) US: New home sales (May)	<b>25</b> US: Durable goods orders (May) US: Final GDP (Q1)	<b>26</b> <b>PL: Retail sales (May)</b> <b>PL: Unemployment rate (May)</b> CZ: Central bank decision US: Personal income (May) US: Consumer spending (May)	<b>27</b> US: Michigan index (Jun)
<b>30</b> <b>PL: Balance of payments (Q1)</b> <b>PL: Inflation expectations (Jun)</b> EZ: Flash HICP (Jun) US: Pending home sales (May)	<b>1 July</b> <b>PL: PMI – manufacturing (Jun)</b> CN: PMI – manufacturing (Jun) DE: PMI – manufacturing (Jun) EZ: PMI – manufacturing (Jun) US: ISM – manufacturing (Jun) CZ: Final GDP (Q1)	<b>2</b> <b>PL: MPC decision</b> US: ADP report (Jun) US: Industrial orders (May)	<b>3</b> EZ: ECB decision EZ: PMI – services (Jun) DE: PMI – services (Jun) US: ISM – services (Jun) US: Non-farm payrolls (Jun) US: Unemployment rate (Jun)	<b>4</b> DE: Industrial orders (May)
<b>7</b> DE: Industrial output (May) CZ: Industrial output (May)	<b>8</b> DE: Exports (May)	<b>9</b> CZ: CPI (Jun) US: FOMC minutes	<b>10</b>	<b>11</b> HU: CPI (Jun)
<b>14</b> <b>PL: Balance of payments (May)</b> <b>PL: Money supply (Jun)</b> EZ: Industrial output (May)	<b>15</b> <b>PL: CPI (May)</b> DE: ZEW index (Jul) US: Retail sales (May)	<b>16</b> <b>PL: Core inflation (Jun)</b> <b>PL: Wages and employment (Jun)</b> US: Industrial output (Jun) US: Fed Beige Book	<b>17</b> <b>PL: Industrial output (Jun)</b> <b>PL: PPI (Jun)</b> EZ: HICP (Jun) US: House starts (Jun) US: Building permits (Jun) US: Philly Fed index (Jul)	<b>18</b> 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 <sup>a</sup>	14 <sup>b</sup>	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. <sup>a</sup> preliminary data for January. <sup>b</sup> January and February.

Source: CSO, NBP, Ministry of Finance, Reuters, Bloomberg.

## Economic data and forecasts for Poland

## Monthly economic indicators

		May 13	Jun 13	Jul 13	Aug 13	Sep 13	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14E	Jun 14E
PMI	pts	48.0	49.3	51.1	52.6	53.1	53.4	54.4	53.2	55.4	55.9	54.0	52.0	50.8	51.0
Industrial production	% YoY	-1.8	2.8	6.3	2.2	6.3	4.6	2.9	6.7	4.2	5.3	5.4	5.4	5.1	2.9
Construction production	% YoY	-27.5	-18.3	-5.2	-11.1	-4.8	-3.2	-2.9	5.8	-3.9	14.4	17.4	12.2	12.1	9.2
Retail sales <sup>a</sup>	% YoY	0.5	1.8	4.3	3.4	3.9	3.2	3.8	5.8	4.8	7.0	3.1	8.4	5.4	4.4
Unemployment rate	%	13.5	13.2	13.1	13.0	13.0	13.0	13.2	13.4	14.0	13.9	13.5	13.0	12.5	12.1
Gross wages in corporate sector	% YoY	2.3	1.4	3.5	2.0	3.6	3.1	3.1	2.7	3.4	4.0	4.8	3.8	4.7	5.3
Employment in corporate sector	% YoY	-0.9	-0.8	-0.7	-0.5	-0.3	-0.2	0.1	0.3	0.0	0.2	0.5	0.7	0.7	0.7
Exports (€)	% YoY	0.3	5.4	7.4	2.8	9.0	3.8	2.3	10.1	10.7	5.7	10.9	6.7	10.5	14.4
Imports (€)	% YoY	-6.1	-1.9	3.1	-0.3	4.2	4.6	0.6	0.0	6.6	6.9	3.1	7.3	10.5	13.8
Trade balance	EUR mn	1	570	137	299	660	259	-25	-85	426	303	475	600	1	728
Current account balance	EUR mn	-176	100	-566	-618	-907	162	-803	-430	-825	-463	517	537	-236	206
Current account balance	% GDP	-2.8	-2.3	-1.9	-1.9	-1.9	-1.7	-1.6	-1.3	-1.1	-1.1	-0.9	-0.9	-0.9	-0.9
Budget deficit (cumulative)	PLN bn	-30.9	-26.0	-25.9	-26.8	-29.6	-39.5	-38.5	-42.2	-2.6	-11.7	-17.5	-21.3	-22.5	-33.7
Budget deficit (cumulative)	% of FY plan	60.0	50.4	50.3	51.9	57.4	76.5	74.7	81.8	5.6	24.7	36.8	44.8	47.4	71.0
CPI	% YoY	0.5	0.2	1.1	1.1	1.0	0.8	0.6	0.7	0.5	0.7	0.7	0.3	0.4	0.5
CPI excluding food and energy	% YoY	1.0	0.9	1.4	1.4	1.3	1.4	1.1	1.0	0.4	0.9	1.1	0.8	0.9	1.1
PPI	% YoY	-2.5	-1.3	-0.8	-1.1	-1.4	-1.4	-1.5	-1.0	-1.0	-1.4	-1.3	-0.7	-0.6	-1.9
Broad money (M3)	% YoY	6.5	7.0	6.6	6.1	6.1	5.9	5.7	6.2	5.4	5.2	5.2	5.4	5.5	5.0
Deposits	%YoY	6.0	6.5	5.6	5.8	6.0	5.9	5.2	6.0	4.9	4.7	4.7	5.4	5.7	5.3
Loans	%YoY	1.4	3.5	3.7	3.3	3.7	2.9	3.8	4.0	4.2	4.7	5.3	6.1	5.5	4.3
EUR/PLN	PLN	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	4.12
USD/PLN	PLN	3.22	3.25	3.27	3.18	3.17	3.07	3.10	3.05	3.07	3.06	3.04	3.03	3.04	3.03
CHF/PLN	PLN	3.36	3.47	3.46	3.43	3.43	3.40	3.40	3.41	3.39	3.42	3.45	3.43	3.42	3.38
Reference rate <sup>b</sup>	%	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	2.50
3M WIBOR	%	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	2.69
Yield on 2-year T-bonds	%	2.55	2.86	2.87	2.98	3.07	2.90	2.80	2.94	2.99	3.06	2.99	2.94	2.79	2.50
Yield on 5-year T-bonds	%	2.80	3.43	3.36	3.67	3.86	3.62	3.64	3.65	3.67	3.79	3.68	3.60	3.36	3.05
Yield on 10-year T-bonds	%	3.28	3.95	3.97	4.31	4.50	4.28	4.38	4.41	4.42	4.47	4.26	4.10	3.80	3.50

Note: <sup>a</sup> in nominal terms, <sup>b</sup> at the end of the period.

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

## 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	1 705.3	378.4	396.3	405.6	455.5	397.4	413.5	420.4	473.9
GDP	% YoY	4.5	2.0	1.6	3.5	0.4	0.8	2.0	2.7	3.4	3.5	3.6	3.6
Domestic demand	% YoY	3.6	-0.1	0.0	3.7	-1.0	-1.6	0.6	1.8	3.0	4.2	3.5	3.9
Private consumption	% YoY	2.6	1.3	0.8	2.8	0.0	0.1	1.0	2.1	2.6	2.8	3.0	3.0
Fixed investments	% YoY	8.5	-1.6	-0.2	6.6	-2.4	-3.3	0.5	2.0	10.7	4.0	6.0	7.0
Industrial production	% YoY	7.7	1.0	2.3	4.8	-2.0	1.2	5.0	4.5	4.8	4.4	4.4	5.5
Construction production	% YoY	12.3	-1.0	-10.3	7.6	-15.6	-22.9	-7.0	0.0	9.8	11.0	7.4	4.6
Retail sales <sup>a</sup>	% YoY	11.2	6.0	2.6	6.3	0.9	0.8	4.0	4.5	5.1	6.2	6.1	7.6
Unemployment rate <sup>b</sup>	%	12.5	13.4	13.4	12.2	14.3	13.2	13.0	13.4	13.5	12.1	11.8	12.2
Gross wages in national economy <sup>a</sup>	% YoY	5.2	3.7	3.4	4.5	2.6	3.3	4.0	3.6	4.2	4.6	4.5	4.7
Employment in national economy	% YoY	0.6	0.0	-0.8	0.4	-0.7	-1.1	-1.2	-0.1	0.0	0.4	0.5	0.5
Exports (€)	% YoY	12.1	5.9	5.0	10.9	3.2	5.5	6.5	5.0	9.1	10.5	11.8	12.0
Imports (€)	% YoY	12.2	2.3	0.0	10.0	-2.0	-2.2	2.4	1.8	5.5	10.5	11.2	12.5
Trade balance	EUR mn	-10 059	-5 175	2 309	3 956	-139	1 203	1 094	151	1 204	1 329	1 455	-33
Current account balance	EUR mn	-18 519	-14 191	-4 984	-3 396	-2 313	486	-2 086	-1 071	-771	261	-1 705	-1 182
Current account balance	% GDP	-5.0	-3.7	-1.3	-0.8	-3.1	-2.3	-1.9	-1.3	-0.9	-0.9	-0.8	-0.8
General government balance	% GDP	-5.1	-3.9	-4.3	5.7	-	-	-	-	-	-	-	-
CPI	% YoY	4.3	3.7	0.9	0.5	1.3	0.5	1.1	0.7	0.6	0.4	0.2	0.7
CPI <sup>b</sup>	% YoY	4.6	2.4	0.7	0.8	1.0	0.2	1.0	0.7	0.7	0.5	0.3	0.8
CPI excluding food and energy	% YoY	2.4	2.2	1.2	0.8	1.2	1.0	1.4	1.2	0.8	0.9	0.7	1.0
PPI	% YoY	7.6	3.4	-1.3	-1.3	-0.7	-2.0	-1.1	-1.3	-1.2	-1.1	-1.9	-1.2
Broad money (M3) <sup>b</sup>	% oY	12.5	4.5	6.2	7.3	6.6	7.0	6.1	6.2	5.2	5.0	6.6	7.3
Deposits <sup>b</sup>	%YoY	11.7	20.6	9.8	9.1	6.6	6.5	6.0	6.0	4.7	5.3	6.5	7.0
Loans <sup>b</sup>	%YoY	14.4	36.6	8.7	8.8	3.5	3.5	3.7	4.0	5.3	4.3	4.4	5.5
EUR/PLN	PLN	4.12	4.19	4.20	4.11	4.16	4.20	4.25	4.19	4.19	4.16	4.09	4.01
USD/PLN	PLN	2.96	3.26	3.16	2.99	3.15	3.22	3.21	3.08	3.06	3.03	2.99	2.88
CHF/PLN	PLN	3.34	3.47	3.41	3.34	3.38	3.41	3.44	3.40	3.42	3.41	3.33	3.18
Reference rate <sup>b</sup>	%	4.50	4.25	2.50	2.50	3.25	2.75	2.50	2.50	2.50	2.50	2.50	2.50
3M WIBOR	%	4.54	4.91	3.02	2.71	3.77	2.96	2.70	2.66	2.71	2.71	2.69	2.72
Yield on 2-year T-bonds	%	4.81	4.30	2.98	2.73	3.29	2.77	2.98	2.88	3.01	2.74	2.51	2.65
Yield on 5-year T-bonds	%	5.44	4.53	3.46	3.35	3.49	3.09	3.63	3.64	3.71	3.34	3.06	3.28
Yield on 10-year T-bonds	%	5.98	5.02	4.04	3.89	3.95	3.58	4.26	4.36	4.38	3.80	3.57	3.82

Note: <sup>a</sup> in nominal terms, <sup>b</sup> at the end of period. Source: CSO, NBP, Finance Ministry, BZ WBK own estimates.

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