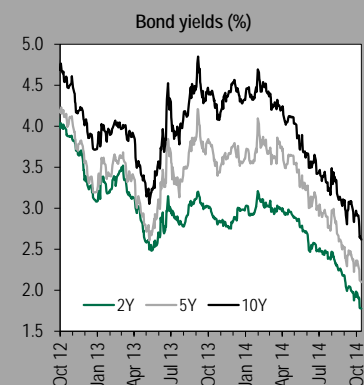
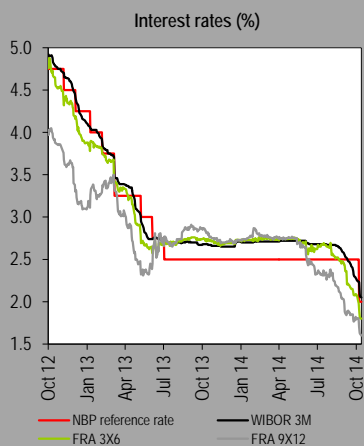


MACROscope

Polish Economy and Financial Markets

October 2014

Slower growth dampens spirits



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■ The last few weeks saw an unprecedented stream of positive news for Poland (Donald Tusk appointed president of the European Council, Mateusz Szczurek named best CEE finance minister, the volleyball team won the world championship and the football team beat Germany for the first time ever). However, the economy seems to be far less jubilant. **Recently-released data confirmed that economic activity in Poland is slowing and that GDP growth in 3Q14 probably slid below 3%YoY.** The deceleration in industrial production, construction output and retail sales in recent months was quite significant. On a positive note, the labour market is still improving (falling jobless rate, growing real labour income), which should support private consumption, and investment growth is probably still decent (no sign of weakness in corporate demand for investment loans, companies are hiring). **We maintain our forecasts of 3.1% average GDP growth in 2014E and 2015E.**

■ Meanwhile, inflation is falling further (-0.3%YoY in August) and will most likely remain below zero until year end, under pressure from low food and commodity prices and slower economic growth. The coming quarters should see a rebound in CPI growth, but a very gradual one, with inflation probably staying below the 2.5% official target until 2H16E.

■ The change in outlook for GDP and inflation led the Monetary Policy Council (MPC) to cut the lombard rate in October by 100bp (to 3.0%), the reference rate by 50bp (to 2.0%) and left the deposit rate unchanged (at 1.0%). It left the door open to further adjustment and, in our view, if the MPC decides to cut rates again in November, it will be 25bp. We stick to our forecast of a 1.75% reference rate at the end of the year.

■ Meanwhile, the financial markets are still expecting a more aggressive monetary policy adjustment ahead. Bond yields and IRS rates fell to new all-time lows, anticipating future rate cuts, and even recent comments by MPC members (not at all dovish, in our view), did not trigger a significant correction. **Even though the market should remain supported by the ECB liquidity injection and the resulting hunt for yield, we think that a correction in the fixed income market is likely, if not in the next week or two (after slightly better-looking economic data), then after the next MPC meeting in early November.**

■ The zloty remained extremely stable versus the euro, but weakened substantially against the dollar in September. **We think the currency may hold steady in the near term and appreciate slightly in the medium run, although potential dollar appreciation in anticipation of Fed rate hikes adds risk to this view.**

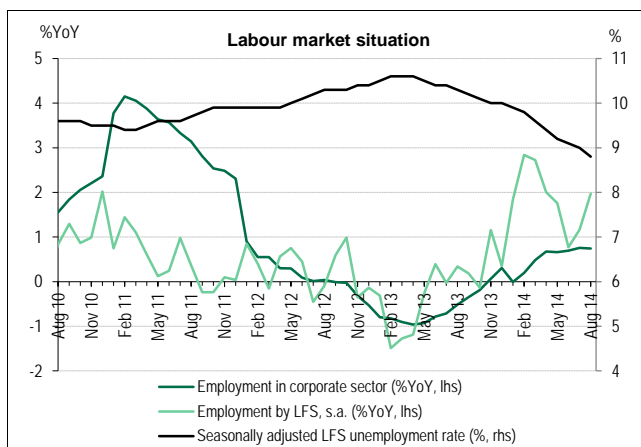
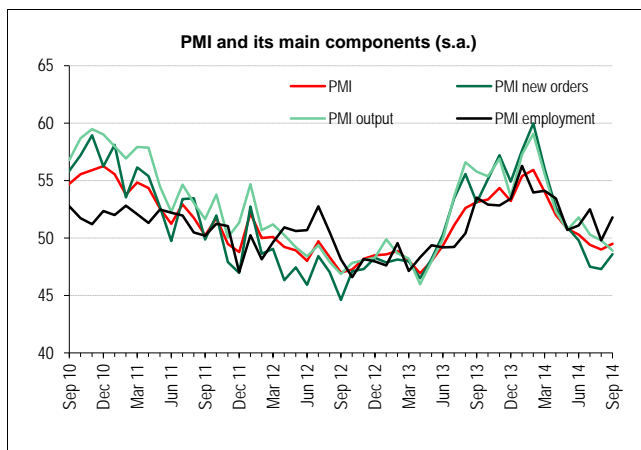
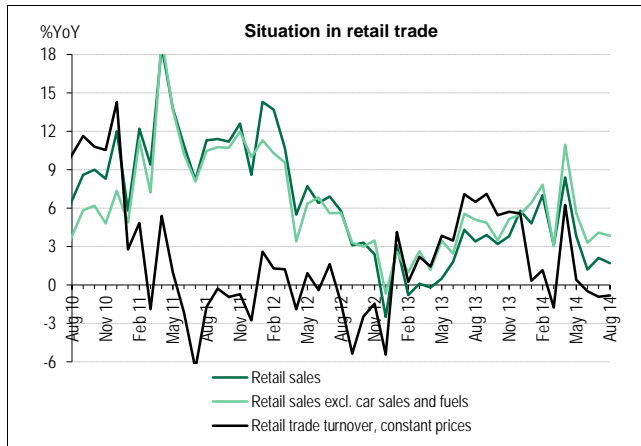
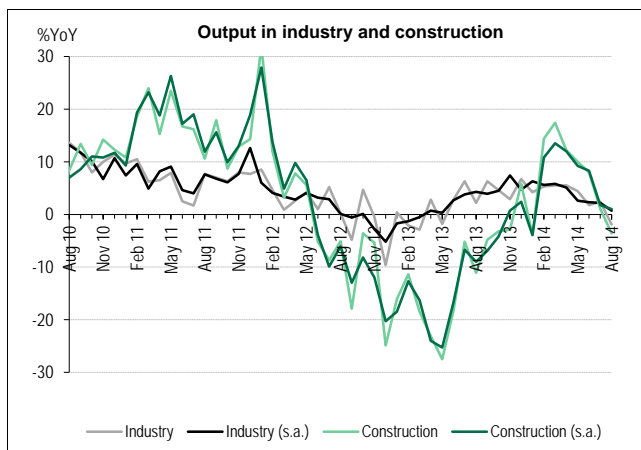
Financial market on 10 October 2014:

NBP deposit rate	1.00	WIBOR 3M	2.06	EURPLN	4.1795
NBP reference rate	2.00	Yield on 2-year T-bond	1.78	USDPLN	3.2985
NBP lombard rate	3.00	Yield on 5-year T-bond	2.12	CHFPLN	3.4540

This report is based on information available until 10.10.2014.

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Economic update



Source: CSO, Reuters, Bloomberg, Markit, BZ WBK.

Some data are still uninspiring . . .

- Industrial output contracted 1.9%YoY in August, the sharpest drop since May 2013, but influenced by the month having one working day less than August 2013. After seasonal adjustment, output expanded by 0.7%YoY, (the weakest increase for over a year) and dropped 1.2%MoM. This suggests that the production slowdown in August was not only a seasonal or calendar-related phenomenon.

- Production of motor vehicles, trailers and semi-trailers contracted 18.6%YoY. Other sectors also fell, including food products, which slipped nearly 5%YoY, partly due to ban on food exports to Russia.

- Construction and assembly output dropped 3.6%YoY in August. In seasonally adjusted terms, the sector expanded by 1%YoY and contracted by 1.8%MoM. The data indicates a slowdown in infrastructure investments, and particularly in real estate, where building construction dropped nearly 16%YoY.

- Retail sales growth slowed in August to 1.7%YoY (from 2.1%YoY in July). In real terms, retail sales added 2.8%YoY compared with 3.1%YoY one month before. The slower growth came mainly from a sharp decline in sales of motor vehicles. Car sales fell 15.1% in monthly terms, while clothing and footwear as well as furniture and household appliances surprised on the upside (rising 4% and 6%, respectively). According to our estimates, retail sales growth excluding cars remained quite stable at 2.2%-2.4%YoY on average in the last three months (still below the c5%YoY average for January-May).

- The statistics office also said that retail trade turnover declined in August by 0.8%YoY (after dropping 0.9%YoY in July). The seasonally-adjusted figures showed an increase of 1.1%YoY after falling by 1.2%YoY one month ago.

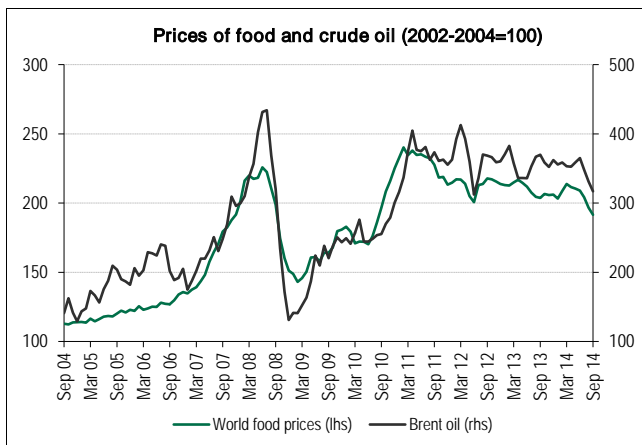
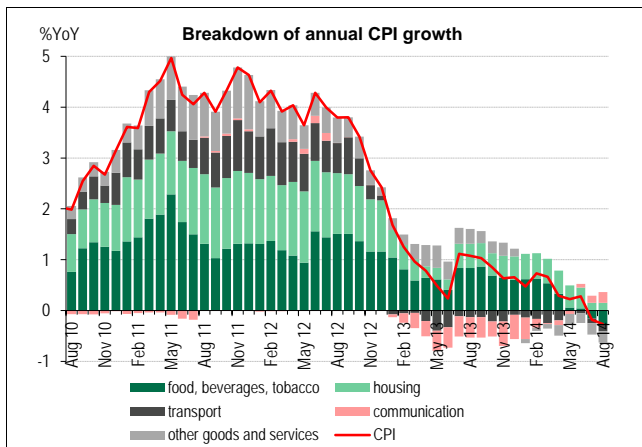
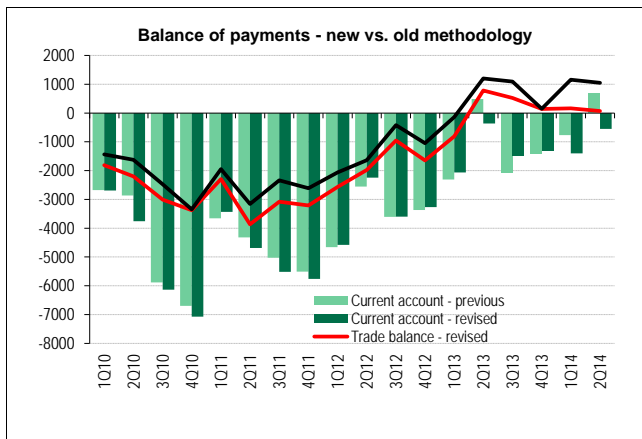
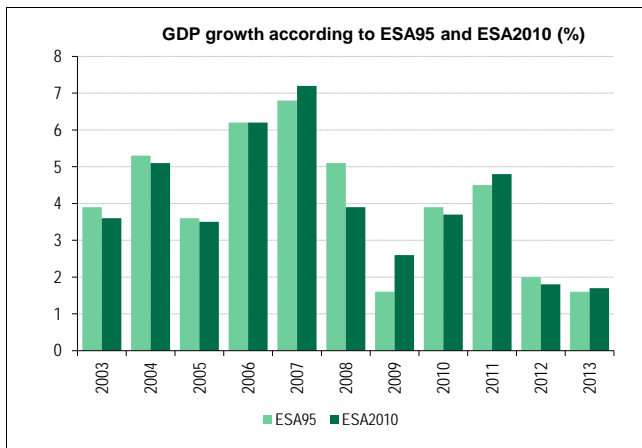
. . . but others paint a brighter picture

- Poland's manufacturing PMI improved to 49.5 points in September from 49.0 points in August, rising for the first time after six consecutive months of declines. Nevertheless, the gauge remained below the neutral level of 50 points in the whole of 3Q. The improvement in the headline PMI figure was driven by a rise in stronger rise in employment than the previous month and a slower decline in new orders. We note that output fell at the fastest pace since May 2013. Companies reported that part of the slowdown was attributable to the Ukraine-Russia crisis. Recent manufacturing PMI readings confirm a visible slowdown in the Polish industrial sector. However, the index for September was clearly above market consensus, and the sub-index for new orders showed some improvement, which is clearly a positive sign although it still has to be confirmed.

- The labour market is certainly a bright spot. The unemployment rate is still declining faster than expected (both registered and LFS-based measures), while new job offers are growing fast (according to the Labour Ministry, they surged to 115k in September, the highest level since 2001). Wage growth is still moderate (3.5%YoY in August), which, combined with growth in employment and negative inflation, leads to pretty high real growth in the wage bill (4.6%YoY in August). In general, labour market data bode well for private consumption in the second half of the year.

- Data from the credit market show that consumer loans and investment loans are growing at a healthy rate. This suggests that not only consumption, but also investment growth is likely to keep supporting the economy in the coming quarters. It seems likely that private sector investment will be joined before year-end by growth in public investment spending.

Economic update



Source: CSO, NBP, FAO, Reuters, BZ WBK.

GDP and balance of payments data revised

- The Polish statistics office released its first National Accounts estimates complying with the EU's new methodology, ESA2010. The new figures for 2002-13 include illegal activities (drugs trade, smuggling and prostitution) plus items like spending on R&D or military equipment. After revision, nominal GDP in 2013 was increased by 1.6%, or PLN26.3bn, of which illegal activities accounted for PLN13.3bn. Real GDP growth under the new methodology reached 1.7% in 2013, instead of 1.6%. The full set of revised data, including annual and quarterly series since 1995, should be available by the end of November.

- The methodological changes also affected the balance of payments. The current account and trade balances for 2010-14 were revised lower. In 2Q14, the current account balance was negative at -€553mn, while previous monthly data for April-June suggested a surplus of €674mn.

- Balance of payments: some goods were reclassified as services (goods sent for processing) and some services as goods (merchandising), but in general this change was more favourable for services, depressing imports and exports of goods and elevating imports and exports of services. The income account was renamed the primary income account, which absorbed some taxes, subsidies and rents from the current transfers account, which was renamed the secondary income account. The revisions widened the 12M rolling current account deficit to 1.2% of GDP from 0.9% in 2Q14.

- We lowered our forecasts for imports and exports due to this change in methodology, but forecasting is more difficult (and forecasts less precise) due to the short time series available.

- The most surprising element of the revision was that the errors and omissions item in the balance of payments data ballooned. The 12-month moving total soared to c. -€10bn (nearly 200% of the current account gap) from -€6bn before.

Inflation below zero until year-end

- The CPI dropped to -0.3%YoY in August, mainly driven by the decline in food (-2.1%YoY) and fuel (-1.9%YoY). Communication prices rose, showing that the telecoms price war is over for now. Core inflation excluding food and energy prices inched up to 0.5%YoY from 0.4%YoY, while PPI inflation was -1.5%YoY versus -2.0%YoY in July.

- There are practically no signs of price pressure and we think the CPI may stay below zero until the end of the year, especially given weakening economic growth and the Russian ban on food imports, which depresses food prices in Europe. The FAO's index of global food prices fell sharply in September for the sixth straight month, to its lowest level since August 2010. Meanwhile, concerns about world economic growth are undermining commodity prices. Brent crude oil dropped below US\$95/barrel in September and was under US\$90 at the start of October, its lowest in more than two years. Even though the zloty weakened substantially against dollar in recent months, Brent oil prices in PLN also dropped, losing c12% between June and early October.

- We estimate inflation fell even further below zero in September (to -0.4%YoY), mainly due to the sustained decline in food and fuel prices. Meanwhile, core inflation excluding food and energy prices is likely to have accelerated to 0.8%YoY, chiefly due to the low base effect in the price of education. We expect some rebound of inflation later on, but think it is likely to be subdued (moving towards 1.5% YoY at the end of 2015E), so it is likely to stay well below the NBP target (2.5%) at least for the next several quarters.

Monetary policy watch

Excerpts from the MPC's communiqué after its October meeting

Economic recovery in the United States continues and the economic outlook remains positive. At the same time, economic activity in the euro area is still subdued and the business climate indicators have recently deteriorated. In the largest emerging market economies GDP growth is also relatively low and in some of them, including Russia, has been decelerating.

In Poland, data on economic activity in 3Q14 point to a further deceleration in economic growth. This is indicated by slowing growth in industrial production, construction and assembly as well as retail sales in recent months. Lower economic activity growth is also indicated by a decrease in business climate indices.

Despite lower economic activity growth, employment in the corporate sector continues to rise. Growing employment contributes to a decline in unemployment. Yet, the unemployment rate remains elevated, which continues to contain wage pressure. As a result, wage growth in the enterprise sector remains moderate.

In August, CPI inflation declined again and remained negative (...). At the same time, core inflation remained very low, which confirms the absence of demand pressure in the economy. The continued decline in producer prices points, in turn, to the absence of cost pressure. This is accompanied by very low inflation expectations of enterprises and households.

In the opinion of the Council, the incoming data point to a deceleration in economic growth and an increased risk of inflation running below the target in the medium term. Therefore, the Council decided to lower NBP interest rates, except for the deposit rate, which remained unchanged, narrowing the spread between the lombard and deposit rate. **The Council does not rule out further adjustment of monetary policy, should the incoming data, including the November NBP projection, confirm a considerable risk of inflation remaining below the target in the medium term.**

The first cut is the deepest

- Poland's Monetary Policy Council (MPC) decided to trim official interest rates. The main reference rate was cut by 50bp to 2.00%, the lombard rate by 100bp to 3.00%, while the deposit rate remained unchanged at 1.00%.

- Consequently, the width of the symmetrical corridor around the reference rate, between the deposit and the lombard rates, narrowed from 3.0pp to 2.0pp. It is the first such decision in more than a decade. However, please note that when the width of the corridor was set at 1.5pp (April 2003), interest rates were much higher than currently (the reference rate was 6.25%), so the decision to narrow the corridor could be interpreted as the simple adjustment to the new environment (in proportion with significantly lower official interest rates). This interpretation was confirmed by the National Bank of Poland's (NBP) governor Marek Belka during the press conference.

- Based on earlier behaviour of the MPC (no cut in September) and comments of its members before the October meeting, we were expecting cautious rate reductions (three cuts of 25bp each between October and December). In our view, the decision to cut rates more sharply justified, taking into account recent information (weakening of economic activity in Poland and in the Euro zone and lower inflation). In fact, we think that the decision to cut rates by 50bp should have been taken in September.

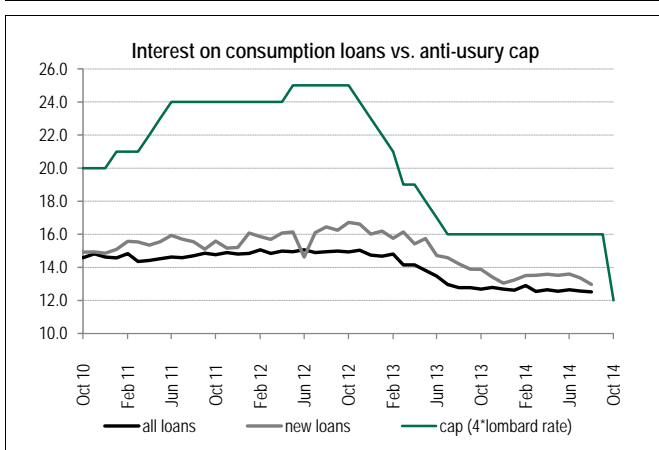
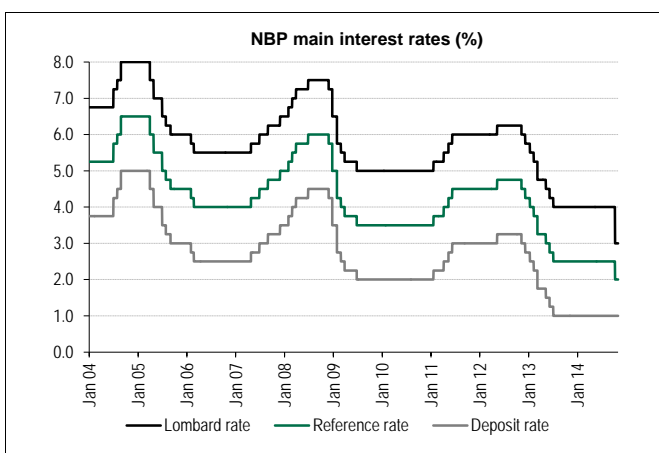
- The MPC suggested in its statement that monetary policy easing is a response to the deterioration of the outlook for economic growth and the change in the prospects for inflation (lack of demand and cost pressure on prices, low inflation expectations). In its key sentence the MPC noted it "does not rule out further adjustment of monetary policy, should the incoming data, including the November NBP projection, confirm a considerable risk of inflation remaining below the target in the medium term". Thus, the door to further policy adjustment was left open.

- Governor Belka stressed during the press conference that the decision was not unanimous, but the MPC members, who voted in favour of a 50bp cut, believed that rate adjustments should be concentrated in time and the easing cycle should be ended quickly in order to limit the pressure on the bond market. His comments about possible further rate cuts were conditional. While he did not rule out further easing, he also said it was not warranted at present and would be data dependent. Similar comments were repeated later in MPC members' interviews.

- We think it is likely that the Monetary Policy Council will cut official interest rates again in November, and if it does the cut will amount to 25bp, in our view. The new NBP projections should confirm that inflation is likely to return to target more slowly than previously expected. On the other hand, the worsening economic outlook should not be bad enough to justify to more decisive move in official rates. Belka also said that setting the deposit rate at 0.50% would imply the central bank was close to using unconventional monetary policy. Consequently, we are sticking to our overall forecast for rate cuts this year, under which the reference rate is likely to reach 1.75% at the end of this year and remain at that level until the end of 2015.

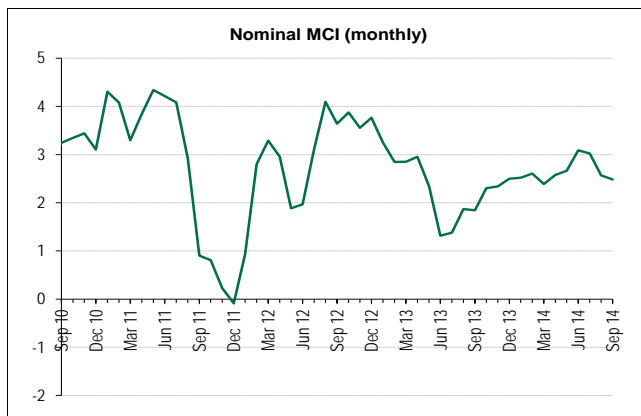
Lombard rate cut will cause repricing of cash loans

- The cut in the lombard rate is significant for the banking sector, as it sets the maximum rate that banks can charge on loans, which is four times the lombard rate. Therefore, reducing the rate to 3% from 4% pushes top loan rates down to 12% from 16% currently. This will impact the pricing of both new (future) and outstanding cash loans. Under the so-called anti-usury law, the re-pricing of the loans in question has to be done pretty much instantly.



Sources: NBP, Reuters, BZ WBK

Restrictiveness of the Monetary Policy (Council)



MCI moving lower, but likely to stabilise soon

- The MCI monetary restrictiveness index edged down in September as money market rates slid lower on the back of expectations of monetary easing in Poland and a stable EURPLN rate.
- We are expecting the index to decline further in October following the cut in interest rates. However, a slight strengthening of the zloty will exert an opposing force. Recent comments by MPC members, cooling expectations of further cuts (see details below) will probably put a brake on the decline in money market rates, so we are expecting the index to stabilize and even to climb a bit in the coming months.



Rzońca (1.44)

Winiński (1.45)

Kaźmierczak (1.41)

Glapiński (1.38)

Hausner (1.03)

Belka (0.96)

Zielińska-Głębocka (0.81)

Chojna-Duch (0.73)

Bratkowski (0.58)

Osiatyński



The 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. Value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights, more distant – lower.

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

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

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

Only one more rate cut to come?

The financial markets interpreted the MPC decision to cut rates more aggressively and the tone of the post-meeting statement and press conference as dovish, which spurred intense speculation about more easing to come. However, our interpretation was different: we think Belka was trying to cool expectations of further rate cuts. He made it clear during the press conference that the MPC wanted to keep the renewed cycle of interest rate cuts as short as possible. The NBP governor also repeated several times that further rate cuts were not guaranteed. He reinforced this later in an interview with the daily *Gazeta Wyborcza*, in which he said that the idea that an October's cut was the beginning of an easing cycle was "completely wrong" and there may be only one more rate cut ahead. In his view, now it is "not so evident" there will be more reductions. He also emphasised that, despite the worsening economic outlook, the central bank is not overly pessimistic about the domestic economy. Surprisingly, in a later interview with Reuters, Belka said that he is comfortable with market expectations of a 50bp cut by year end, but decisions will depend on many factors, including the new inflation projection.

Interestingly, comments by other MPC members that appeared after the October meeting were also not so dovish. While it was not a big news that Adam Glapiński and Jan Winiński said they saw no room for further policy easing (as they are generally seen as advocates of more restrictive monetary policy), Elżbieta Chojna-Duch, who was among the most dovish members, said the Council should wait to see the results of the deeper-than-expected move in October before taking further decisions, unless the new NBP projection gives additional arguments for cuts. This view followed her earlier statement (made before the October cut) that after a 50bp rate cut in October the Council should pause and that excessive easing may be risky and ineffective. In this earlier interview she was also questioned why the financial market was pricing-in rate cuts of as much as 100bp.

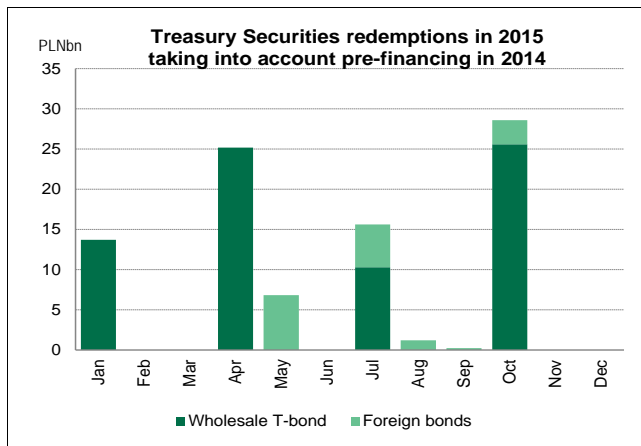
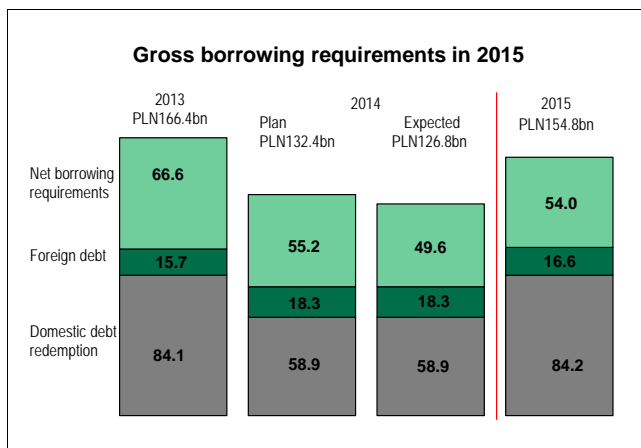
... and no more big moves?

The most dovish comment recently was presented by Andrzej Bratkowski. In his opinion, there is still room to cut rates by 50-75bp in a scenario of GDP growth below 3% and inflation below 1.5% until the end of 2015. At the same time, Bratkowski sees the chances of another 50bp as low and he thinks that a 25bp rate cut in November is "obviously possible, but not a foregone conclusion and will depend on the incoming data".

Such comments reinforce our view that we may see only one more reduction in the main interest rates, probably by 25bp in November. If policy easing is to be condensed in time – as suggested by the NBP governor – there may be only one more cut ahead. If so, the repeat of a 50bp cut seems unlikely, given that even the dovish Andrzej Bratkowski thinks it improbable, plus the fact that we are expecting slightly better macro readings. Therefore, we stick to our view that the NBP reference rate should end this year at 1.75% and may stay at this level throughout 2015.

Source: NBP, Reuters, BZ WBK

Fiscal policy watch



Funding net borrowing requirements in 2015 (PLN mn)

	2014 expected realisation	2015E
Net borrowing needs	47,377.9	53,977.4
Domestic financing	51,458.1	42,517.2
1. Issuance on the domestic market	47,184.5	42,517.2
2. Funds on the budget accounts	4,273.6	0.0
Foreign financing	-4,080.2	11,460.2
1. Issuance on foreign market	3,808.5	3,933.8
2. Loans	4,946.0	5,170.0
3. Management of EU funds	-6,987.5	-7,088.6
4. Flows on FX account	-5,847.3	9,444.2

	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	10.10	change since 9.09.14	change since 31.12.13	10.10	change since 9.09.14	change since 31.12.13
Poland	178	-18	-60	69	7	-10
Czech	20	-2	-39	47	2	-14
Hungary	345	-16	-32	164	11	-91
Greece	567	109	-94	-	-	-
Spain	117	-3	-104	76	13	-78
Ireland	81	14	-71	52	1	-68
Portugal	208	-8	-201	154	8	-193
Italy	143	7	-72	96	8	-73
France	35	1	-14	43	4	-11
Germany				18	-1	-8

Source: Ministry of Finance, Reuters, BZ WBK.

New government approved, fiscal consolidation to proceed

PM Donald Tusk stepped down after being appointed president of the European Council and parliament approved a new government led by PM Ewa Kopacz. In her inaugural speech, Ms Kopacz listed a set of policy actions (including higher spending on investments, defence and education, introduction of a new tax code, measures to protect the mining industry). Finance Minister Mateusz Szczurek said the annual cost of the measures should not exceed PLN3.2-3.6bn by 2016 and they will not prevent the fiscal deficit from falling below 3% of GDP in 2015. This would allow Poland to exit the EU's Excessive Deficit Procedure in 2016.

Higher (net) borrowing needs in 2015

The draft 2015 budget assumes a deficit of PLN46.1bn, net borrowing needs of PLN53.98bn and gross borrowing needs of PLN154.8bn. The increase in the borrowing requirement compared with 2014 is mainly due to the larger budget deficit and a sharp increase in debt redemptions.

We think it is possible that the next year's budgeted spending will be at least PLN5bn less than planned. In 2009-13 actual annual expenditure was under budget by an average of cPLN7bn. However, there is a risk of revenues being below budget as both GDP growth and inflation next year may fall short of the Finance Ministry's assumptions. On balance, it is hard to argue, at this point, that the budget deficit – and the net borrowing needs – will be significantly lower than projected in 2015.

That said, the total supply of debt next year may be lower than suggested by the budget's gross borrowing requirements (possibly by as much as PLN30bn), as the latter do not take into account the pre-financing that has already started this year. We think it very likely that the ministry will pre-fund at least 20% of its 2015 borrowing requirements by year-end 2014, taking advantage of favourable market conditions and strong demand for Polish bonds from foreign investors. If this is the case, gross borrowing needs next year should be no higher than in 2014.

More flexible foreign financing

PLN-denominated securities (mainly fixed-rate T-bonds) will still play the main role in funding the country's net borrowing needs (nearly 80%). The Finance Ministry plans to keep foreign currency bond issues and net foreign loans at similar levels to this year (respectively, nearly PLN4bn and PLN5bn). However, the importance of foreign funding will be substantially higher than this year, as the ministry also plans to use liquid money accumulated in the FX account (PLN9.4bn).

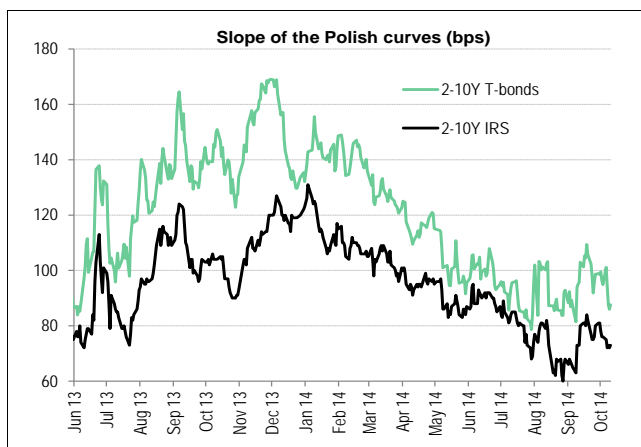
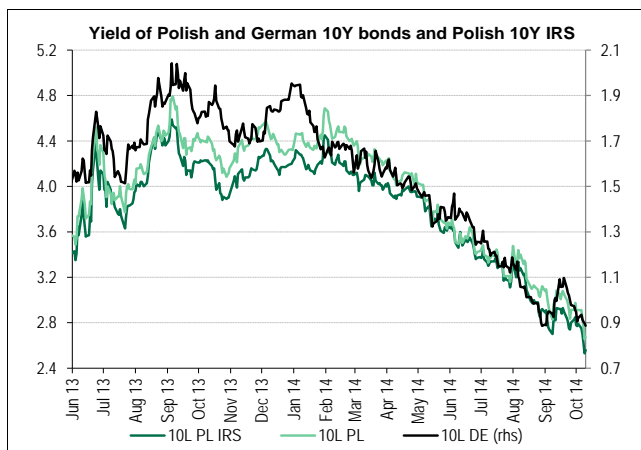
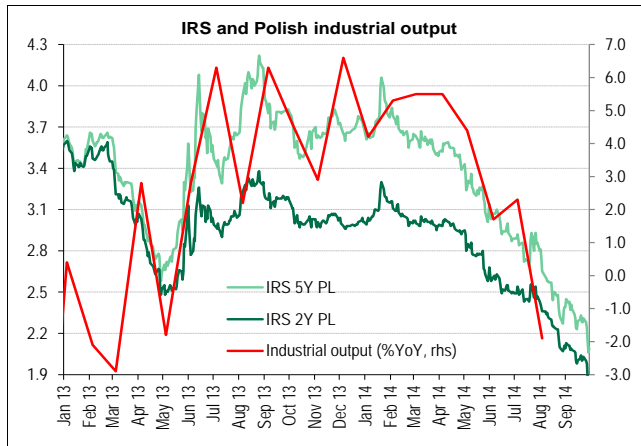
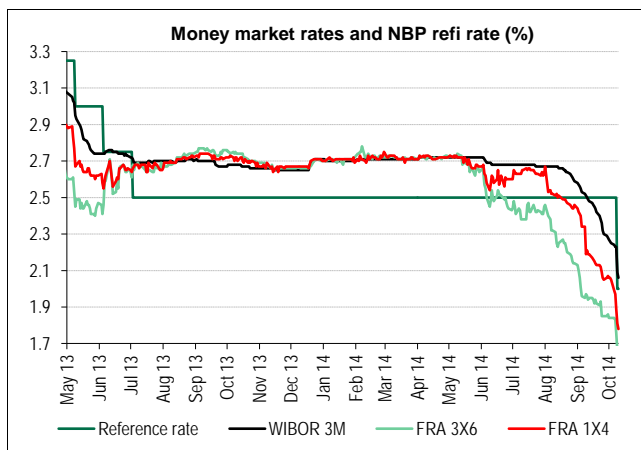
This implies greater flexibility in foreign financing. The ministry will not be under any time pressure to place debt on the international markets as it will be able to use money in the FX account to repay foreign debt or pay interest.

Overall 2015 gross FX issuance is projected at PLN18.3bn. We think euro-denominated issues will account for the majority of this. The rest is likely to be US dollar debt.

Hopes for ECB easing still support spread compression

Euro zone peripheral bond yields dropped further last month, with Greece the only exception, but they fell only fractionally more than German debt. The yield of the 10Y Spanish bond shed 14bp, Italian 4bp and Portuguese 19bp, while the 10Y Bund dropped by 10bp. Thus, the spreads of peripherals vs. Bunds did not change much on monthly basis. The market was supported by expectations of a fresh inflow of cash from the ECB, but the scope for further gains was limited by concerns about the Euro zone economy. CDS rates moved higher, adjusting to the market overhaul and introduction of new definitions to incorporate events from the financial crisis.

Interest rate market



Source: Reuters, BZ WBK.

The market expects aggressive monetary easing

- Money market rates fell significantly in September as rate cut expectations strengthened after weak macro data and dovish comments from MPC members, suggesting deeper cuts in official rates than the market earlier anticipated. In monthly terms, WIBORs fell by 19-39bp across the board, with the 12M rate dropping most.
- Money market rates continued to ease in the first ten days of October after the MPC surprised the market by cutting the reference rate by 50bp. Our baseline scenario still assumes that the total adjustment will reach 75bp by year end. Therefore, we still see room for a small decline in WIBOR rates in the coming weeks.
- We stick to our forecasts of 3M WIBOR declining towards 1.90% at the end of this year, based on further monetary easing, weak macro data and a prolonged period of below-zero inflation. As we do not expect any further changes in the NBP policy rate during 2015E, we expect stable short-term money market rates next year, with WIBOR 3M averaging close to 2%.

Strong rally follows MPC cut and dovish FOMC minutes

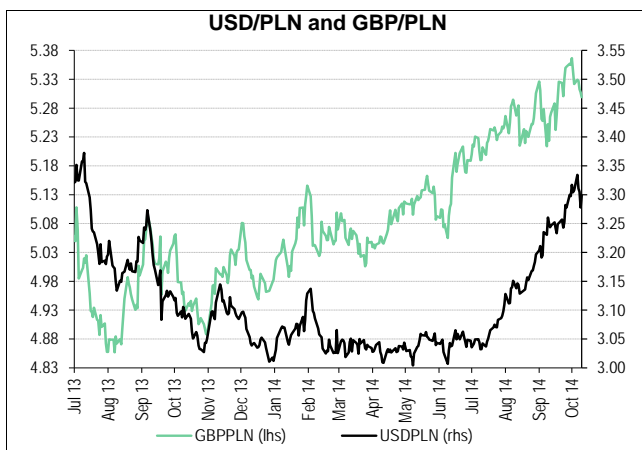
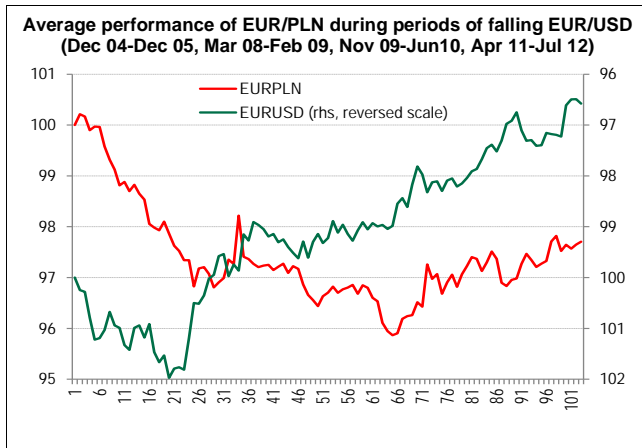
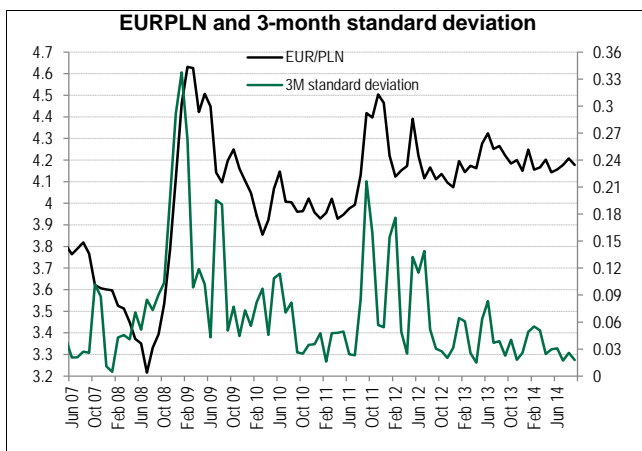
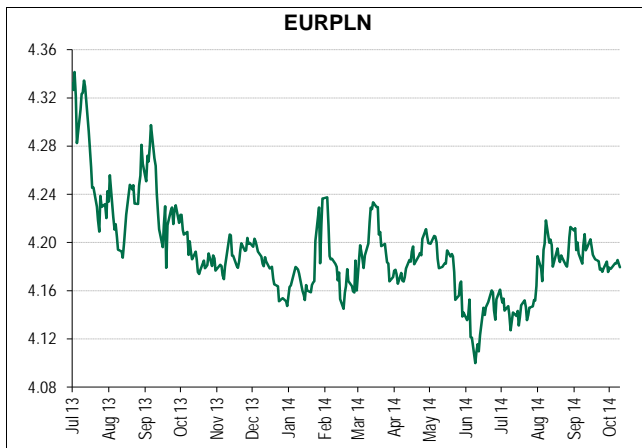
- Poland's fixed income market gained considerably in September. Yields and IRS rates declined to fresh all time-lows, following the drop in core debt market yields and due to comments from Polish MPC members, which fuelled speculation about deeper rate cuts than were already priced-in. September's FOMC meeting, which has sparked concern about earlier monetary tightening in the US, brought only a short-lived correction at the long end of curves.
- Domestic T-bonds and IRS continued down the road of lower yields/rates after the 50bp cut by the MPC and dovish tone of the FOMC minutes, suggesting that the Fed is still in no rush to raise rates. Poland's T-bonds benefited from Euro zone yields dropping to new record-lows. The 10Y benchmark fell below 2.70%, to its lowest level ever, and the 2Y benchmark fell below 1.80%.

- The spread over Bunds continued to narrow, dropping towards 170bp (the lowest level since May 2013). After a slight steepening in September, domestic curves returned to a bull flattening pattern, in line with the global trend.

Time for a short-term correction?

- T-bond yields and IRS rates are now very close to or even below our targets for November. We see limited room for further falls at the short end of the curve. Since the market is pricing-in a substantial further interest rate adjustment ahead, we think that a correction is likely, if not in the nearest weeks (after slightly better-looking economic data and MPC members' comments), then after the next MPC meeting in early November, when we think the Council will cut rates by only 25bp. Such a decision would trim market expectations about the total scale of policy easing in this cycle, in our view.
- For the long end of curves, slightly-better data and a smaller rate cut in November may trigger some correction. However, this may be only short-lived as investors may continue to believe that further easing will be necessary when economic growth disappoints and inflation stays low for longer than expected. This would be supported by anticipated accommodative ECB policy – as the search for yield will continue to help shrink risk premiums – and by recent dovish signals from the Fed.
- Thin supply of T-bonds in 4Q14 should be a supportive factor for the domestic debt market. We would remind readers that in October-December the Ministry offers T-bonds worth PLN8-12bn at only two regular auctions.

Foreign exchange market



Sources: CSO, Reuters, BZ WBK.

Zloty proves surprisingly stable vs. the euro . . .

- The zloty has proved surprisingly stable vs. the euro in the last couple of weeks. EUR/PLN stayed above the crucial support level at c4.17 and below the late August peak of c4.23. Consequently, the EUR/PLN monthly trading range in September was the narrowest since April 1998 (with a max-min spread of just over PLN0.05). Also, both implied volatilities and monthly standard deviations are clearly moving lower: 3-month EUR/PLN implied volatility is at its lowest since late July, and the average levels seen in the last few months are even below those of just before the 2007-08 financial crisis; and 3-month standard deviation for monthly data is at its lowest since April and only marginally above the levels observed in late 2007.

. . . but will the dollar's gains change this?

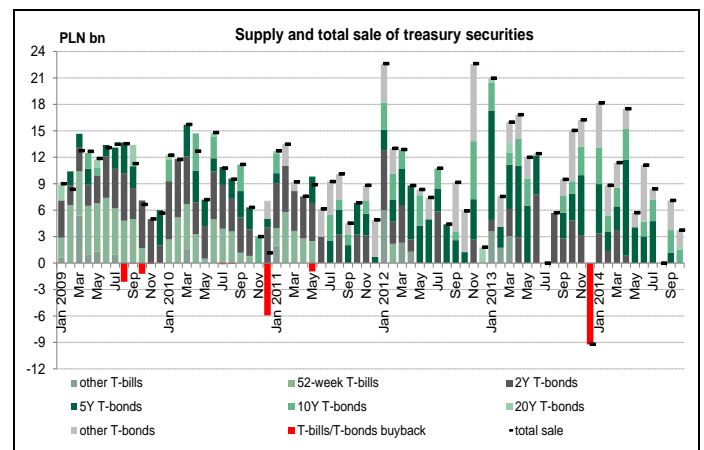
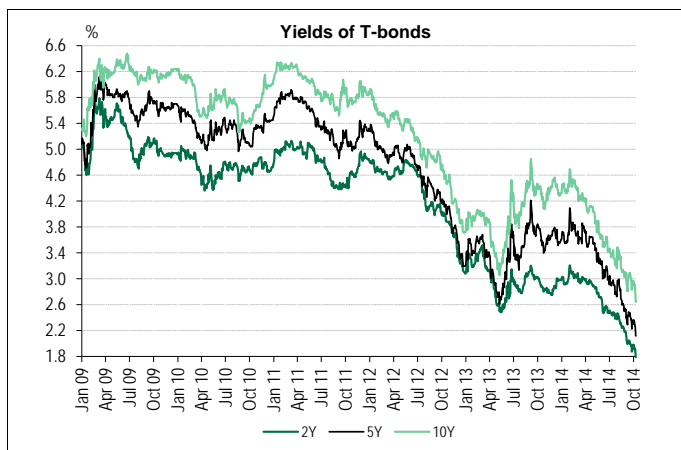
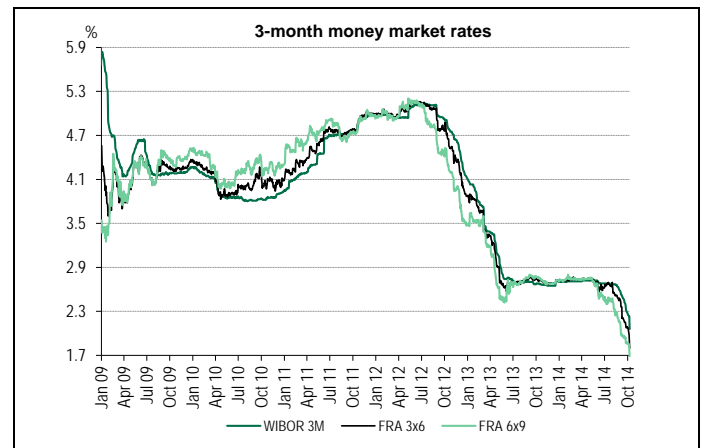
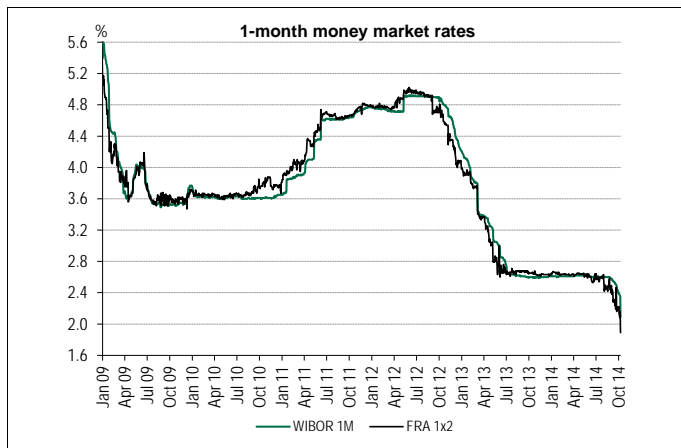
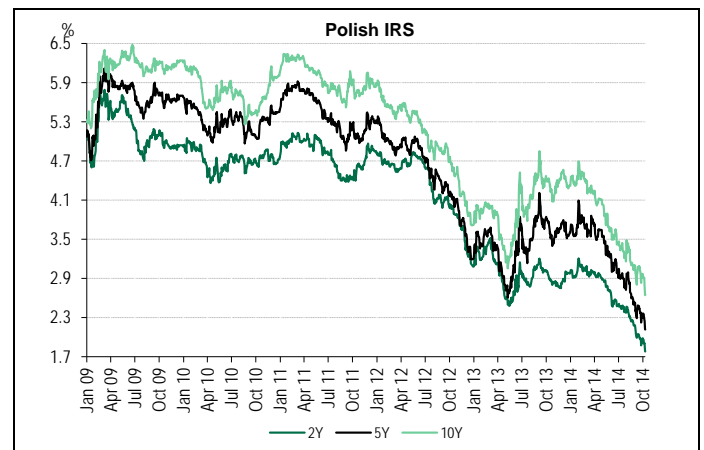
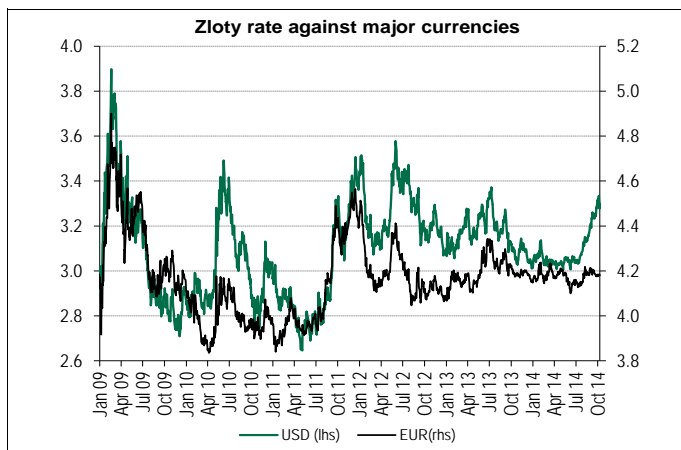
- The zloty has suffered significantly vs. the dollar in the last few months – USD/PLN rose for 12 weeks in a row and since mid-September alone has climbed from c.3.22 to c3.35. This raises the question of whether the dollar's strength in the global market will finally push the domestic currency lower vs. the euro.

- The EUR/PLN rate tends to be negatively correlated with the EUR/USD. In the past ten years we found only three periods of clear divergence between the two exchange rates, including the current episode. What those past periods had in common was that the Polish economy was in the middle of a vigorous recovery after a major slowdown and the zloty was appreciating steadily following significant losses incurred during the economic downturn. This is not exactly the case this time, as the pace of (modest) economic recovery has just started abating and the zloty has been moving horizontally for quite some time. This creates a risk that, if the dollar surge continues, it may have more of a negative effect on the zloty.

- We have also noticed that, in the four episodes of clear downward trend in the EUR/USD in 2004-13, the zloty depreciated versus the euro only when the EUR/USD was falling in a climate of high risk aversion (financial crisis in the US, debt crisis in the Euro zone) or looming Fed rate hikes. The current circumstances – with an unresolved crisis in Ukraine and high tensions in the Middle East – could potentially trigger a wave of the risk aversion. Looming rate hikes in the US obviously fit the pattern from the past. Still, within those four periods, we only saw negative correlation between the EUR/USD and the EUR/PLN in two (-0.79 during the financial crisis and -0.59 during the debt crisis in 2011-12). The average correlation was -0.15.

- It seems that dollar's appreciation does not necessarily have to lead to a zloty depreciation vs. the euro, but it obviously generates some risk to our forecasts of lower EUR/PLN in the months to come. The sudden EUR/USD drop has recently put a pressure on emerging market currencies (the rouble, Brazilian real or Turkish lira vs. the dollar and the euro). However, we note that EM bonds have also suffered, while Polish debt gained noticeably amid expectations of MPC interest rate cuts and an inflow of the foreign capital. It may be the fall in Polish bond yields that is preventing EUR/PLN from making a significant upward move. We see some upside risk to our forecasts, but have decided to leave them unchanged for now on the assumption that expectations of an inflow of the fresh liquidity from the ECB should support risky assets, including the zloty. Also, comments from MPC members after last week's surprising 50bp rate cut were not very dovish, in our view, which may limit market expectations for a deep monetary policy easing in Poland and put less pressure on the domestic currency.

Market monitor



Treasury bond auctions in 2013/2014 (PLN mn)

month	date	First auction			Second auction			Switch auction			
		T-bonds	offer	date	T-bonds	offer	date	T-bonds	offer		
October '13	3.10	PS0718	2500-4500	3008.0	22.10	OK0116/IZ0823/DS1023	6000-	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-	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-	11722.3			
May	8.05	PS0719/WZ0119	3000-5000	5694.2	22.05	IDS1024	1000-2000	1270.0			
June	5.06	DS/MWS/WZ	3000-5000	4989.7					18.06	OK0714/WZ0115	WZ0119/PS0719
July	3.07	DS0725/WS0428	1000-3000	2419.0	23.07	WZ0119/PS0719	2000-6000	5999.0			
August											
September	4.09	DS0725/WS0124	2000-3000	3595.0	25.09	USD20150716**	Up to 400	354.4	18.09	WZ0115/PS0415	WZ0119/PS0719
October	23.10	To be chosen	2000-6000						2.10	WZ0115/PS0415	WZ0124/DS0725/WS0428

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

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
13 October	14 PL: Balance of payments (Aug) PL: Money supply (Sep) DE: ZEW index (Aug) EZ: Industrial output (Aug)	15 PL: CPI (Sep) PL: Core inflation (Sep) US: Retail sales (Sep) US: Fed Beige Book	16 PL: Wages and employment (Sep) EZ: HICP (Sep) US: Industrial output (Sep) US: Philly Fed index (Oct)	17 PL: Industrial output (Sep) PL: PPI (Sep) US: House starts (Sep) US: Building permits (Sep) US: Flash Michigan (Oct)
20	21 US: Home sales (Sep)	22 US: CPI (Sep)	23 PL: MPC minutes PL: Retail sales (Sep) PL: Unemployment rate (Sep) CN: Flash PMI – manufacturing (Sep) DE: Flash PMI – manufacturing (Sep) EZ: Flash PMI – manufacturing (Sep)	24 US: New home sales (Sep)
27 DE: Ifo index (Oct) US: Pending home sales (Sep)	28 US: Durable goods orders (Sep) HU: Central bank decision US: Consumer confidence index (Oct)	29 US: FOMC decision	30 US: Advance GDP (Q3)	31 PL: Inflation expectations (Oct) EZ: Flash HICP (Oct) US: Personal income (Sep) US: Consumer spending (Sep) US: Michigan index (Oct)
3 November PL: PMI – manufacturing (Oct) CN: PMI – manufacturing (Oct) DE: PMI – manufacturing (Oct) EZ: PMI – manufacturing (Oct) US: ISM – manufacturing (Oct)	4 US: Industrial orders (Jan)	5 PL: MPC decision EZ: PMI – services (Oct) DE: PMI – services (Oct) US: ISM – services (Oct) US: ADP report (Oct)	6 EZ: ECB decision CZ: Central bank decision CZ: Industrial output (Sep) DE: Industrial orders (Sep)	7 DE: Industrial output (Sep) DE: Exports (Sep) US: Non-farm payrolls (Oct) US: Unemployment rate (Oct)
10 CZ: CPI (Sep)	11 PL: The Independence Day HU: CPI (Sep)	12 EZ: Industrial output (Sep)	13 PL: CPI (Oct) PL: Balance of payments (Sep)	14 PL, CZ, HU, DE, EZ: Advance GDP (Q3) PL: Money supply (Oct) EZ: HICP (Oct) US: Retail sales (Oct) US: Flash Michigan (Nov)

Calendar of MPC meetings and data releases for 2014

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
ECB meeting	8	6	6	3	8	5	3	7	4	2	6	4
MPC meeting	7-8	4-5	4-5	8-9	6-7	2-3	1-2	19	2-3	7-8	4-5	2-3
MPC minutes	23	20	20	17	22	20	-	21	18	23	20	18
Flash GDP*	-	14	-	-	15	-	-	14	-	-	14	-
GDP*	-	28	-	-	30	-	-	29	-	-	28	-
CPI	15	14 ^a	14 ^b	15	14	13	15	13	15	15	13	15
Core inflation	16	-	14	16	15	16	16	14	16	15	17	16
PPI	21	19	19	17	20	18	17	20	17	17	20	17
Industrial output	21	19	19	17	20	18	17	20	17	17	20	17
Retail sales	24	24	25	24	26	26	23	26	23	-	-	-
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			30			
Balance of payments	17	12	17	11	15	13	14	13	15	14	13	
Money supply	14	14	14	14	14	13	14	14	12	14	14	
Business climate indices	23	21	21	23	22	23	22	22	22	22	21	19

* quarterly data. ^a preliminary data for January. ^b January and February.

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

Economic data and forecasts for Poland

Monthly economic indicators

		Sep 13	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep14E	Oct14E
PMI	pts	53.1	53.4	54.4	53.2	55.4	55.9	54.0	52.0	50.8	50.3	49.4	49.0	49.5	49.7
Industrial production	% YoY	6.3	4.6	2.9	6.7	4.2	5.3	5.5	5.5	4.4	1.8	2.4	-1.9	4.7	2.6
Construction production	% YoY	-4.8	-3.2	-2.9	5.8	-3.9	14.4	17.4	12.2	10.0	8.0	1.1	-3.6	2.2	-1.7
Retail sales ^a	% YoY	3.9	3.2	3.8	5.8	4.8	7.0	3.1	8.4	3.8	1.2	2.1	1.7	2.5	2.9
Unemployment rate	%	13.0	13.0	13.2	13.4	13.9	13.9	13.5	13.0	12.5	12.0	11.8	11.7	11.5	11.5
Gross wages in corporate sector	% YoY	3.6	3.1	3.1	2.7	3.4	4.0	4.8	3.8	4.8	3.5	3.5	3.5	3.5	3.4
Employment in corporate sector	% YoY	-0.3	-0.2	0.1	0.3	0.0	0.2	0.5	0.7	0.7	0.7	0.8	0.7	0.8	0.8
Exports (€)	% YoY	9.9	4.3	3.0	11.6	8.4	7.3	9.5	4.1	9.2	5.2	6.2	-1.8	9.8	5.0
Imports (€)	% YoY	5.2	3.7	-1.7	0.7	5.8	6.9	4.1	8.0	10.8	5.9	4.8	-1.1	10.5	8.2
Trade balance	EUR mn	608	80	206	-150	105	-79	132	29	-178	222	71	-64	576	-370
Current account balance	EUR mn	-551	-92	-584	-652	-1,100	-651	345	421	-237	-746	-681	-986	-551	-973
Current account balance	% GDP	-1.9	-1.7	-1.5	-1.3	-1.3	-1.3	-1.2	-1.1	-1.1	-1.2	-1.3	-1.4	-1.4	-1.6
Budget deficit (cumulative)	PLN bn	-29.6	-39.5	-38.5	-42.2	-2.6	-11.7	-17.5	-21.3	-22.5	-25.4	-26.4	-24.6	-25.2	-30.5
Budget deficit (cumulative)	% of FY plan	57.4	76.5	74.7	81.8	5.6	24.7	36.8	44.8	47.3	53.4	55.5	51.9	53.0	64.2
CPI	% YoY	1.0	0.8	0.6	0.7	0.5	0.7	0.7	0.3	0.2	0.3	-0.2	-0.3	-0.4	-0.5
CPI excluding food and energy	% YoY	1.3	1.4	1.1	1.0	0.4	0.9	1.1	0.8	0.8	1.0	0.4	0.5	0.8	0.5
PPI	% YoY	-1.4	-1.4	-1.5	-1.0	-1.0	-1.4	-1.3	-0.7	-1.0	-1.8	-2.0	-1.5	-1.6	-0.7
Broad money (M3)	% YoY	6.1	5.9	5.7	6.2	5.4	5.2	5.2	5.4	5.2	5.2	6.0	7.4	7.8	7.4
Deposits	%YoY	6.0	5.9	5.2	6.0	4.9	4.7	4.7	5.4	5.5	5.5	6.7	7.8	7.4	7.1
Loans	%YoY	3.7	2.9	3.8	4.0	4.2	4.7	5.3	6.1	5.4	4.9	5.4	6.3	6.2	7.2
EUR/PLN	PLN	4.24	4.19	4.19	4.18	4.18	4.18	4.20	4.18	4.18	4.14	4.14	4.19	4.19	4.18
USD/PLN	PLN	3.17	3.07	3.10	3.05	3.07	3.06	3.04	3.03	3.04	3.04	3.06	3.15	3.25	3.30
CHF/PLN	PLN	3.43	3.40	3.40	3.41	3.39	3.42	3.45	3.43	3.42	3.39	3.41	3.46	3.47	3.46
Reference rate ^b	%	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	2.00
3M WIBOR	%	2.69	2.67	2.65	2.67	2.70	2.71	2.71	2.72	2.72	2.69	2.68	2.65	2.45	2.10
Yield on 2-year T-bonds	%	3.07	2.90	2.80	2.94	2.99	3.06	2.99	2.94	2.79	2.54	2.45	2.30	2.02	1.78
Yield on 5-year T-bonds	%	3.86	3.62	3.64	3.65	3.67	3.79	3.68	3.60	3.36	3.10	2.89	2.73	2.40	2.08
Yield on 10-year T-bonds	%	4.50	4.28	4.38	4.41	4.42	4.47	4.26	4.10	3.80	3.54	3.34	3.23	2.98	2.70

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

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

Quarterly and annual economic indicators

		2012	2013	2014E	2015E	1Q14	2Q14	3Q14E	4Q14E	1Q15E	2Q15E	3Q15E	4Q15E
GDP	PLN bn	1,596.4	1,635.7	1,696.3	1,760.4	397.4	413.5	418.4	467.0	404.4	426.9	436.9	492.2
GDP	% YoY	2.0	1.6	3.1	3.1	3.4	3.3	2.8	2.8	2.5	3.1	3.2	3.5
Domestic demand	% YoY	-0.1	0.0	3.9	4.0	3.0	5.1	3.9	3.6	3.5	3.9	4.2	4.3
Private consumption	% YoY	1.3	0.8	2.8	2.8	2.6	2.8	2.9	2.9	2.8	2.7	2.8	2.9
Fixed investments	% YoY	-1.6	-0.2	7.5	5.4	10.7	8.4	7.0	6.0	5.0	5.0	5.0	6.0
Industrial production	% YoY	1.0	2.3	3.2	3.2	4.9	3.7	1.8	2.4	2.1	2.9	3.7	4.2
Construction production	% YoY	-1.0	-10.3	3.8	4.7	9.8	9.9	-0.1	0.6	0.9	0.6	6.5	7.8
Retail sales ^a	% YoY	6.0	2.6	3.7	6.3	5.1	4.6	2.2	3.0	4.0	4.8	7.6	8.4
Unemployment rate ^b	%	13.4	13.4	11.8	11.5	13.5	12.0	11.5	11.8	12.1	10.9	10.8	11.5
Gross wages in the national economy ^a	% YoY	3.7	3.4	3.5	4.1	4.2	3.5	3.1	3.4	3.7	3.7	4.8	4.6
Employment in the national economy	% YoY	0.0	-1.1	0.2	0.4	-0.3	0.1	0.4	0.4	0.4	0.4	0.2	0.3
Exports (€)	% YoY	6.5	5.7	6.1	7.5	8.4	6.1	5.0	5.0	6.0	7.0	8.0	9.0
Imports (€)	% YoY	2.2	0.2	6.7	9.9	5.6	8.2	4.9	8.2	9.0	10.0	10.0	10.5
Trade balance	EUR mn	-7,146	635	-278	-4,042	159	71	583	-1,091	-985	-1,087	-154	-1,816
Current account balance	EUR mn	-13,697	-5,245	-7,024	-11,171	-1,403	-553	-2,218	-2,850	-2,924	-1,552	-3,221	-3,475
Current account balance	% GDP	-3.6	-1.3	-1.7	-2.6	-1.2	-1.2	-1.4	-1.7	-2.1	-2.3	-2.5	-2.6
General government balance	% GDP	-3.9	-4.3	5.7	-2.9	-	-	-	-	-	-	-	-
CPI	% YoY	3.7	0.9	0.1	0.8	0.6	0.3	-0.3	-0.3	0.0	0.7	1.0	1.5
CPI ^b	% YoY	2.4	0.7	-0.2	1.6	0.7	0.3	-0.4	-0.2	0.1	0.9	1.3	1.6
CPI excluding food and energy	% YoY	2.2	1.2	0.8	1.4	0.8	0.8	0.6	0.8	1.2	1.4	1.4	1.5
PPI	% YoY	3.4	-1.3	-1.1	0.9	-1.2	-1.2	-1.7	-0.4	0.2	1.0	1.2	1.1
Broad money (M3) ^b	% oY	4.5	6.2	5.7	5.5	5.2	5.2	7.8	5.7	5.6	5.6	5.5	5.5
Deposits ^b	%YoY	4.7	6.0	6.1	6.2	4.7	5.5	7.4	6.1	6.1	6.1	6.2	6.2
Loans ^b	%YoY	1.2	3.6	5.5	5.6	5.3	4.9	6.2	5.5	5.5	5.5	5.6	5.6
EUR/PLN	PLN	4.19	4.20	4.17	4.09	4.19	4.17	4.18	4.16	4.13	4.10	4.07	4.05
USD/PLN	PLN	3.26	3.16	3.13	3.21	3.06	3.04	3.15	3.28	3.20	3.22	3.23	3.17
CHF/PLN	PLN	3.47	3.41	3.43	3.27	3.42	3.42	3.45	3.43	3.36	3.31	3.26	3.16
Reference rate ^b	%	4.25	2.50	1.75	1.75	2.50	2.50	2.50	1.75	1.75	1.75	1.75	1.75
3M WIBOR	%	4.91	3.02	2.49	1.96	2.71	2.71	2.59	1.97	1.93	1.95	1.97	1.99
Yield on 2-year T-bonds	%	4.30	2.98	2.45	1.88	3.01	2.76	2.26	1.79	1.79	1.80	1.87	2.07
Yield on 5-year T-bonds	%	4.53	3.46	2.95	2.11	3.71	3.35	2.67	2.05	2.03	2.08	2.13	2.18
Yield on 10-year T-bonds	%	5.02	4.04	3.51	2.75	4.38	3.82	3.18	2.67	2.63	2.68	2.77	2.93

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

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