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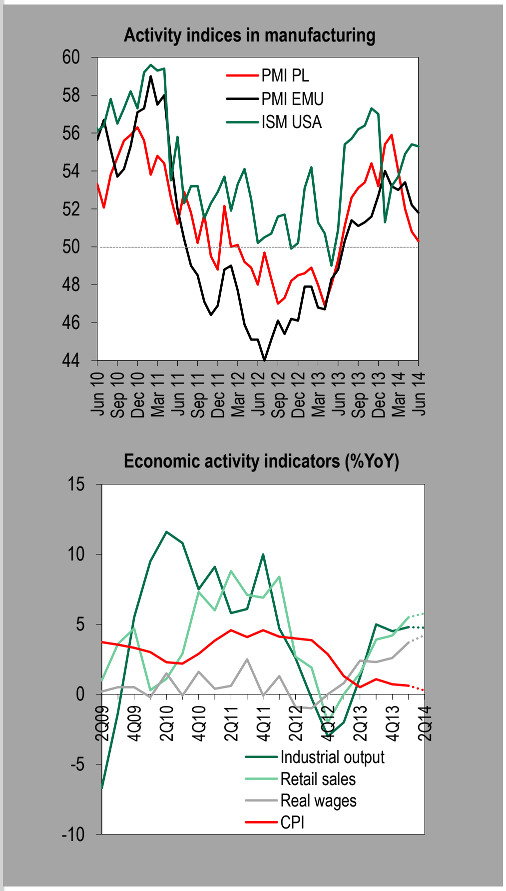
MACROscope

Polish Economy and Financial Markets

July-August 2014

Naturally neutral



In this issue:

■ **In July the Polish Monetary Policy Council (MPC) decided to remove the sentence declaring interest rates would remain stable until the end of 3Q14 from the official statement. Does this suggest a rate cut in September? Not at all.** The National Bank of Poland (NBP) governor said so explicitly at the post-meeting conference. He also reiterated that the probability of policy easing is still very low, in the Council's opinion. It should be emphasised that the MPC maintained its view after receiving the new NBP projections, which are not overly optimistic. They assume flat GDP growth (or even a slight decrease) and inflation below zero in the few next months, returning gradually towards the target in the medium-term. In July, the MPC returned to the informal neutral bias in monetary policy. Reading recent MPC members' comments, it is quite clear that the factors that could change their minds about adopting some easing include: a sharp slowdown in economic growth and/or a rapid appreciation of the zloty. The negative YoY CPI numbers the market expects to see in the next few months will be no surprise for the MPC and are unlikely to influence its decisions.

■ **Data due in the next few months will show if Poland is heading towards an economic slowdown or whether recent weaker-than-expected indicators were just a blip and the economy is still expanding at decent pace. We see the latter scenario as the baseline** and, even if we expect a minor slowdown in 2Q14 GDP compared with 1Q14, this won't be an argument for the central bank to act. To some extent, one can argue that the first quarter was exceptionally good in terms of economic growth (excellent weather supported construction and investment) and some weakening in 2Q14 would be a natural result. In fact, our estimates suggest that retail sales, industry output and construction did not slow in 2Q. The first monthly indicators for 3Q14 will be important and we expect a continuation of the positive trend. We maintain our full-year GDP growth forecast of 3.5% for 2014.

■ **We expect June inflation data to show the YoY CPI at a similar level to May. Starting in July, we are likely to enter a period of a few months (in our opinion just two) of negative readings.** This will be largely driven by very low food inflation (in fact food deflation since May) as well as a strong statistical base effect. We agree with the conclusions of the last NBP inflation report, that this temporary 'deflation' phenomenon should not be a cause for concern for the Polish authorities and, in fact, is even positive for real growth in disposable incomes. Our medium-term (2015-16) inflation forecasts are slightly higher than the central bank's projections.

Financial market on 10 July 2014:

NBP deposit rate	1.00	WIBOR 3M	2.68	EURPLN	4.1341
NBP reference rate	2.50	Yield on 2-year T-bond	2.44	USDPLN	3.0323
NBP lombard rate	4.00	Yield on 5-year T-bond	2.93	CHFPLN	3.4040

This report is based on information available until 10.07.2014.

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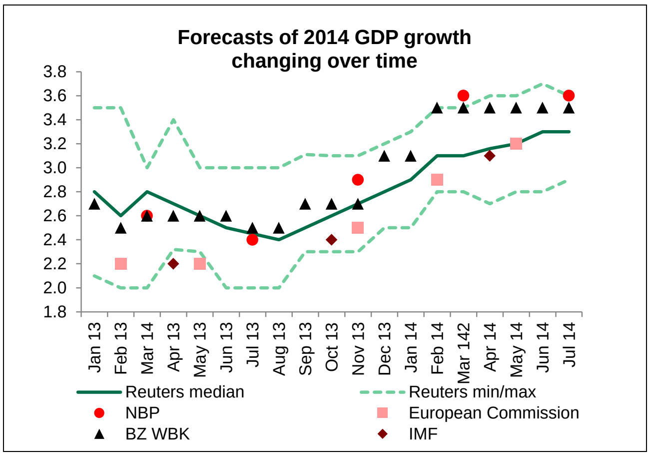
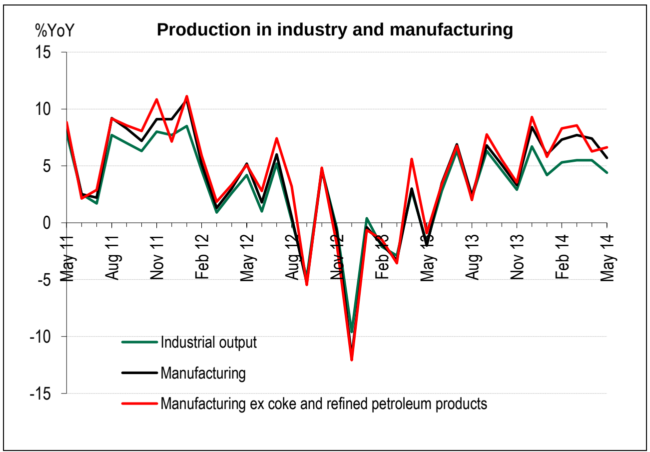
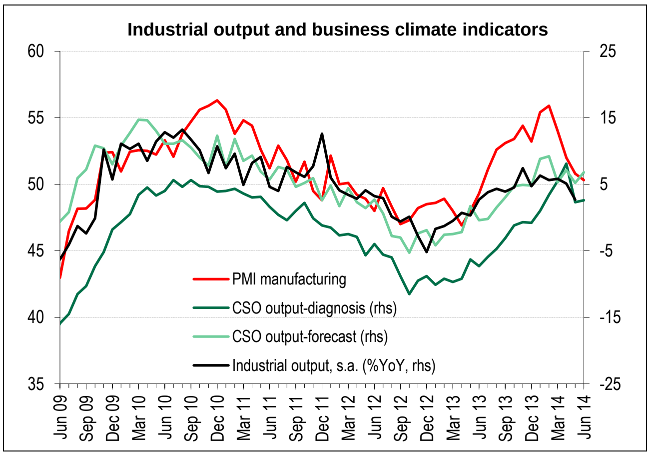
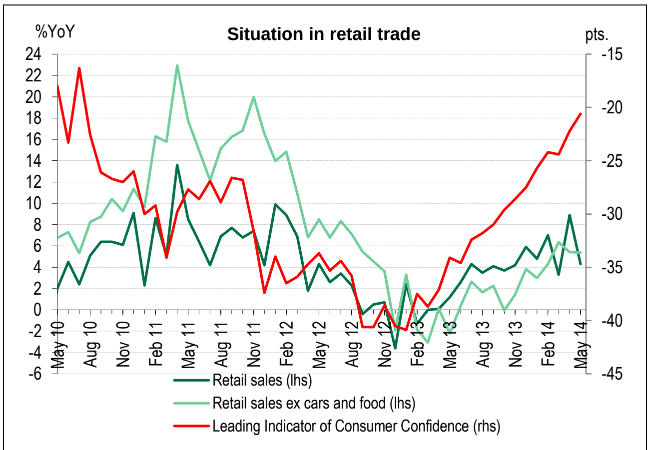
Economic update









Source: CSO, NBP, EC, IMF, Reuters, Markit, BZ WBK

Worries about a slowdown exaggerated

- Recent data on the real economy was rather disappointing, with the main indicators, such as the PMI index, industrial output, construction and assembly output, surprising on the downside. This fuelled concern that the economic recovery may not be as strong as expected or even that the Polish economy may slow down again. In our view, although GDP growth in 2Q could have been slightly lower than in 1Q, the difference was very small and the current weakness in some major indicators is only a soft patch, not a prelude to a slowdown. Interestingly, the recent weaker data did not cause a significant revision of market forecasts of GDP growth (see chart).

Industry undermined by mining, but underlying trend positive

- Industrial output growth decelerated in May to 4.4% YoY. Seasonally-adjusted growth was 2.7% YoY, the lowest level in a year. However, 27 out of 34 industrial sectors increased output in annual terms, with the highest growth in export-oriented ones (furniture 18.3% YoY, machinery and devices 13.2% YoY, manufacture of metal products 11.6% YoY, computers 11.6% YoY). We note that, as happened in other months so far this year, the overall reading was undermined by the weak performance of mining (-8.7%YoY) and energy (-1.7%YoY). Industrial manufacturing itself expanded by 5.7% YoY, despite weaker readings in the manufacture of coke and refined petroleum products, which are strongly related to output in mining.
- Mining is in doldrums due to declining global coal prices, making imports of this commodity more competitive. This is likely to continue, given the structural problems of Polish mining. However, other sectors are posting positive results and some are even showing double-digit growth rates, as noted above. Thus, we foresee no broad-based deceleration in industry and think the underlying trend remains positive.

Business climate indices are not unanimous

- Polish manufacturing PMI disappointed again in June, falling to 50.3 points, a one-year low. The new orders index fell to around 50, while the new export orders index was below 50s for the second straight month. Employment and output indices climbed slightly, but this was not enough to outweigh the general negative impression.
- However, the PMI is still running above 50 points, the border between expansion and contraction, suggesting there is no slowdown. We note the signals sent by the PMI survey are not in line with the CSO business climate indices, which recorded an improvement in all sectors in June.

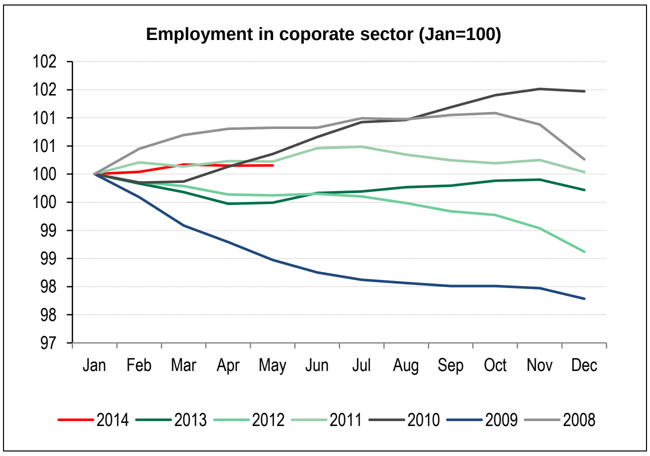
Construction likely to be supported by public spending

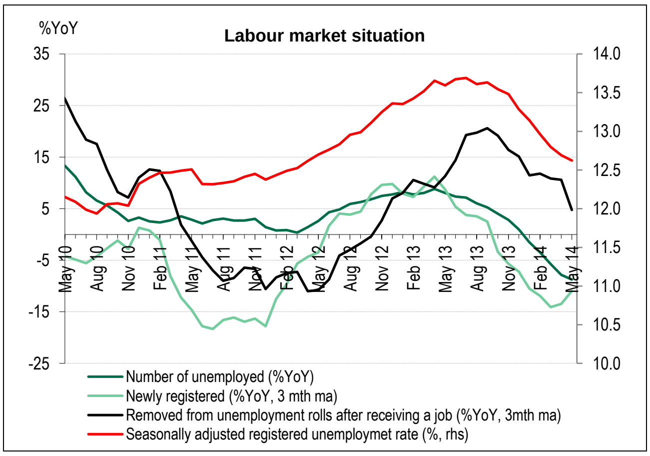
- Construction and assembly output were also disappointing in May at 10% YoY compared with market forecasts of c14% YoY. Seasonally-adjusted output in construction increased by 8.3% YoY, the weakest reading since January, according to the CSO.
- The slowdown in construction is mainly due to a fall in homebuilding, connected to a recent oversupply of flats. This sector may remain sluggish for some time to come, but other construction sectors, like civil engineering, are likely to be strongly underpinned by public spending and EU funds.

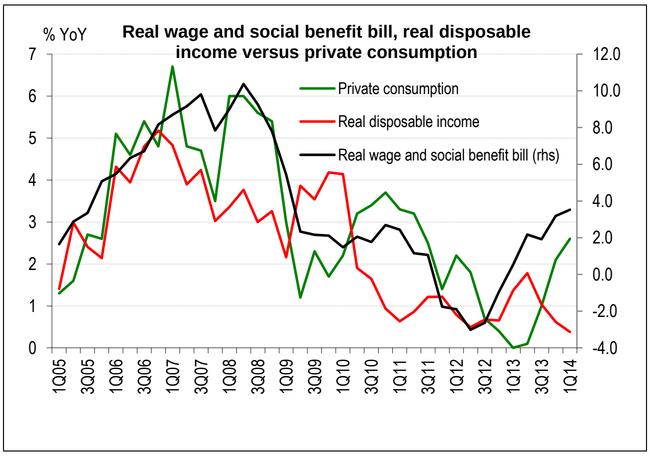
Sales strongly distorted

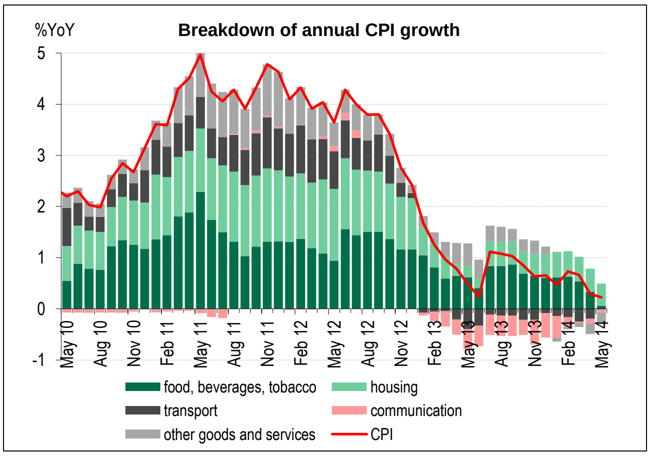
- Retail sales advanced by 3.8% YoY in May compared with 8.4% YoY in April and 3.1% YoY in March.
- Sales were mainly dragged lower by declining car sales, after very strong gains in the first quarter when people brought forward purchases to take advantage of tax allowances. This, plus other statistical issues like the timing of Easter, which distorted sales in March/April, make it difficult to pinpoint the current trend in sales. Our estimates suggest that real sales advanced by 5.5% in 1Q and 5.8% in 2Q. This shows the strength of consumer demand, which is likely to be supported further by the strength of the labour market.

Economic update









Source: CSO, Eurostat, BZ WBK.

Slower improvement in the Polish labour market

- Recent data from the labour market have shown some deceleration in the pace of improvement, both in terms of employment and unemployment figures.
- Average employment in the corporate sector amounted to 5.515mn in May, ie almost unchanged versus April. Annual employment growth was 0.7% YoY for the second month in a row. Thus, the upward trend in the number of jobs in recent months has slackened somewhat. Our forecasts assume that demand for labour should accelerate slightly later in the year, thanks to a revival in investment growth, among other things. However, it is worth keeping a close eye on employment data in the coming months, because, if employment does not start to rise again, it may indicate a slowing of the economic recovery.
- The registered unemployment rate fell to 12.5% in May. The number of jobless was 8.7% lower than a year earlier (vs -7.8% YoY in April), but, in our opinion, these data have started to signal that the labour market is losing steam. For example, the number of newly-registered unemployed declined by 5.4% YoY in May compared with double-digit falls in January-April. The number of people leaving the register due to taking up a job was lower than in the same period of 2013. This slowdown came partly from a base effect (as the labour market rebound started one year ago). However, seasonally-adjusted data also show that the rebound is not as strong as it was in February or March. All in all, we still expect a further decline in the registered unemployment rate, but think the downward trend will be not as strong as in the previous months.
- We note that, according to the Labour Force Survey, the unemployment rate is back at levels seen in 2010/2011 (c9.5%). The registered unemployment rate is also likely to return to levels of three or four years ago soon (c12.0-12.5% after seasonal adjustment). Thus, unemployment rate is actually relatively low given the post-crisis situation.

Disposable income lags behind wage growth

- Average wage growth accelerated to 4.8%YoY in May, the highest level since January 2012. Accelerating wage growth, combined with low inflation and a slight increase in employment implies a considerable rise in households' labour income. Real growth of the corporate sector wage bill surged to 5.1%YoY, the highest since June 2011. Such apparent growth in labour income should support a further recovery of consumer demand in the coming quarters. We expect the real wage and social benefit bill to expand by more than 4% this year, which would support a gradual rise in consumer prices in the longer term.
- Surprisingly, despite accelerating labour income, the quarterly sector accounts show that growth in real household disposable income is sluggish and decelerating. Still, private consumption seems to be more closely tied to real wages and social benefits than to real disposable incomes (see chart).

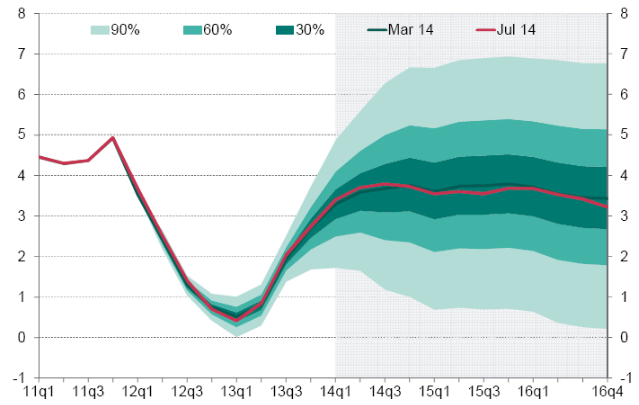
Inflation to an all-time low

- The inflation rate fell to 0.2% YoY in May, equalling the July 2013 all-time low. The CPI was driven lower mainly by prices of food and non-alcoholic beverages, which dropped by 0.4% MoM and was negative YoY (-0.8%) for the first time since June 2006. The biggest fallers were vegetables and sugar.
- We are expecting the CPI to edge up 0.3% YoY in June (our forecast is above the market consensus) before turning negative in July and August. We reiterate that by no means are we expecting Japanese-style deflation. Deflation in Poland is likely to be only a statistical effect on the long road from hyperinflation in 1990s (1108% YoY in January 1990) to the current price stability. In the coming quarters, inflation should be pushed upwards by reviving domestic demand.
- Other inflation gauges like core CPI or PPI still show no signs of rising price pressure.

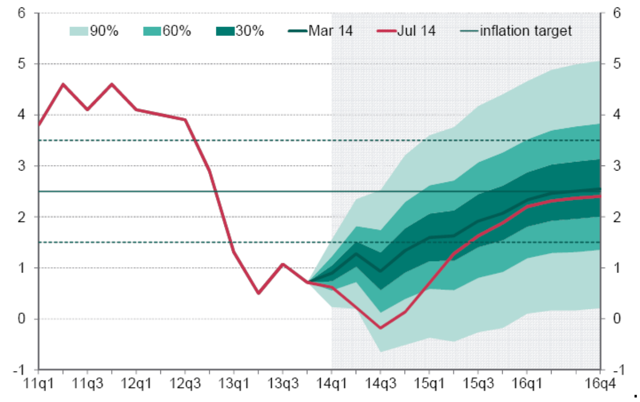
Monetary policy watch

Excerpts from the MPC's communiqué after its July 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 economies.
In Poland, a gradual economic recovery continues. Nonetheless, May data show that annual growth in industrial output, construction and assembly output as well as in retail sales was slower than in the preceding months. (…) a recent decline in some business climate indices points to a possible slowdown in economic recovery.
Labour market conditions are improving gradually. Corporate sector data for May indicate a stabilisation of employment and a slight acceleration in wage growth.
In May, CPI inflation was lower than expected and stood at 0.2%, remaining markedly below the NBP inflation target of 2.5%. At the same time, all core inflation measures remained very low.
In the opinion of the Council, in the coming months inflation will remain very low and may temporarily fall below zero. In the following quarters, the ongoing economic recovery and improvement in the labour market should support a gradual increase in inflation and its approaching the target. This assessment is supported by the July projection of inflation and GDP. Nonetheless, uncertainty persists over the scale of further acceleration of economic growth and the prospects of inflation returning to the target.
The Council decided to keep NBP interest rates unchanged. The Council decisions in the coming months will depend on the incoming information, which impacts the assessment of the outlook for economic growth and inflation in the medium term.

July projection versus March projection: GDP (%YoY)



July projection versus March projection: CPI (%YoY)



Sources: NBP, BZ WBK.

Neutral bias instead of forward guidance

- The Monetary Policy Council kept interest rates unchanged in July, with the reference rate at 2.5%. However, it made considerable changes in its post-meeting statement.
- In particular, it removed the sentence declaring interest rates would be stable until the end of 3Q14 (the so-called forward guidance). This came as no surprise, as the MPC has been suggesting for some time that, after seeing the new NBP projection in July, it would be better able to assess the monetary policy outlook and modify its communication with the market.
- Instead, the MPC said that its decisions in the coming months will depend on incoming information and its potential impact on economic growth and inflation in the medium term. The important thing is that, at the very beginning of the post-meeting press conference, NBP president Marek Belka emphasised that the change in the statement does not mean there is likely to be an interest rate cut in September and he repeated that the probability of policy easing is still very low, in the Council's opinion. He added that the change in communication means that there could be a move in monetary policy in any direction in the coming months and that a decision will depend on the economic data available. In our view, this means the MPC has returned to a neutral bias in monetary policy.
- We would emphasise the MPC assessed the probability of further rate cuts as very low after receiving the new NBP projection. The projection is not overly optimistic – it assumes stable economic growth (or even a slight decrease), inflation below zero in the next few months and a subdued pick-up in the coming quarters (see details below). It confirms our opinion that monetary easing in the next few months is only likely if economic data are very weak. Sub-zero inflation will be no surprise, as such a scenario is already anticipated by the MPC.
- The next decision-making meeting is scheduled for September and by then there will be abundant data to help to verify if we are heading towards an economic slowdown or whether (as we expect) recent weaker-than-expected indicators were just a temporary blip in the trend and economic activity will continue to expand at a decent pace (the first monthly indicators for 3Q14 will probably be even more important for the Council than 2Q14 GDP growth). In the latter scenario, which we still see as the baseline, interest rate cuts in Poland are unlikely.

NBP expects stable GDP growth and low inflation

- The NBP forecasts indicate a very similar path for GDP growth as that predicted in March: growth is expected to stabilise near 3.5% in the next three years, exceeding the potential output growth rate. The output gap will remain negative throughout most of the projection period, closing only at the end of 2016. The NBP's scenario assumes a gradual acceleration of private consumption growth, which is consistent with our forecasts. However, we think it is over conservative for the investment outlook (the central bank assumes investment growth will slow gradually in the next three years, while we think it should gain speed until 2016).
- The near-term inflation the central bank expects is clearly lower than its previous projection: after dropping below zero in the next three to four months, CPI growth is predicted to start picking up slowly towards the NBP's target of 2.5%. The main reason for the revision was lower growth of food and energy prices, but also the negative output gap. We think that a pick-up in domestic demand may trigger faster price growth than the NBP anticipates.
- Interestingly, the NBP's *Inflation Report* highlights changes to monetary transmission mechanisms in Poland that took place in recent years. In particular, the central bank's study shows the impact of the exchange rate on inflation has weakened and that inflation is more responsive to changes in short-term interest rates.

Monetary policy watch

The 'tape affair': Belka stays . . . and the bad taste as well

- In mid-June, recordings of talks (held in July 2013) between the Internal Affairs Minister Bartłomiej Sienkiewicz and the NBP Governor Marek Belka triggered a political storm. The talks covered, among other issues, changes in the NBP Act. Belka also used strong language about the interest rate-setting panel.
- We wrote in detail about the issue in a special comment. In general, while implementing the rotation of MPC members and allowing the option of a potential debt purchase in the secondary market, aimed at stabilising the financial system, generates no significant controversies, we think stability tools should be the direct responsibility of the MPC.
- Cooperation between the NBP governor and the MPC members is likely to continue. While relations may be tense in some cases, this should not have a major impact on the Council's specific responsibilities.

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 the 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.

Probability of rate cuts very small

The NBP president stressed during the MPC press conference that the change in the statement and the move to abandon forward guidance do not mean that a rate cut should be expected in September. Belka reiterated last month's stance that the Council assesses the probability of such a move as very low and he added this change opens the door to all types of action by the MPC in the coming months. He repeated those statements in an interview with *Dziennik Gazeta Prawna* daily, saying that the Council "does not have to think intensively about rate cuts". These comments should cool market expectations of rate cuts (although the effect after the MPC meeting was only temporary).

Strong convergence of views . . .

During the July's MPC press conference, Belka said there is a "strong convergence of views" about monetary policy within the MPC. A few examples of this were visible during the post-meeting week. MPC member Adam Glapiński said in an interview with Bloomberg that "there will be no rate cut in September" and that he "definitely" expects no rate cuts until the end of the year. In his view, the MPC may revise monetary policy in early 2015 and "if no significant economic slowdown occurs, rates should remain unchanged until the end of next year". Anna Zielińska-Głębocka said that in the current environment both cuts and hikes in interest rates can be regarded as "extreme scenarios" and "there is no room for rate cuts". In her view, the most likely scenario is stable official rates for some time. When asked about the possibility of hikes, she mentioned an (unlikely) scenario of a significant recovery in the Euro zone, which would then change the outlook for Polish GDP and CPI. Andrzej Bratkowski said recently that the MPC's next move is still more likely to be to hike rates than to cut them.

. . . though apparently there are other views too

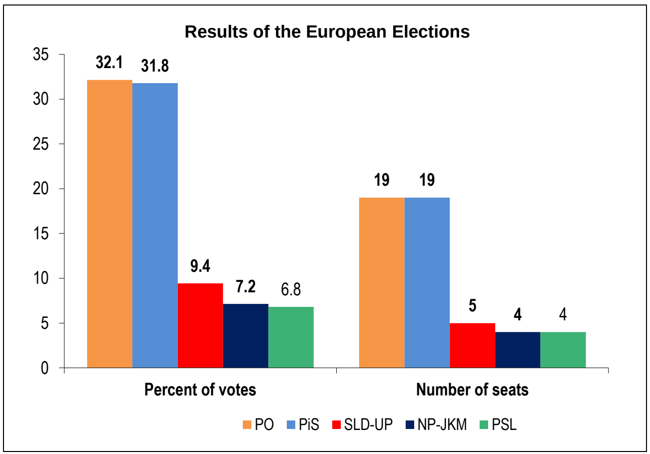
The MPC's Elżbieta Chojna-Duch said in an interview with the Polish Press Agency that the new NBP projection gave a very clear signal and should encourage the council to cut interest rates. In another interview she even said explicitly that rates should be reduced by 25bp or even by 50bp in the case of prolonged deflation. The dovish views of Chojna-Duch are not surprising given her previous comments but, in the light of other members' views, it seems obvious that she is in a minority. Curiously, she also expressed hope that macro data will convince other MPC members to abandon the stable rates policy, which made it sound like she did not wish the Polish economy well.

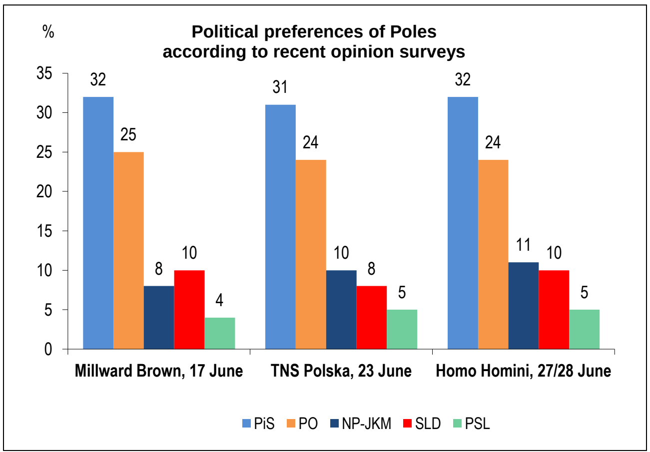
A sharp slowdown or fast PLN appreciation could change the MPC's mind

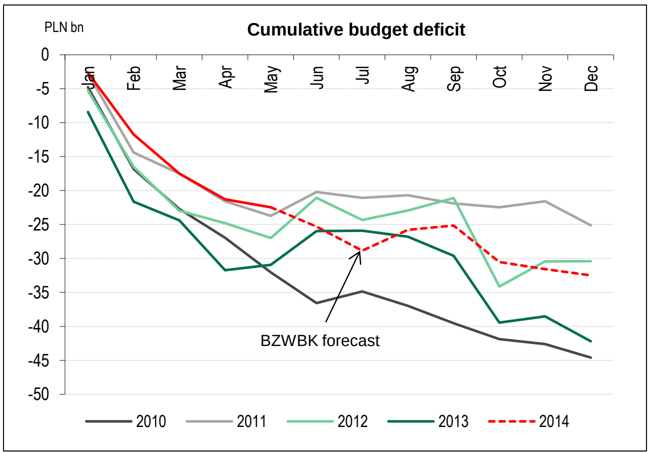
While the view of MPC majority is quite clear, the question is what would have to happen to change their minds. Asked when interest rates could be trimmed, Belka said: "If economic activity deteriorates significantly or when there are visible signals that this may happen. Alternatively, when the zloty gains a lot due to, for example, decisions of other central banks". A similar line was repeated recently by Bratkowski and Zielińska-Głębocka. Neither a sharp GDP slowdown nor a fast zloty appreciation is our base-case scenario. It seems not to be expected by the NBP staff either. As regards the zloty, the head of the NBP economic institute, Andrzej Sławiński, said that he did not expect the next ECB liquidity operation to have a visible impact on the zloty, as it is smaller in scale than the previous ones, which did not influence the domestic currency significantly.

Source: NBP, Reuters, BZ WBK.

Fiscal policy watch







	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	10.07	change since 11.06.14	change since 31.12.13	10.07	change since 11.06.13	change since 31.12.13
Poland	217	5	-20	58	-1	-21
Czech	30	2	-28	45	-7	-15
Hungary	318	5	-59	167	-23	-89
Greece	506	70	-155	103	5	67
Spain	161	38	-60	71	-6	-154
Ireland	114	9	-39	50	-9	-70
Portugal	275	71	-135	175	6	-171
Italy	173	38	-42	94	-11	-75
France	33	0	-16	40	-3	-14
Germany				22	0	-5

Source: Ministry of Finance, PKW, BZ WBK.

Political situation stable, despite the ‘tape scandal’

- In the second half of June, public opinion in Poland was shaken by the ‘tape scandal’, which involved leaked secret recordings of controversial conversations between top politicians (including the NBP governor). This threatened to disrupt the government and prompted speculation about an early election.
- The political uncertainty did not last long, as PM Donald Tusk declared that no dismissals of ministers were on the agenda and the government quite easily won a confidence vote in parliament. While opposition parties may continue to put pressure on the government (possible motions of no-confidence against some ministers, and even a motion to send the NBP president to the State Tribunal), the chances of major political destabilisation are small.
- Still, the ‘tape scandal’ had some influence on public opinion, undermining support for the ruling PO party and increasing support for main opposition party, the PiS. The latter is now leading in most recent opinion polls, while in European Parliament election a month before the scandal broke, the two were almost even.
- Local elections are scheduled in Poland this autumn, while general and presidential elections are set for 2015.

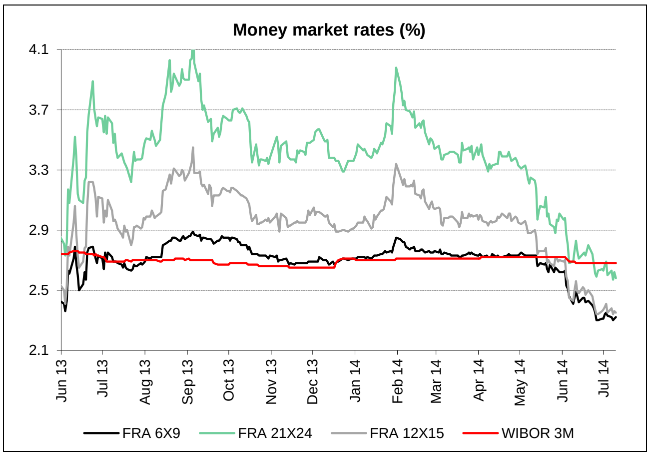
Lower privatisation inflows, but budget gap also falls short

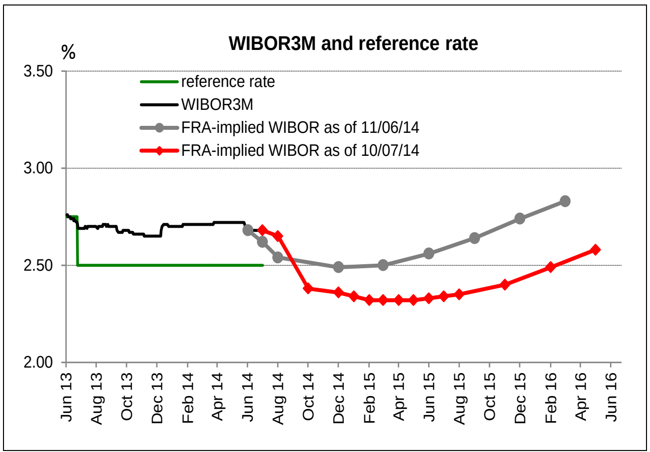
- Privatisation inflows to the state budget are well behind schedule. The Finance Ministry said that in 1H14 privatization inflows were PLN769mn, which is only 21% of this year’s target. This is due to the fact that a large part of the receipts come from capitalising the Polish Investments for Development (PIR) programme. It seems likely that privatisation inflows this year will be substantially lower than planned (perhaps some PLN2.5bn lower). However, this should not complicate the financing of this year’s budget deficit, as the latter is also likely to be much lower than planned.
- The deficit had reached cPLN22.5bn at the end of May, roughly in line with expectations and equivalent to 47.3% of this year’s target, significantly less than in the last three years. The data clearly confirm that the economic recovery is helping the budget by boosting tax revenue and that the deficit at the end of the year is likely to be significantly – cPLN15bn – smaller than forecast in the budget, according to our estimates.
- At the end of June, the ministry had secured as much as 90% of its planned gross borrowing needs for 2014. However, if we take into account that both the budget deficit and privatisation flows this year may be lower than assumed in the budget, we think all the 2014 borrowing needs are already covered.

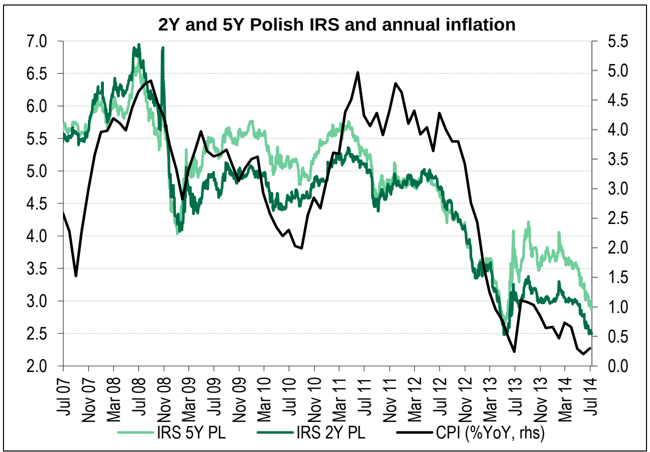
Correction in Euro zone peripheral debt after rally

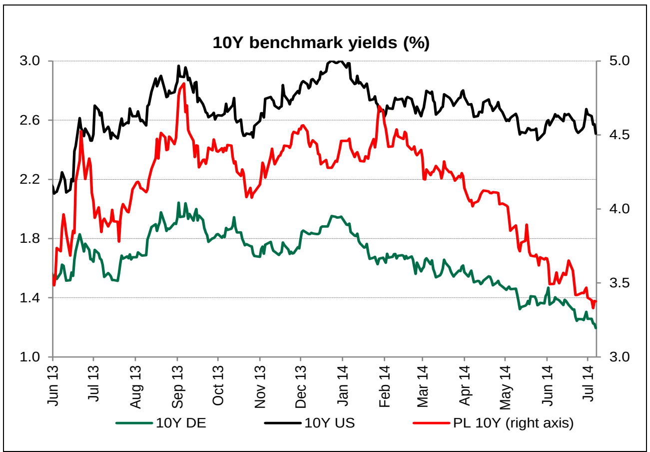
- While the Fed is staying the course with respect to its current monetary policy stance (end of QE3 in October), the ECB has announced a comprehensive package of measures, which should support the economic recovery. Consequently, at the end of June German bond yields were close to all-time lows, with the 10Y benchmark near 1.25%. Peripheral bonds also strengthened substantially, with the spread over Bunds narrowing to the lowest levels since 2010. At the same time, the 10Y Treasuries yield has risen above 2.60% as investors predict the first US rate hike will come sooner rather than later.
- Negative news about Portugal and Banco Espirito Santo (BES) prompted a wave of risk aversion at the beginning of July. Reports of a major BES shareholder’s difficulty in servicing its short-term debt prompted concern about the entire Portuguese financial system. The 10Y Bund yield fell below 1.20%, while risk premiums widened slightly. This, in our view, was a result of profit-taking rather than an actual change of sentiment on risky assets, fostered by the absence of other significant news and thinner market liquidity in the summer. The market is likely to keep monitoring developments on this front, which could weigh on peripheral debt valuations in the coming months.

Interest rate market









Source: Reuters, BZ WBK.

The MPC scales back rate cut expectations . . .

▪ The interest rate market continued to strengthen in June, amid higher expectations for rate cuts after the inflation surprise and some disappointing economic data. While WIBOR rates fell only moderately, FRAs, T-bond yields and IRS dropped across the board by 20-40bp on average. A correction in the second half of the month, due to the 'tape affair' and worries about a snap election, proved neither strong nor long-lasting. The government won a vote of confidence in parliament and this quickly brought bond yields and IRS rates down to their lowest levels in a year. Domestic bonds were also underpinned by strengthening bonds in core markets.

▪ The domestic fixed income market strengthened significantly in 2Q. Growing expectations of an interest rate cut and ECB action caused a considerable decline in bond yields, IRS and FRA rates. As compared to end of 1Q, the bond yield curve moved down by 50-80bp and the IRS curve decreased by 50-70bp, with the most considerable strengthening on the middle and the longer end of curves. At the same time, FRA rates declined by 10-80bp, with WIBOR rates declining by 3-5bp.

▪ The beginning of July again brought a correction in the downward trend in yields/rates as the MPC scaled back expectations of rate cuts. Despite that, forward guidance was dropped and the council said the probability of a rate cut is low. This put temporary negative pressure on Polish assets, in particular middle to longer dated ones, although the ECB's tone helped the market trim earlier losses (the 10Y benchmark yield dipped slightly below 3.40%).

▪ T-bond auctions attracted relatively healthy demand from both domestic and foreign investors. Although the first auction in July was not the most successful, financing costs remained low. What is more, the Finance Ministry has already managed to cover almost all of this year's planned borrowing needs.

. . . but the market strongly believes in easing later this year

▪ Investors strongly believe that the MPC may decide to cut rates later this year as the FRA3x6 is nearly 25bp below 3M WIBOR. The market expects 3M WIBOR to stay well below (nearly 40bp) current level for the next year and then start to gradually increase. We think the low inflation rate (the CPI may temporarily drop below zero in the summer months) may result in a gradual fall in WIBOR rates in the coming months. However, in the medium term, we still assume there will be a gradual increase in WIBOR and FRA rates, as we think that monetary easing will not materialise until data show that economic growth remains robust, while inflation is likely to accelerate.

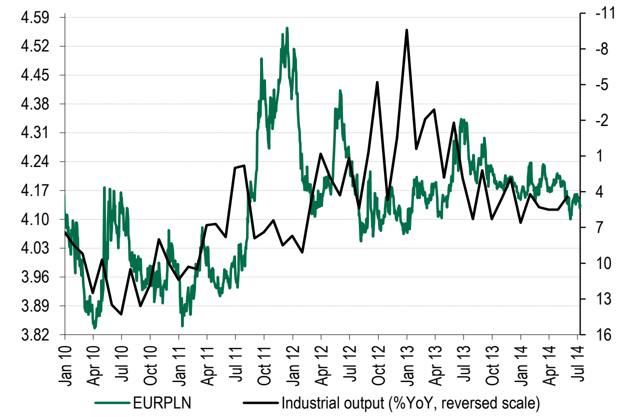
▪ Expectations that the MPC should cut rates have fuelled a gradual decrease in yields/rates. In our opinion, the current valuation of assets at the front end of curves is based on expectations that the CPI will fall below zero in July-August. Therefore, we foresee a horizontal trend in the coming weeks, especially as a rate cut is far from guaranteed and macro data for June should confirm a further gradual economic recovery (our forecasts for industrial output and wages are above market consensus, while for retail sales we are very close to market expectations).

▪ The middle and long end of the curves are more dependent on core markets. We note that in recent weeks the correlation between the yields of 10Y Polish and German T-bonds remains strongly positive (c0.80 for June-July). We think that the scope for further strengthening of Polish debt is diminishing and yields are approaching the bottom (yields of 5Y and 10Y benchmarks are very close to their all-time minimums of May 2013).

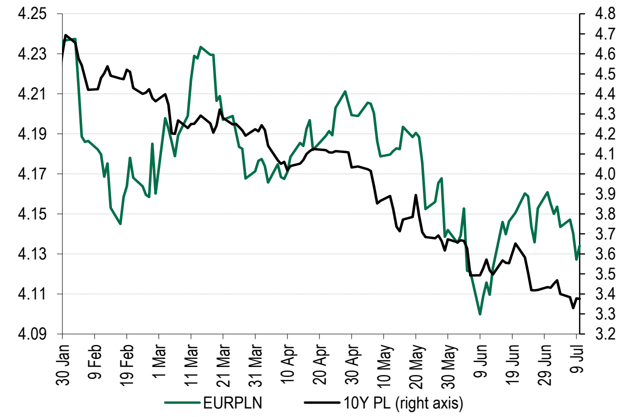
▪ The trend may reverse after the summer, when it becomes clear that further monetary easing in Poland is unlikely. We expect this scenario will be confirmed by the next batch of economic data, showing GDP growth above 3%YoY in 2Q14 and further economic expansion at the start of 3Q14. An upward move of long-term bond yields in the core Euro zone markets would also put some pressure on Polish debt.

Foreign exchange market

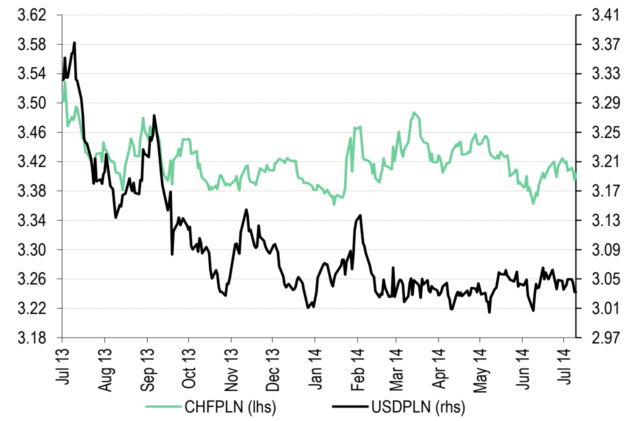
EURPLN and Polish industrial output



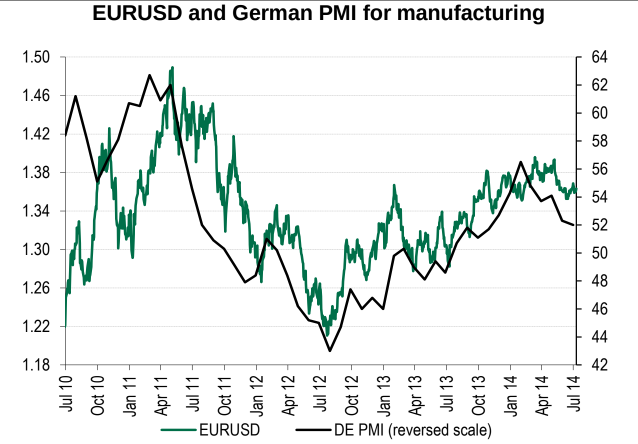
EURPLN and yield of Polish 10Y bond



USDPLN and CHFPLN



EURUSD and German PMI for manufacturing



Sources: CSO, Reuters, BZ WBK

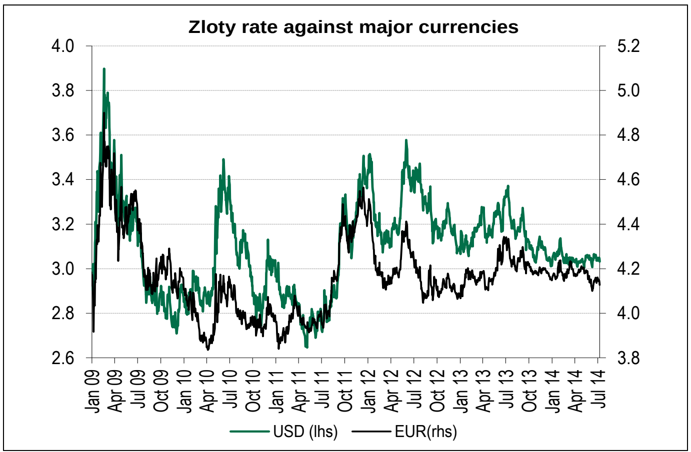
Volatile June, hot summer ahead

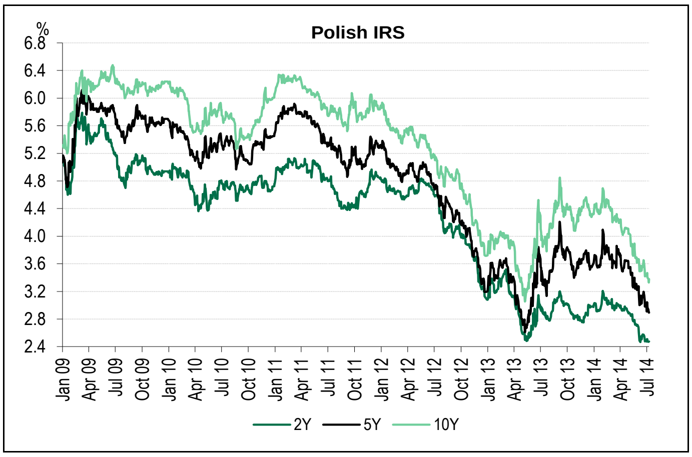
- The weeks since the publication of our June MACROscope have been interesting in the Polish FX market. As we expected, the zloty pared some of its gains versus the euro as the key reason for its appreciation (expectations of ECB easing) disappeared. Poor economic activity numbers for Poland (industrial output, retail sales, manufacturing PMI) and inflation surprised on the downside again. The ‘tape scandal’ in mid-June also undermined confidence in the Polish market and the zloty and the global environment has also not been supportive: the unstable situation in Ukraine and Iraq hit the zloty as well. Consequently, the EURPLN rose from 4.09 to 4.17.
- The performance of the other emerging market (EM) currencies has been mixed since the first week of June. Changes vs the euro and the dollar ranged from -2.0% to +1.6%.
- We still believe that the zloty should appreciate in the medium run, supported by robust economic growth, low external imbalance and the interest rate disparity between Poland and core markets. However, in the summer months, the currency is likely to be influenced by mixed economic data shaping market expectations about growth and possible monetary policy decisions. Economic activity data and flash GDP for 2Q should, in our view, confirm that the economy is not heading for a major slowdown. This may have a moderately positive impact on the zloty. On the other hand, low inflation (possible deflation in July-August) may keep investors’ hopes for rate cuts alive. The impact of this on the exchange rate may be twofold. While expectations of a smaller interest rate disparity may be negative for the zloty, the currency may be strengthened by an inflow of foreign money to the domestic bond market. Continuing geopolitical tensions (conflicts in Ukraine, Iraq and Israel) may continue to weigh on Emerging Market currencies in the short run. Meanwhile, the zloty should strengthen should the ECB signal more clearly that quantitative easing is on the horizon.
- On balance, we expect the EURPLN to be at 4.14 and 4.10 on average in July and August, respectively, and to fall to 4.0 in December.

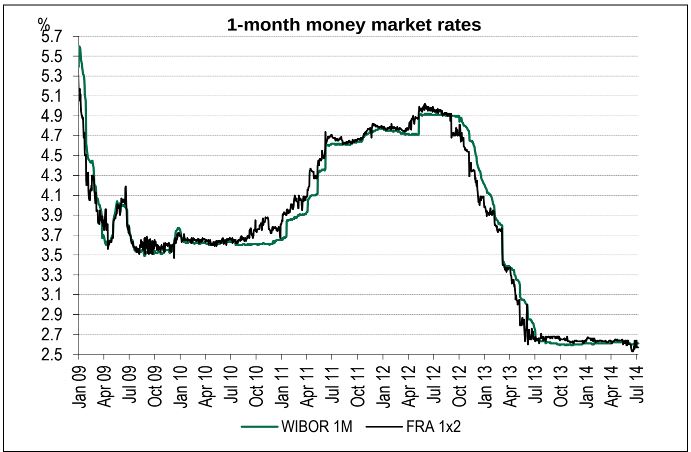
EURUSD stable after the ECB decision

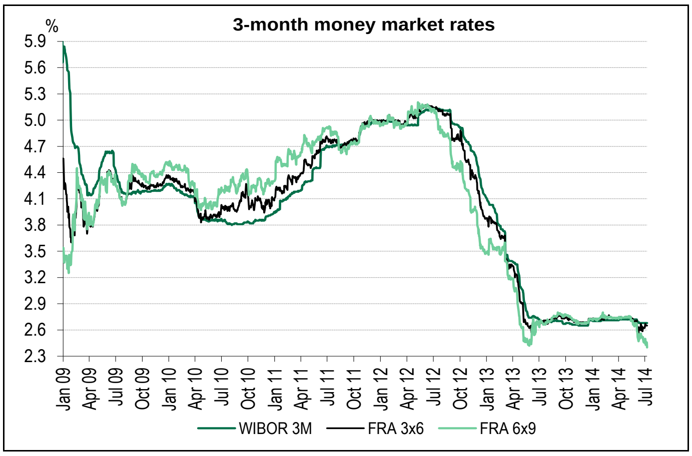
- No major changes occurred in the case of EURUSD. The exchange rate stayed in the 1.35-1.37 range, close to the level it reached after the ECB cut the deposit rate in early June. The dollar failed to gain further vs the euro due to dovish signals from the FOMC and comments from ECB officials pointing out that the central bank is likely to refrain from further action until it sees the result of decisions made in June.
- Expectations of central bank action are likely to remain the main driver of EURUSD. Given the ECB comments, no further action (QE) should be expected in the short term and this should provide some relief for the euro. On the other hand, recent economic data are clearly disappointing and will put pressure on the ECB. Furthermore, FOMC is talking about exit strategies from its ultra-easy monetary policy and this may support the dollar. However, US central bankers claim that accommodative monetary policy is expected to remain in place for a considerable time.
- Given the fact that dollar failed to appreciate further after the June ECB decision and that further easing the Euro zone is unlikely in the short term, we leave our EURUSD forecast unchanged (1.40 at the year-end).

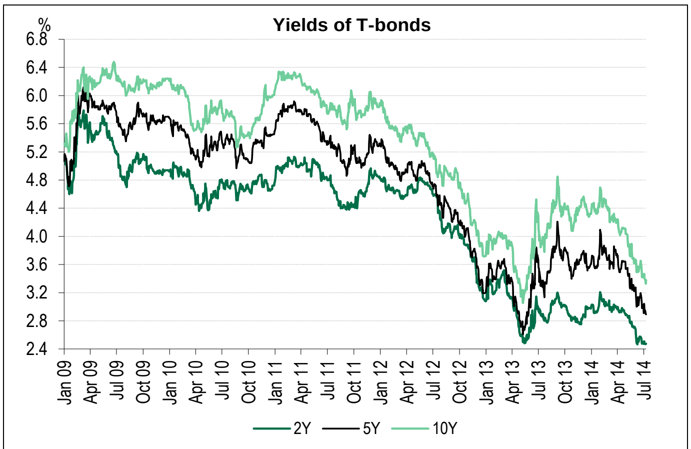
Market monitor

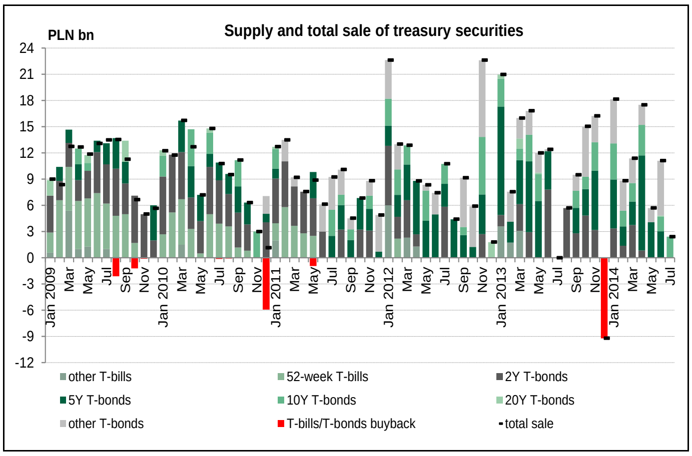












Treasury bond auctions in 2013/2014 (PLN mn)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
July '13	-	-	-	-	-	-	-	-	-	-	-
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	1270.0			
June	5.06	DS/WS/WZ	3000-5000	4989.7					18.06	OK0714/WZ0115	
July	3.07	DS0725/WS0428	1000-3000	2419.0	23.07	to be chosen	2000-6000				

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

Source: MoF, Reuters, BZ WBK.

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
7 July DE: Industrial output (May) CZ: Industrial output (May)	**8** DE: Exports (May)	**9** CZ: CPI (Jun) US: FOMC minutes	**10**	**11** HU: CPI (Jun)
14 ***PL: Balance of payments (May)*** ***PL: Money supply (Jun)*** EZ: Industrial output (May)	**15** ***PL: CPI (May)*** DE: ZEW index (Jul) US: Retail sales (May)	**16** ***PL: Core inflation (Jun)*** ***PL: Wages and employment (Jun)*** US: Industrial output (Jun) US: Fed Beige Book	**17** ***PL: Industrial output (Jun)*** ***PL: PPI (Jun)*** EZ: HICP (Jun) US: Housing starts (Jun) US: Building permits (Jun) US: Philly Fed index (Jul)	**18** US: Flash Michigan (Jun)
21	**22** HU: Central bank decision US: CPI (Jun) US: Home sales (Jun)	**23** ***PL: Retail sales (Jun)*** ***PL: Unemployment rate (Jun)***	**24** CN: Flash PMI-manufacturing (Jul) DE: Flash PMI-manufacturing (Jul) EZ: Flash PMI-manufacturing (Jul) US: New home sales (Jun)	**25** DE: Ifo index (Jul) US: Durable goods orders (Jun)
28 US: Pending home sales (Jun)	**29** US: Consumer confidence index (Jul)	**30** US: ADP report (Jul) US: Advance GDP (Q2) US: FOMC decision	**31** ***PL: Inflation expectations (Jul)*** EZ: Flash HICP (Jul) CZ: Central bank decision	**1 August** ***PL: PMI – manufacturing (Jul)*** CN: PMI – manufacturing (Jul) DE: PMI – manufacturing (Jul) EZ: PMI – manufacturing (Jul) US: ISM – manufacturing (Jul) US: Non-farm payrolls (Jul) US: Unemployment rate (Jul) US: Personal income (Jun) US: Consumer spending (Jun) US: Michigan index (Jul)
4	**5** EZ: PMI – services (Jul) DE: PMI – services (Jul) US: ISM – services (Jul) US: Industrial orders (Jun)	**6** DE: Industrial orders (Jun) CZ: Industrial output (Jun)	**7** EZ: ECB decision DE: Industrial output (Jun)	**8** DE: Exports (Jun)
11 CZ: CPI (Jul)	**12** DE: ZEW index (Aug) HU: CPI (Jul)	**13** ***PL: CPI (Jul)*** ***PL: Balance of payments (Jun)*** EZ: Industrial output (Jun) US: Retail sales (Jul)	**14** ***PL: Core inflation (Jul)*** ***PL: Money supply (Jul)*** ***PL: Flash GDP (Q2)*** DE: Flash GDP (Q2) EZ: Flash GDP (Q2) CZ: Flash GDP (Q2) HU: Flash GDP (Q2) EZ: HICP (Jul)	**15** ***PL: Market holiday*** US: Industrial output (Jul) US: Flash Michigan (Aug)
18	**19** ***PL: Wages and employment (Jul)*** US: CPI (Jul) US: House starts (Jul) US: Building permits (Jul)	**20** ***PL: Industrial output (Jul)*** ***PL: PPI (Jul)*** US: FOMC minutes	**21** ***PL: MPC minutes*** CN: Flash PMI-manufacturing (Aug) DE: Flash PMI-manufacturing (Aug) EZ: Flash PMI-manufacturing (Aug) US: Philly Fed index (Aug) US: Home sales (Jul)	**22**
25 DE: Ifo index (Aug) US: New home sales (Jul)	**26** HU: Central bank decision US: Durable goods orders (Jul) US: Consumer confidence index (Aug)	**27**	**28** US: Preliminary GDP (Q2) US: Pending home sales (Jul)	**29** ***PL: GDP (Q2)*** ***PL: Inflation expectations (Aug)*** EZ: Flash HICP (Aug) US: Personal income (Jul) US: Consumer spending (Jul) US: Michigan index (Aug)
1 September ***PL: PMI – manufacturing (Aug)*** CN: PMI – manufacturing (Aug) DE: PMI – manufacturing (Aug) EZ: PMI – manufacturing (Aug) DE: GDP (Q2)	**2** US: ISM – manufacturing (Aug)	**3** ***PL: MPC decision*** HU: GDP (Q2) EZ: Preliminary GDP (Q2) EZ: PMI – services (Aug) DE: PMI – services (Aug) US: Industrial orders (Jul) US: Fed Beige Book	**4** EZ: ECB decision DE: Industrial orders (Jul) US: ADP report (Aug) US: ISM – services (Aug)	**5** DE: Industrial output (Jul) US: Non-farm payrolls (Aug) US: Unemployment rate (Aug)
8 DE: Exports (Jul) CZ: Industrial output (Jul)	**9** CZ: CPI (Jul)	**10**	**11** HU: CPI (Jul)	**12** ***PL: Money supply (Aug)*** EZ: Industrial output (Jul) US: Retail sales (Aug) US: Flash Michigan (Sep)

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

Economic data and forecasts for Poland

Monthly economic indicators

		Jun 13	Jul 13	Aug 13	Sep 13	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14E	Jul 14E
PMI	pts	49.3	51.1	52.6	53.1	53.4	54.4	53.2	55.4	55.9	54.0	52.0	50.8	50.3	50.5
Industrial production	% YoY	2.8	6.3	2.2	6.3	4.6	2.9	6.7	4.2	5.3	5.5	5.5	4.4	4.4	5.9
Construction production	% YoY	-18.3	-5.2	-11.1	-4.8	-3.2	-2.9	5.8	-3.9	14.4	17.4	12.2	10.0	8.2	5.3
Retail sales [a]	% YoY	1.8	4.3	3.4	3.9	3.2	3.8	5.8	4.8	7.0	3.1	8.4	3.8	3.8	4.0
Unemployment rate	%	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	12.0
Gross wages in corporate sector	% YoY	1.4	3.5	2.0	3.6	3.1	3.1	2.7	3.4	4.0	4.8	3.8	4.8	4.9	4.3
Employment in corporate sector	% YoY	-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	0.7
Exports (€)	% YoY	5.4	7.4	2.8	9.0	3.8	2.3	10.1	10.5	5.8	10.9	6.8	12.1	12.8	11.8
Imports (€)	% YoY	-1.9	3.1	-0.3	4.2	4.6	0.6	0.0	6.6	7.3	3.1	5.3	8.5	13.2	11.2
Trade balance	EUR mn	570	137	299	660	259	-25	-85	406	268	484	856	433	597	232
Current account balance	EUR mn	100	-566	-618	-907	-6	-911	-497	-873	-508	615	1,028	552	225	-393
Current account balance	% GDP	-2.3	-1.9	-1.9	-1.9	-1.8	-1.7	-1.4	-1.2	-1.2	-1.0	-0.8	-0.7	-0.6	-0.6
Budget deficit (cumulative)	PLN bn	-26.0	-25.9	-26.8	-29.6	-39.5	-38.5	-42.2	-2.6	-11.7	-17.5	-21.3	-22.5	-25.3	-28.9
Budget deficit (cumulative)	% of FY plan	50.4	50.3	51.9	57.4	76.5	74.7	81.8	5.6	24.7	36.8	44.8	47.3	53.3	60.8
CPI	% YoY	0.2	1.1	1.1	1.0	0.8	0.6	0.7	0.5	0.7	0.7	0.3	0.2	0.3	-0.2
CPI excluding food and energy	% YoY	0.9	1.4	1.4	1.3	1.4	1.1	1.0	0.4	0.9	1.1	0.8	0.8	0.9	0.4
PPI	% YoY	-1.3	-0.8	-1.1	-1.4	-1.4	-1.5	-1.0	-1.0	-1.4	-1.3	-0.7	-1.0	-2.0	-1.9
Broad money (M3)	% YoY	7.0	6.6	6.1	6.1	5.9	5.7	6.2	5.4	5.2	5.2	5.4	5.3	5.5	6.2
Deposits	%YoY	6.5	5.6	5.8	6.0	5.9	5.2	6.0	4.9	4.7	4.7	5.4	5.6	5.8	6.7
Loans	%YoY	3.5	3.7	3.3	3.7	2.9	3.8	4.0	4.2	4.7	5.3	6.1	5.4	4.1	5.0
EUR/PLN	PLN	4.28	4.28	4.23	4.24	4.19	4.19	4.18	4.18	4.18	4.20	4.18	4.18	4.14	4.14
USD/PLN	PLN	3.25	3.27	3.18	3.17	3.07	3.10	3.05	3.07	3.06	3.04	3.03	3.04	3.04	3.03
CHF/PLN	PLN	3.47	3.46	3.43	3.43	3.40	3.40	3.41	3.39	3.42	3.45	3.43	3.42	3.39	3.39
Reference rate [b]	%	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	2.50
3M WIBOR	%	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	2.66
Yield on 2-year T-bonds	%	2.86	2.87	2.98	3.07	2.90	2.80	2.94	2.99	3.06	2.99	2.94	2.79	2.54	2.42
Yield on 5-year T-bonds	%	3.43	3.36	3.67	3.86	3.62	3.64	3.65	3.67	3.79	3.68	3.60	3.36	3.10	2.95
Yield on 10-year T-bonds	%	3.95	3.97	4.31	4.50	4.28	4.38	4.41	4.42	4.47	4.26	4.10	3.80	3.54	3.40

Note: [a] in nominal terms, [b] 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	1,703.4	378.4	396.3	405.6	455.5	397.4	413.8	419.5	472.7
GDP	% YoY	4.5	2.0	1.6	3.5	0.4	0.8	2.0	2.7	3.4	3.3	3.6	3.6
Domestic demand	% YoY	3.6	-0.1	0.0	3.6	-1.0	-1.6	0.6	1.8	3.0	3.7	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	6.2	-2.4	-3.3	0.5	2.0	10.7	2.0	6.0	7.0
Industrial production	% YoY	7.7	1.0	2.3	5.7	-2.0	1.2	5.0	4.5	4.8	4.8	5.8	7.0
Construction production	% YoY	12.3	-1.0	-10.3	6.7	-15.6	-22.9	-7.0	0.0	9.8	9.9	6.4	3.7
Retail sales [a]	% YoY	11.2	6.0	2.6	5.8	0.9	0.8	4.0	4.5	5.1	5.5	5.5	7.0
Unemployment rate [b]	%	12.5	13.4	13.4	12.2	14.3	13.2	13.0	13.4	13.5	12.1	11.9	12.2
Gross wages in the national economy [a]	% YoY	5.2	3.7	3.4	4.3	2.6	3.3	4.0	3.6	4.2	4.5	4.2	4.3
Employment in the national economy	% YoY	0.6	0.0	-0.8	0.3	-0.7	-1.1	-1.2	-0.1	0.0	0.3	0.4	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	9.6	-2.0	-2.2	2.4	1.8	5.6	9.0	11.2	12.5
Trade balance	EUR mn	-10,059	-5,175	2,309	4,468	-139	1,203	1,094	151	1,159	1,886	1,455	-33
Current account balance	EUR mn	-18,519	-14,191	-5,328	-2,371	-2,313	486	-2,086	-1,415	-766	1,982	-1,162	-2,425
Current account balance	% GDP	-5.0	-3.7	-1.4	-0.6	-3.1	-2.3	-1.9	-1.4	-1.0	-0.6	-0.3	-0.6
General government balance	% GDP	-5.1	-3.9	-4.3	5.7	-	-	-	-	-	-	-	-
CPI	% YoY	4.3	3.7	0.9	0.3	1.3	0.5	1.1	0.7	0.6	0.3	-0.1	0.5
CPI [b]	% YoY	4.6	2.4	0.7	0.6	1.0	0.2	1.0	0.7	0.7	0.3	0.1	0.6
CPI excluding food and energy	% YoY	2.4	2.2	1.2	0.7	1.2	1.0	1.4	1.2	0.8	0.8	0.6	0.8
PPI	% YoY	7.6	3.4	-1.3	-1.4	-0.7	-2.0	-1.1	-1.3	-1.2	-1.2	-1.8	-1.2
Broad money (M3) [b]	% oY	12.5	4.5	6.2	7.0	6.6	7.0	6.1	6.2	5.2	5.5	7.1	7.0
Deposits [b]	%YoY	11.7	20.6	9.8	9.1	6.6	6.5	6.0	6.0	4.7	5.8	7.0	6.7
Loans [b]	%YoY	14.4	36.6	8.7	8.8	3.5	3.5	3.7	4.0	5.3	4.1	4.2	5.5
EUR/PLN	PLN	4.12	4.19	4.20	4.12	4.16	4.20	4.25	4.19	4.19	4.17	4.12	4.03
USD/PLN	PLN	2.96	3.26	3.16	3.00	3.15	3.22	3.21	3.08	3.06	3.04	3.00	2.90
CHF/PLN	PLN	3.34	3.47	3.41	3.36	3.38	3.41	3.44	3.40	3.42	3.42	3.35	3.23
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
3M WIBOR	%	4.54	4.91	3.02	2.69	3.77	2.96	2.70	2.66	2.71	2.71	2.65	2.68
Yield on 2-year T-bonds	%	4.81	4.30	2.98	2.73	3.29	2.77	2.98	2.88	3.01	2.76	2.49	2.67
Yield on 5-year T-bonds	%	5.44	4.53	3.46	3.34	3.49	3.09	3.63	3.64	3.71	3.35	3.03	3.28
Yield on 10-year T-bonds	%	5.98	5.02	4.04	3.85	3.95	3.58	4.26	4.36	4.38	3.82	3.47	3.73

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

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