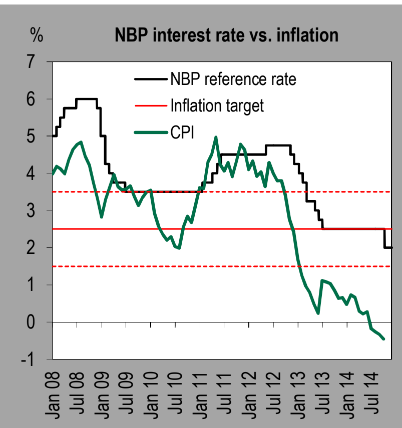
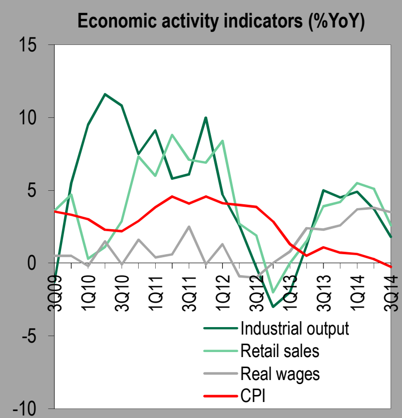
MACROscope

Polish Economy and Financial Markets

November 2014

(De)concentration of monetary policy





In this issue:

- After September's decision to keep rates on hold, the Polish Monetary Policy Council kicked off the final quarter of 2014 with a 50bp rate cut. The MPC said that monetary easing was required given the change in the economic situation and that it should be concentrated in a short period. That comment meant the market and economists were widely expecting a further cut.

- **Surprisingly, the MPC did not deliver in November, but kept rates on hold. This was despite the central bank's latest projections, which definitely supported additional easing.** Its substantial downward revisions to both GDP and CPI forecasts were predictable, given the recent domestic and foreign data flow. The central bank sees average inflation at c1.2% in 2016 and probably close to 1.5% at the end of that year (as a reminder, the target in Poland is 2.5%). What is more, the MPC statement pointed to downside risk to both CPI and GDP projections. Even so, this was clearly not enough for some members to continue with easing.

- **There are two scenarios for the coming months. First, the concentration of monetary policy easing already took place with just one shot in October (which we find hard to reconcile with the economic outlook). Second, the MPC has 'de-concentrated', or put easing on hold, for a while and will be back with more sooner or later. We think the second is more likely,** but note that the difficulty of building a majority within the Council in November shows that we should not expect significant further easing. We maintain our forecast of the reference rate reaching 1.75% in this cycle from 2% now. This is also in line with our better-than-NBP growth forecast for the coming quarters.

- What does this mean for the rates market? **The market will probably price in additional monetary easing in the coming months (if not December, then 1Q15). Therefore, the recent correction may prove temporary, especially if our forecast for a low CPI reading (-0.5%YoY for October) proves accurate**. Flash 3Q GDP numbers are due the day after the October CPI data and may be just as important (the MPC suggested that GDP is more significant than CPI). Nevertheless, we maintain our view that if the market starts to price in very aggressive easing – exceeding additional 50bp – as has been the case in the last few weeks, we would think this excessive.

- We still believe the zloty has the potential to gain slightly in the final months of this year, supported by possible liquidity injections by the ECB, a smaller probability of much lower interest rates in Poland and some improvement in economic confidence.

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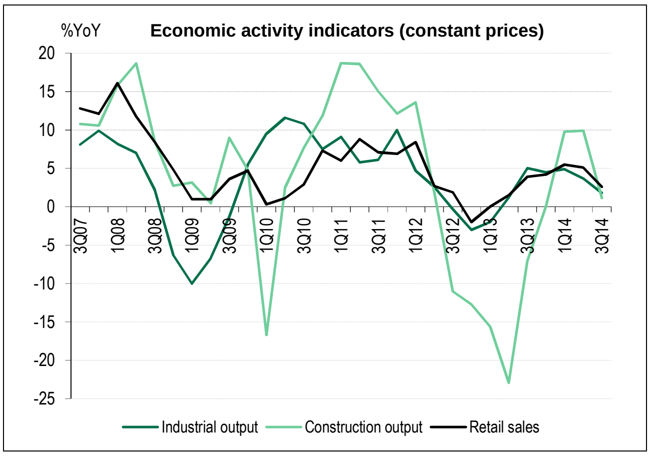
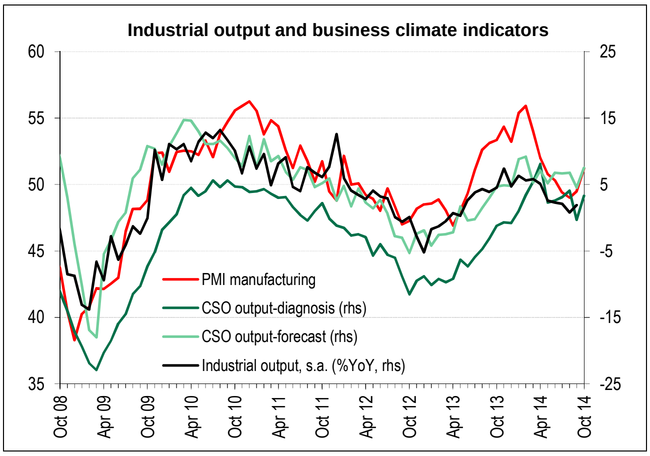
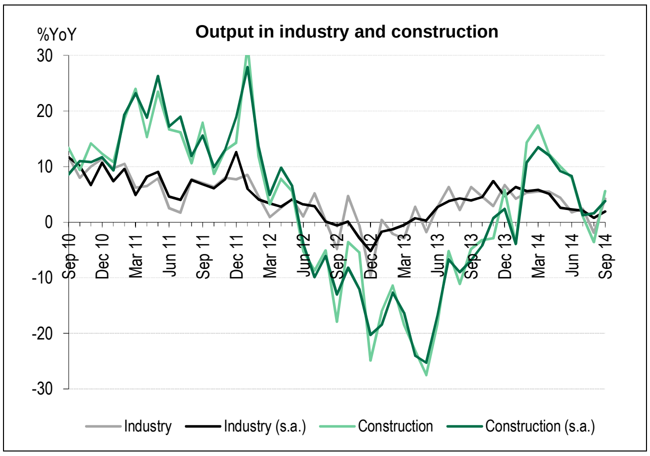
Financial market on 6 November 2014:					
NBP deposit rate	1.00	WIBOR 3M	2.02	EURPLN	4.2250
NBP reference rate	2.00	Yield on 2-year T-bond	1.81	USDPLN	3.3769
NBP lombard rate	3.00	Yield on 5-year T-bond	2.08	CHFPLN	3.5083

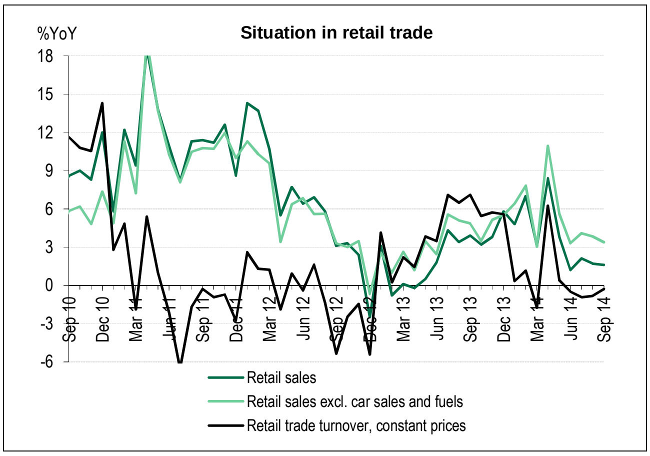
This report is based on information available until 6.11.2014.

Economic update









Source: CSO, Markit, BZ WBK.

Latest data look a bit more optimistic

▪ Recent Polish macroeconomic data proved a bit more upbeat, with October's PMI for manufacturing probably the most optimistic piece of information and further positive surprises in industrial and construction output. In general, the 3Q economic performance was weaker than 2Q and we think that economic growth decelerated below 3% YoY (although the margin of errors in this forecast is higher as the new GDP data will be based on ESA2010 methodology). As regards prospects for 4Q, the National Bank of Poland's (NBP) survey of the business climate showed that companies' expectations about demand, orders and investment deteriorated. Additionally, the outlook for the economy remains very much dependent on the situation in the Euro zone. There are some signs of a better mood in the Euro area, but it is hard to say whether that will last. Thus, we are not very sanguine about growth in 4Q and expect it to stabilize below 3.0%YoY.

PMI rises above 50 points again

▪ The PMI Index for Polish manufacturing surged to 51.2pts in October from 49.5pts in September, well above expectations and marking its highest level since April. This was the largest monthly increase since January. Almost all the index components improved, with the strongest increase in domestic orders and production – both of which have performed well since April. Rising output has supported the labour market – employment continued to grow for the 15th month in a row, according to the survey.

▪ The PMI confirmed that domestic demand remains robust, preventing the economy from slowing down significantly. October's development was the second increase in a row, suggesting that the economy may be bottoming-out. Business climate indices calculated by Central Statistical Office (CSO) also rose in October for all major sectors.

Industry and construction helped by calendar differences

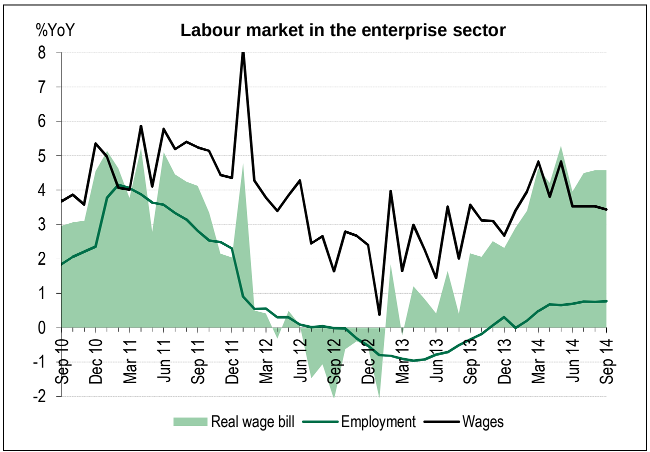
▪ In September industrial output increased by 4.2%YoY and construction output by 5.6%YoY, both numbers were above consensus and data for August (-1.9%YoY and -3.6%YoY, respectively), but we should remember that they were positively affected by differences in the number of working days, so the situation is not as positive as the rebound from the previous month may suggest. Nor was the economic situation in August as bad as the headline figure implies, as seasonal factors worked in the opposite direction. Seasonally-adjusted industrial production rose 1.9%YoY in September compared with only 0.7%YoY the previous month. Average growth in May-July was 2.4%YoY.

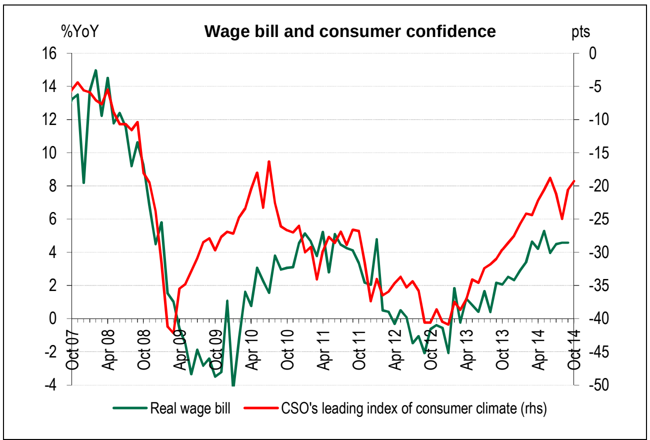
Retail sales were depressed by good weather

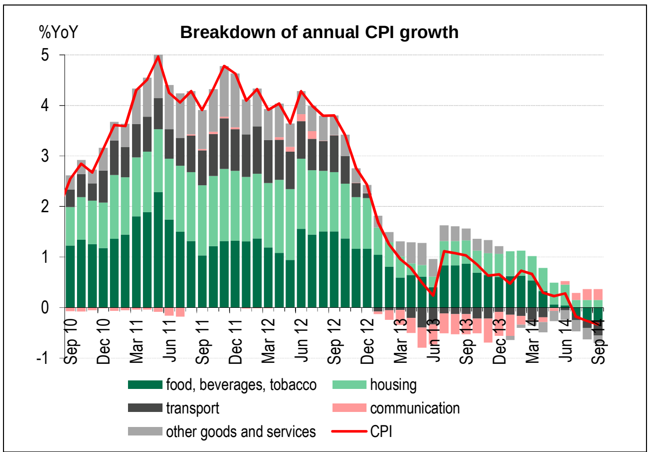
▪ Growth rate in retail sales slowed in September to 1.6%YoY from 1.7%YoY in August, below expectations. Weak footwear and clothing sales were the main source of the negative surprise. Usually, spending on both goes up considerably in September (16.6%MoM in September 2013, 11%MoM on average in the last seven years), as consumers are buying new clothes for the autumn and winter season. However, this year sales fell 5.9%MoM and 3.9%YoY, probably due to exceptionally good weather. September 2014 was the warmest since 2006 and this probably encouraged consumers to postpone purchases. If this is the case, we may expect this demand to materialize in the following months and boost sales.

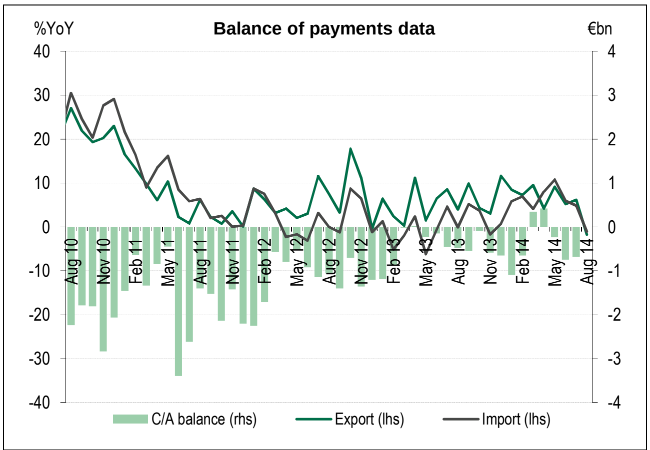
▪ We think retail sales growth already rebounded in October, based on information about new car registrations, which surged by nearly 20%MoM for the second straight month, among other things.

Economic update









Source: CSO, NBP, BZ WBK.

Labour market strengthened in 3Q

- Employment in the corporate sector increased by 0.8%YoY and wages added 3.4%YoY in September. For 3Q as a whole, employment increased by 0.8%YoY, wages by 3.5%YoY and the real wage bill by 4.5%YoY.
- We expect the positive trends in the corporate sector to continue in the coming months, but the deceleration in industrial output may have a negative impact on the demand for labour. As much as 45% of jobs in the corporate sector are in industry, so a slowdown here affects the sector-wide result.
- The unemployment rate dropped to 11.5% in September from 11.7% in August. Interestingly, the number who left the unemployment rolls was higher than a year ago (+8.5%) for the first time in several few months. Of these, the number who left because they found work increased by 5.6%YoY, although that growth was only 0.6%YoY after subsidized jobs are excluded. Additionally, the number of job offers was the highest for over four years. Seasonally-adjusted data confirm that job creation improved in 3Q after some temporary slowdown in 2Q.
- The corporate sector and unemployment data confirmed the positive trends in the labour market strengthened in 3Q after some deterioration in 2Q. This was due, to some extent, to the Labour Ministry's action, but this factor was not decisive. A better situation in the labour market supports hopes for good growth in consumption in the second half of the year. However, we could question how sustainable this improvement is, given the economic slowdown.

Inflation still below zero

- Consumer prices dropped 0.3%YoY in September, the same rate as in August. Food prices interrupted a seven-month-long downward trend and edged marginally higher in September (+0.1%MoM). However, we do not expect the rebound to continue for long. Russia's sanctions on food imports from Europe and this year's plentiful harvests should keep food prices low for many months to come. At the same time, other categories show no significant upward moves. On monthly basis, only clothing and footwear increased noticeably (by 1.1% MoM), but this was only a seasonal phenomenon (the end of discounts and introduction of new autumn collections). CPI growth is likely to stay below zero until December.
- Core inflation, excluding food and energy, was slightly higher in September, at 0.7%YoY, but it should remain low in the coming months (below 1% until the year-end, we estimate).

Sharp drop in foreign trade volumes in August

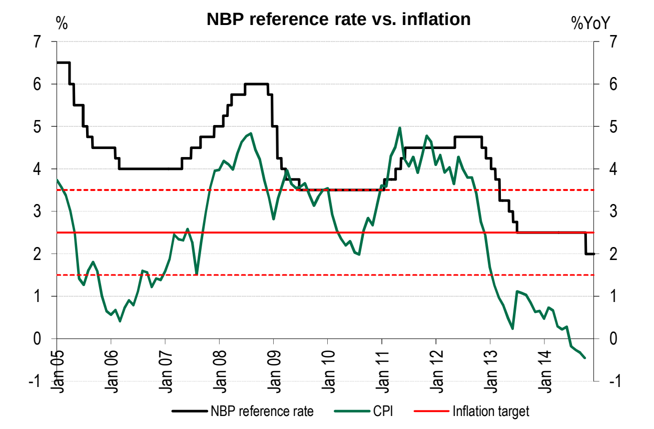
- Both exports and imports decelerated significantly in August. f Export growth (in euros) decelerated from over 6%YoY to -1.8%YoY in August and imports from 4.8%YoY to -1.1%YoY. This is the weakest export growth in the available data series (since 2011) and, if we also take into account data under the old methodology, it would be the lowest since October 2009. Although we should remember that exports and imports were negatively affected by the month having one working day less than a year ago (as for industrial output), our forecast took this factor into account and the data were still disappointing. Apparently, the slowdown in the Euro zone weighs more and more on Polish foreign trade.
- The current account deficit reached -€986mn. The July number was revised to -€681mn from -€175mn. Consequently, the 12-month rolling current account deficit increased to -1.4% of GDP (the highest for nine months), according to our estimates.

Monetary policy watch

Excerpts from the MPC's communiqué after its November meeting
Economic recovery in the United States growth is also relatively low and in some places, including Russia, has been decelerating.
Growth in global economic activity remains moderate, although economic situation varies across countries. In the United States, economic growth in 2013 Q3 remained relatively robust. In the euro area, economic activity is still low and the projections for economic growth in the euro area have been revised downwards. At the same time, the economic growth in the euro area next year is expected to be higher than this year. This is accompanied by a slowdown in GDP growth in China and growth in economic activity in Russia coming to a halt.
In Poland, data on economic activity point to deceleration in economic growth in 2014 Q3. Growth in industrial production, construction and retail sales was lower in 2014 Q3 than in the previous quarter. This was accompanied by a deceleration of exports growth driven by economic slowdown in Poland's major trading partners.
Despite lower economic activity growth, employment in the corporate sector continues to rise, which is conducive to a gradual decline in unemployment. Yet, the unemployment rate remains elevated, which continues to contain wage pressure. As a result, wages increase in a pace close to real GDP growth. At the same time, expansion in lending to households has been stable, while the growth in lending to the corporate sector has been increasing gradually.
The economic growth and inflation risk distribution points to a greater probability of these variables remaining below the central projection throughout the whole projection horizon than above the central projection.
In the opinion of the Council, the October adjustment of monetary policy and the stable, despite some slowdown, economic growth limit the risk of inflation remaining below the target in the medium term. Therefore, the Council decided to keep NBP interest rates unchanged, However, the Council highlights that uncertainty regarding the economic conditions in the environment of the Polish economy persists. Therefore, the Council does not rule out further adjustment of monetary policy, should the incoming data point to a risk of deterioration in economic growth outlook.

NBP projections in the subsequent *Inflation reports*

	GDP growth (%)			
	Nov 13	Mar 14	Jul 14	Nov 14
2014	2.0-3.9	2.9-4.2	3.2-4.1	2.9-3.5
2015	2.1-4.5	2.7-4.8	2.6-4.5	2.0-3.7
2016		2.3-4.8	2.3-4.5	1.9-4.2
	CPI inflation (%)			
	Nov 13	**Mar 14**	**Jul 14**	**Nov 14**
2014	1.1-2.2	0.8-1.4	-0.1-0.4	0.0-0.2
2015	1.1-2.6	1.0-2.6	0.5-2.1	0.4-1.7
2016		1.6-3.3	1.3-3.1	0.6-2.3



Sources: NBP, CSO, Reuters, BZ WBK

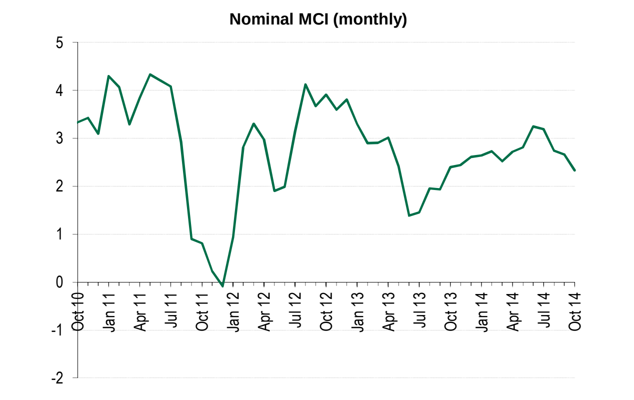
Which button did they press, pause or stop?

- As we already discussed in detail earlier this month, in our instant comment after the MPC meeting, the no-cut decision was surprising and seems unjustified, given both the results of the new NBP projection (see below) and the previous communication of the Council (see next page).
- Unfortunately, neither in the official statement nor during the press conference after the meeting was there any clear indication of future moves or even a clear justification of November's decision. The statement says that "the Council does not rule out further adjustment of monetary policy, should the incoming data point to a risk of deterioration in economic growth outlook". This compares with the (most important) sentence in October's statement: "should the incoming data, including the November NBP projection, confirm a considerable risk of inflation remaining below the target in the medium term". So, the focus moved to growth from inflation. This is probably because most of the Council members see growth prospects as better than those outlined in the projection. At the same time, they see the main drivers of low inflation as supply-side in nature.
- It is really hard to have a convincing call for the December meeting. Before November's decision, our forecast for the additional scale of monetary adjustment (after 50bp in October) was an additional 25bp. We still think the reference rate will reach 1.75%, although it is hard to say whether the data to be released in November will be enough to convince the doubters as early as December. Economic activity data are unlikely to change the picture much, still pointing to below 3% GDP growth. Inflation can surprise to the downside (our forecast is below consensus). Theoretically, this should be enough to trigger a cut. But, theoretically, they should have already cut in November . . .

Projection justifies further easing, but only if you believe it!

- The new NBP projection for both GDP and CPI (details in the table) was much lower than the previous one. The substantial changes should not be surprising, given the recent domestic and foreign dataflow. As regards GDP growth, the mid-point of the forecast for 2015 was cut from c3.5% to below 3%. This represents the adjustment of as much as 0.7pp. The change was less significant for 2016 – from 3.4% to c.3%. The previous projection put the output gap for 2014 at -0.7 (as a % of potential GDP) and did not expect it to close until 2016. With new forecasts and a new starting point (the GDP growth forecast for 2014 was also lowered by c.0.5pp), one can hardly expect upward pressure on prices. This is reflected in the inflation projection, which was revised downwards by more than 1pp for 2016, with average inflation at c1.2% and year-end probably close to 1.5% (as a reminder, the target in Poland is 2.5%!). What is more, the MPC statement mentioned downside risk to both CPI and GDP projections.
- Probably the most surprising element of the projection is how the MPC members perceive it. First, according to the majority of the MPC, growth prospects are better than those outlined in the projection. Second, they probably do not believe the significantly-below-target scenario for inflation, as, if they did, they would have to react. So the interesting questions are: On what basis do the MPC members form their own forecasts?; What kind of model do they use?; and Which assumptions of the projection do they disagree with? We would like to see answers in the next (probably many, as usual) interviews with MPC members. We hope they will at least touch on these subjects rather than going off at a tangent.

Restrictiveness of the Monetary Policy (Council)



MCI declined but may rebound soon

- The MCI monetary policy restrictiveness index declined in October on the back of falling money market rates, in line with expectations for monetary easing by the Polish MPC and the PLN depreciation, fuelled by the deterioration of the global economic outlook.
- We are expecting a stabilization of the MCI in November, and the index may soon bottom-out, as the MPC proved less eager-than-expected to cut rates and we are expecting the zloty to strengthen. This means that after a few months of easier monetary policy conditions (the index has been declining since June), now they may become tighter, putting downward pressure on prices in the medium term.

Rzońca (1.26)

Winiecki (1.25)

Kaźmierczak (1.23)

Glapiński (1.21)

Hausner (1.17)

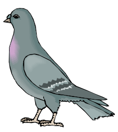
Belka (0.69)

Chojna-Duch (0.65)
AGAINST CUT IN NOV?

Zielińska-Głębocka (0.58)

Bratkowski (0.55)

Osiatyński (0.23)



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.

Decision was contrary to previous communication . . .

There is no doubt the MPC decision in November was surprising to (almost) everybody. The bias of forecasts was towards an even more significant monetary easing, and the financial market had priced in a more than 25bp reduction. The market reaction proved that the MPC did not deliver this time. During the press conference, NBP Governor Marek Belka, when asked about communication in the context of the surprising decision, replied that: “It was not about the art of communication, which was at the highest level, but about the decision which was taken”. This is probably the best summary of November’s MPC meeting – the decision was not in line with previous communication. Neither, in our view, was it consistent with the projections of the central bank, which were significantly revised downwards for both GDP and CPI.

. . . while current communication looks inconsistent

We think the NBP governor, Marek Belka, appeared unhappy with the decision and one can question the MPC’s consistency on a number of points. For example, Belka said that “it is not a risk that inflation will be below the target, this is certain”. This was in line with the new inflation projection (c1.5% mid 2016 against the target of 2.5%). However, at the same time, the statement reads “the October adjustment of monetary policy and the stable, despite some slowdown, economic growth limit the risk of inflation remaining below the target in the medium term”. So, it would appear that the majority of the MPC does not believe in the projection. However, during the press conference Belka said that there was consensus within the MPC that inflation will be below the target in the medium term. So, why didn’t they cut interest rates?

Who changed his (or rather her) mind?

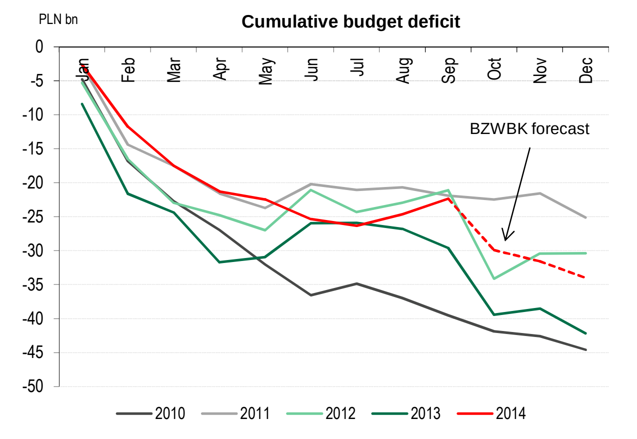
Belka said that the MPC’s decision in November was “obviously not unanimous”. If we were to bet on which member changed their mind since the October vote, we would name Professor Elżbieta Chojna-Duch. When asked about monetary policy prospects, the NBP president clearly deferred to Chojna-Duch to answer. She said that growth in 4Q14 should accelerate compared with 3Q14.

We disagree and think 4Q growth will be lower and the next flow of macroeconomic data should confirm this. We also have a dovish call for the next CPI reading, which might also be a convincing argument for an additional cut. In general, we think that the development of the economic situation in line with the projection (or probably even slightly higher GDP, as in our scenario) should be a convincing argument for members to cut rates again. It is hard to say whether this will happen in December, but the Council’s October statement, to the effect that monetary easing should be concentrated in the very short period of time, might be still binding. We simply hope the Council did not ‘de-concentrate’ completely.

This time, in our index of restrictiveness of MPC members, presented on this page, we included our forecasts of voting in October and November. The former we assume was 5-5 with the casting vote of the President, the latter 4-6 with Chojna Duch against the rate cut.

Source: NBP, Reuters, BZ WBK

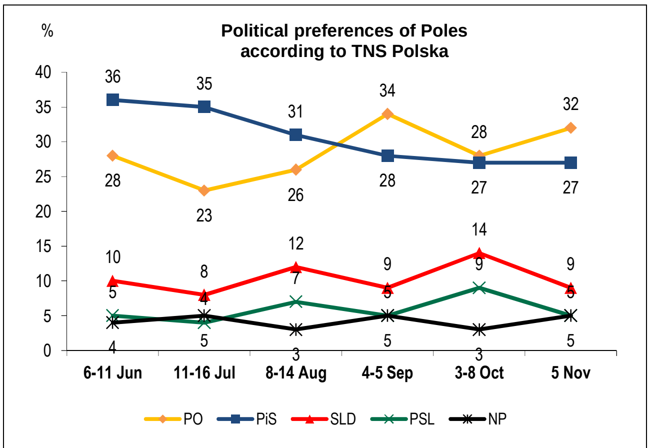
Fiscal policy watch



European Commission's autumn economic forecasts for Poland

	2012	2013	2014	2015	2016
GDP growth	1.8	1.7	3.0	2.8	3.3
Private consumption	0.9	1.0	2.5	2.7	3.0
Fixed investment	-1.5	0.9	7.7	5.7	6.3
HICP inflation	3.7	0.8	0.2	1.1	1.9
Unemployment rate [a)]	10.1	10.3	9.5	9.3	8.8
Current account balance [b)]	-3.8	-1.4	-2.0	-2.4	-2.8
General government balance [b)]	-3.7	-4.0	-3.4	-2.9	-2.8
General government debt [b)]	54.4	55.7	49.1	50.2	50.1

a) Eurostat definition; b) as % of GDP



	Spread vs. Bunds (10Y) in bp			CDS (5Y USD)		
	6.11	change since 10.10.14	change since 31.12.13	6.11	change since 10.10.14	change since 31.12.13
Poland	2.60	-7	-172	67	-2	-12
Czech	0.89	-20	-164	47	0	-13
Hungary	3.96	-38	-175	182	17	-74
Greece	7.86	131	-68	-	-	-
Spain	2.14	8	-201	92	16	-62
Ireland	1.74	4	-173	56	4	-64
Portugal	3.23	26	-280	188	34	-158
Italy	2.36	4	-173	116	20	-53
France	1.19	-6	-125	50	7	-4
Germany	-	-	-	18	0	-8

Source: Finance Ministry, Reuters, TNS Polska, BZ WBK.

2014 budget deficit likely to be below PLN35bn

- The state budget deficit reached PLN22.4bn in the first nine months of the year, i.e. 47% of the annual plan. This means that in September alone the budget was in surplus (for the second straight month) to the tune of PLN2.3bn. This was largely thanks to noticeable improvement in revenues, which, after nine months, were c.PLN7.6bn higher than the Finance Ministry's budget has assumed at this stage. The biggest improvement was in non-tax income, while tax revenues continued to grow at a moderate pace.
- According to Finance Ministry's flash estimates, the deficit was still below PLN30bn at the end of October. We think it is likely to be nearly PLN34bn at the end of this year, i.e. PLN13bn less than planned in the original 2014 budget.

European Commission becomes more pessimistic on Poland

- The European Commission reduced its GDP forecasts for many European countries, including Poland. It now thinks Poland will grow 3% this year and decelerate to 2.8% in 2015 (we are slightly more optimistic in our estimates with growth of 3.1% in both 2014 and 2015). The EC thinks that weaker demand from the Euro zone and the situation in Ukraine will weigh on the pace of growth, but the strength of this negative factor will fade during the next year. Meanwhile, it says decent domestic demand and a healthy labour market should prevent a sharper economic slowdown.
- According to the EC, Poland's fiscal deficit will drop to 2.9% of GDP next year from 3.4% in 2014. This is consistent with our forecast. However, Finance Minister Mateusz Szczurek said Poland will do better than the Commission's fiscal forecasts on the spending side, as the EC did not account for full weight of Poland's statutory caps on spending growth. In his opinion, the fiscal deficit could be below 3% of GDP as soon as this year, although there is still some uncertainty surrounding local government budgets. Earlier the government planned to cut fiscal gap to 3.3% of GDP in 2014 and to 2.5% in 2015. We think that a slight slippage in deficit reduction in 2015 would not be very bad news (as long as the gap remains below 3% of GDP), as it would help the economy to recover.

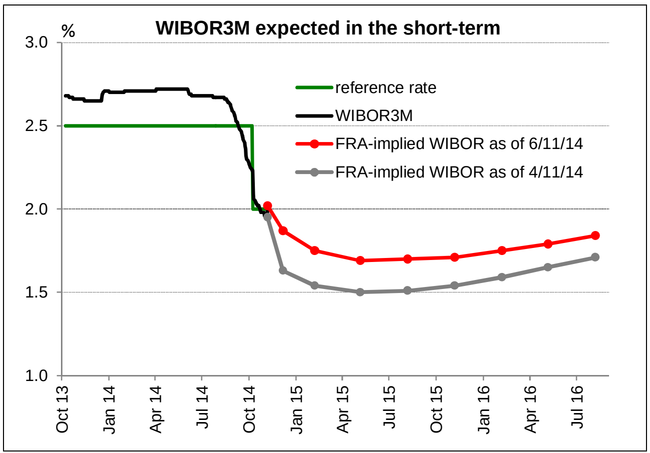
Local elections ahead

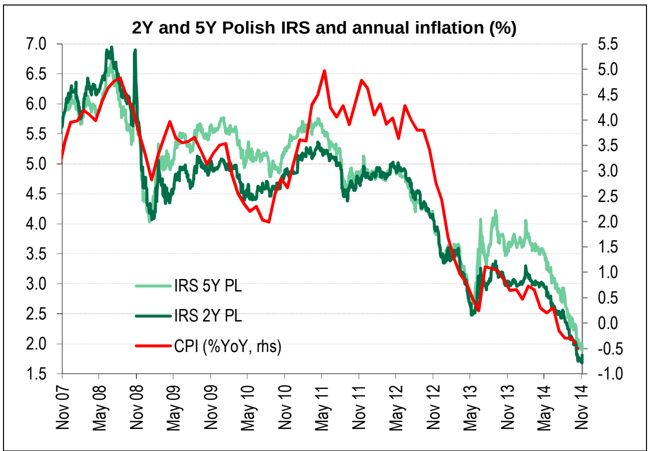
- Poland holds local elections on November 16. The ruling Civic Platform (PO) is still in the lead in most recent opinion polls, although the gap between it and the main opposition party, Law and Justice (PiS), has recently narrowed. This is mid-way through the election cycle that started with the European election in May and continues with the presidential election in next spring and the parliamentary election in autumn 2015.

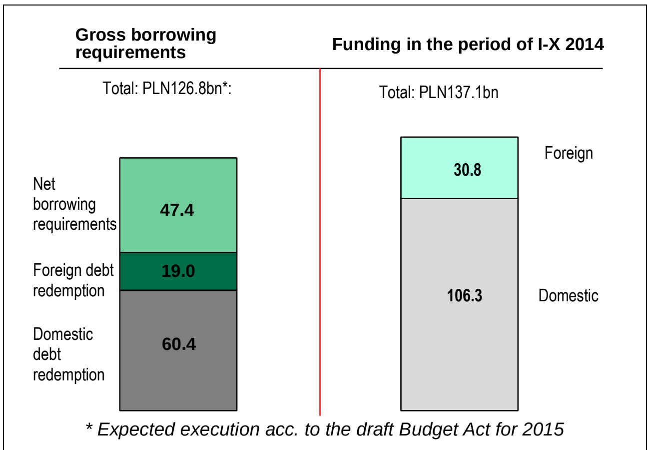
Core Euro zone debt market still strong

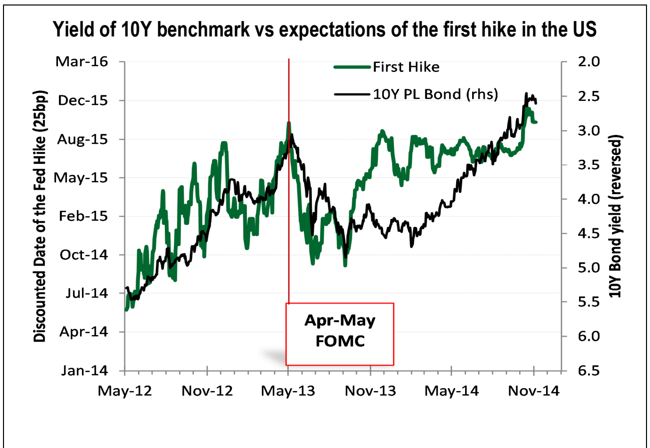
- Over the past month, long-term debt (in core and peripheral markets) has continued its strong rally, due to the weak global outlook. 10Y Bund yields hit a new record low of 0.75%, while 10Y Spanish and Italian benchmark yields fell again to record low levels, last seen in September, of 2.05% and 2.26%, respectively. The spreads over Bunds widened slightly on a monthly basis (with the highest increase in Greece) as investors focused more sharply on the fundamentals of the individual countries.
- In November ECB remained in a wait and see mode. In our opinion, the combination of weak data and low inflation will keep QE speculation alive in the Euro zone, leaving room for a further gradual decline in yields. However, Italian debt is likely to remain under pressure due to the weak macro outlook, while the unofficial referendum in Catalonia may weigh on Spanish bonds.

Interest rate market









Source: Finance Ministry, Reuters, Bloomberg, BZ WBK.

WIBOR may fall further

- October was the fifth month in a row in which money market rates declined significantly and followed the unexpected MPC decision to cut the reference rate by 50bp in October amid still weak domestic macro data. WIBORs shed 29-40bp in the month, with the 1M rate retreating the most. The downward trend in FRA rates was halted by hawkish comments from some of the MPC members.
- The beginning of November also brought considerable decline in money market rates ahead of expected further monetary easing by the MPC (particularly as some investors expected a cut of 50bp). However, the MPC surprised the market by leaving official rates unchanged and, as a result, money market rates increased sharply, with WIBORs rising by 11-6bp and FRAs by 20-26bp. Moreover, market players quickly adjusted their interest rate outlook to a new environment. The FRA market is currently pricing-in a rate cut of 25bp over the next three months (vs at least 50bp previously).
- We still see room for one more cut of 25bp (possibly as soon as December). This should be supported by the next data releases, which are likely to show subdued economic activity and sub-zero inflation (we expect the CPI to drop 0.5%YoY in October). Therefore, we think that money market rates will return to a downward trend in the coming weeks.

Correction after a strong rally

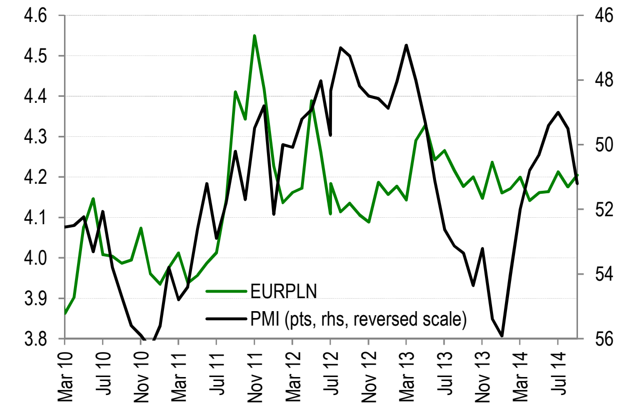
- Domestic T-bond and IRS markets have continued their strong rally with both yields and IRS rates reaching new record lows in October. Sentiment in global markets was also supportive for domestic fixed income as the 10Y Bund yield hit a new record low (0.75%). Upward corrections (mainly due to higher risk aversion or more hawkish rhetoric from some MPC members) were only short-lived. A bullish flattener developed in both markets, tracking the global trend. The spread over Bunds has continued to narrow for all sectors and temporarily dropped to 160bp for 10Y debt, the lowest level ever recorded.
- While early November was still favourable for the debt market (the 10Y benchmark hit a fresh record low at 2.50%), the MPC's decision to keep rates unchanged caused quite a sharp correction. One day after the MPC meeting yields and IRS rates rose 10-15bp. The front end of the curves gained the most and a bear flattener developed in both markets as a result. However, the sharp drop in prices has activated the demand side as some investors used correction to rebuild their position in T-bonds and IRS.

Limited decline in yields is still likely

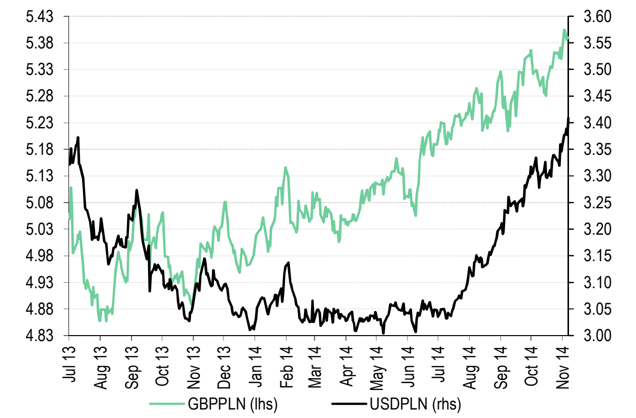
- Fundamentally, we see room for a further 25bp rate cut before the end of 1Q15 if not in December. We think that the correction in T-bonds / IRS markets observed after the MPC's decision could come to a halt if October inflation is low (c.-0.5%YoY), as this would again fuel expectations of easing. Therefore, we are sticking to our yield/IRS forecasts for the end of this year.
- The Finance Ministry has already issued more debt than was planned for 2014. At the end of October financing totalled PLN137.1bn vs expected gross borrowing needs of PLN126.8bn. Very low supply of T-bonds on the primary market up to year-end should also be supportive for domestic debt.
- Polish bond yields (in particular 10Y rates – see chart) seem to have been highly correlated with investors' expectations about Federal Reserve monetary policy in recent quarters. Any swing in market expectations towards faster rate hikes in the US is a risk factor for Polish bonds (at least until the ECB starts expanding its balance sheet).

Foreign exchange market

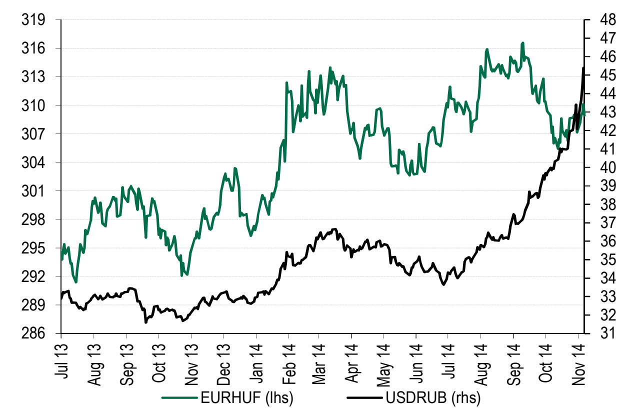
EUR/PLN and Polish manufacturing PMI



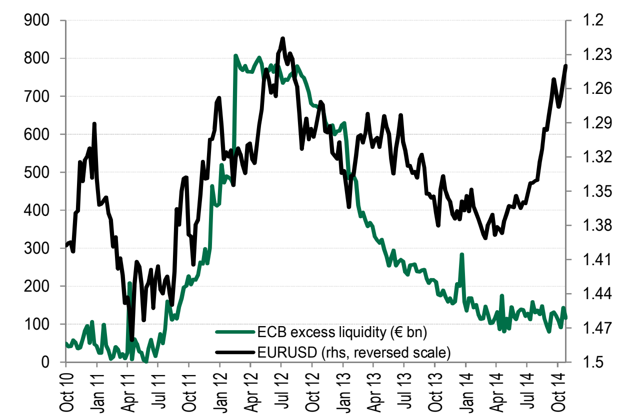
GBP/PLN and USD/PLN



USD/RUB and EUR/HUF



EUR/USD and the ECB excess liquidity



Sources: Reuters, Bloomberg, Markit, BZ WBK.

Increase in the zloty's volatility

- Last month we stressed the zloty's surprisingly low volatility vs. the single currency and then saw a noticeable move as the exchange rate surged to nearly 4.24 (its highest since March) in mid-October. Three-month implied volatility (which had dropped to pre 2007 crisis levels in September) also jumped from 5.04 to 6.03 (the highest since mid-August) over a few days. This sudden move was triggered by global risk aversion due to uncertainty about world economic growth, leading to a significant weakening of EM currencies and debt markets.
- EUR/PLN stabilized at this level in the following weeks while USD/PLN continued its upward move as EUR/USD resumed a downward trend. The USD/PLN rate rose temporarily to 3.40, highest level since July 2012.

Room for the zloty to gain vs the euro . . .

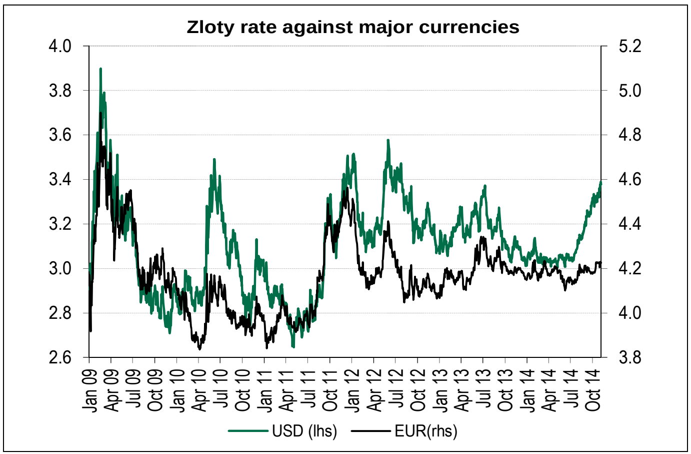
We still believe the zloty has the potential to gain slightly in the final months of this year. The Monetary Policy Council has clearly surprised when it left interest rates unchanged in November and now the market is far more cautious in pricing-in more monetary policy easing in the nearest future. Our forecast of the October CPI is below the consensus (-0.5% YoY vs. -0.4% YoY), but the economic activity data may, in our view, surprise on the upside. In particular, we expect much more upbeat retail sales, which should be backed by solid car sales. There have been also some positive signals from Europe (improvement in manufacturing PMI in Germany and the Euro zone as a whole) and the US economy continues to grow at a healthy rate. This may support investors' hopes that the global economy has already passed the trough and that coming quarters will show some recovery or at least stabilization.

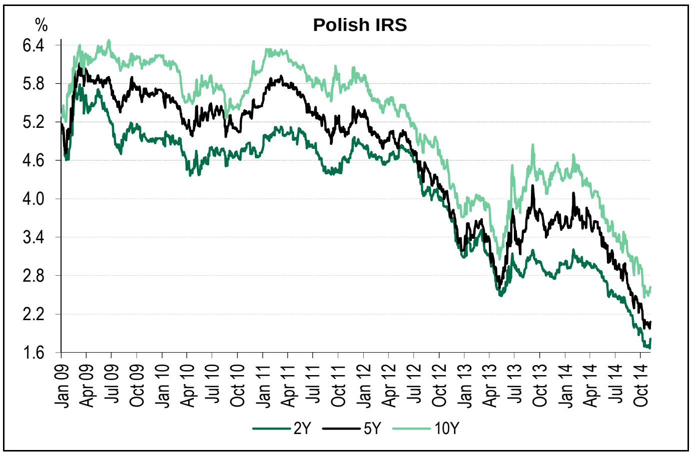
- Even if the ECB does not expand its asset purchase programme to government debt or to corporate bonds, its ultra-accommodative monetary policy is expected to stay in place for at least two years. Hopes that the low interest rates will continue to support the economy and that the Poland-Euro zone interest rate differential will not narrow any more in months to come should thus back the zloty.
- As usually, there are some risks: (1) a greater probability of faster interest rate hikes in the US; (2) depreciation of the rouble and the still-tense situation in Ukraine; and (3) a further deterioration of the economic situation in Europe, triggering worries about Euro zone stability and integrity (which are already mounting due to speculation about Greece leaving the bailout programme earlier than planned) and about its impact on world economic growth.

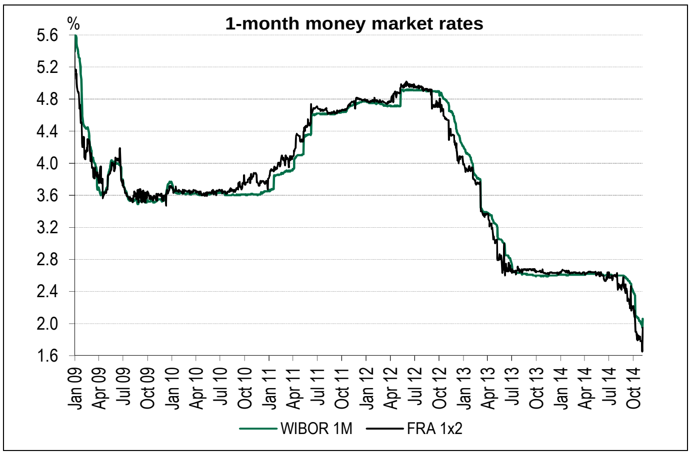
. . . and vs the US dollar

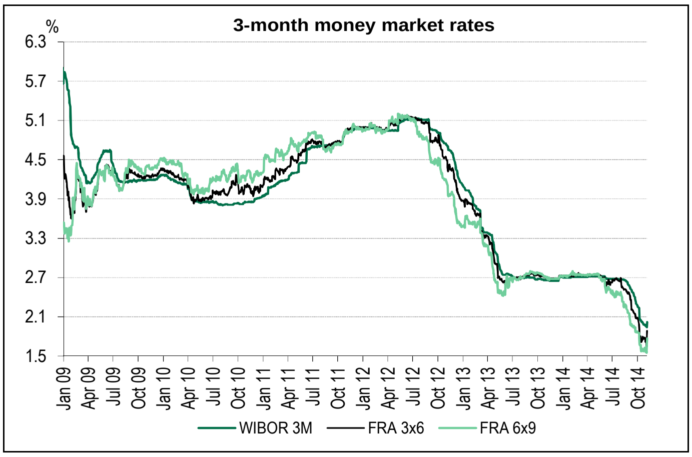
- We see also some room for the zloty to recover vs. the euro. The ECB does not seem to be in a rush to extend its asset purchases as it stayed put in November. The last chart on this page shows the market has already priced-in the inflow of an additional cash into the system and the room for a further decline of the EUR/USD seems to be limited. Additionally, recent Euro zone data were better than expected, making it more likely that investors will decide to take profits after the sharp depreciation of the euro.
- An increase of EUR/USD to 1.26 or even 1.28 in the coming two months could provide significant support for the zloty vs. the US currency and USD/PLN might drop to c3.30 then.
- The risk to this scenario is that exceptionally strong US macro data could make investors believe that Fed rate hikes are likely to come earlier rather than in late 2015.

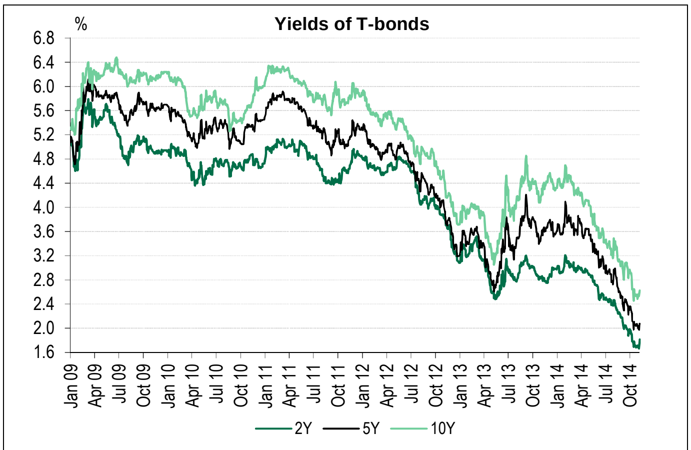
Market monitor

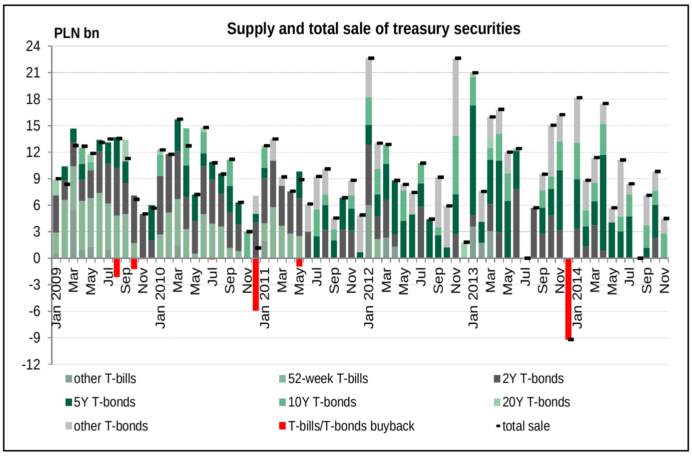












Treasury bond auctions in 2013/2014 (PLN mn)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
November'13	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/WS/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	OK0716/PS0719	2000-6000	6062.1					2.10	WZ0115/PS0415	WZ0124/DS0725/WS0428
November	6.11	WZ/DS/WS	2000-4000	4495.7					20.11	To be chosen	WZ0115/PS0415/OK0715

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

Source: MoF, Reuters, BZ WBK.

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
10 November 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)
17 ***PL: Core inflation (Oct)*** US: Industrial output (Oct)	**18** DE: ZEW index (Nov)	**19** ***PL: Wages and employment (Oct)*** US: House starts (Oct) US: Building permits (Oct) US: FOMC minutes	**20** ***PL: Industrial output (Oct)*** ***PL: MPC minutes*** CN. DE. EZ: Flash PMI – manufacturing (Nov) US: CPI (Oct) US: Philly Fed index (Nov) US: Home sales (Oct)	**21** US: Flash Michigan (Oct)
24 DE: Ifo index (Nov)	**25** ***PL: Retail sales (Sep)*** ***PL: Unemployment rate (Sep)*** DE: GDP (Q3) HU: Central bank decision US: Preliminary GDP (Q3) US: Consumer confidence index (Nov)	**26** US: Durable goods orders (Oct) US: Personal income (Oct) US: Consumer spending (Oct) US: Michigan index (Nov) US: Pending home sales (Oct) US: New home sales (Oct)	**27**	**28** ***PL: GDP (Q3)*** ***PL: Inflation expectations (Nov)*** CZ: Flash GDP (Q2) EZ: Flash HICP (Nov)
1 December ***PL: PMI – manufacturing (Nov)*** CN: PMI – manufacturing (Nov) DE: PMI – manufacturing (Nov) EZ: PMI – manufacturing (Nov) US: ISM – manufacturing (Nov)	**2**	**3** ***PL: MPC decision*** HU: GDP (Q3) DE. EZ: PMI – services (Nov) US: ISM – services (Nov) US: ADP report (Nov) US: Fed Beige Book	**4** EZ: ECB decision	**5** DE: Industrial orders (Oct) US: Non-farm payrolls (Nov) US: Unemployment rate (Nov) US: Industrial orders (Oct)
8 DE: Industrial output (Oct) CZ: Industrial output (Oct)	**9** DE: Exports (Oct) CZ: CPI (Nov)	**10**	**11** HU: CPI (Nov) US: Retail sales (Nov)	**12** ***PL: Money supply (Nov)*** EZ: Industrial output (Oct) US: Flash Michigan (Dec)
15 ***PL: CPI (Nov)*** ***PL: Balance of payments (Oct)*** US: Industrial output (Nov)	**16** ***PL: Core inflation (Nov)*** ***PL: Wages and employment (Nov)*** DE: ZEW index (Dec) HU: Central bank decision US: House starts (Nov) US: Building permits (Nov)	**17** ***PL: Industrial output (Nov)*** ***PL: PPI (Nov)*** CZ: Central bank decision EZ: HICP (Nov) US: CPI (Nov) US: FOMC decision	**18** ***PL: MPC minutes*** DE: Ifo index (Dec) US: Philly Fed index (Dec)	**19**

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	23	25	-
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			30
Balance of payments	17	12	17	11	15	13	14	13	15	14	13	15
Money supply	14	14	14	14	14	13	14	14	12	14	14	12
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

		Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep14	Oct14E	Nov 14E
PMI	pts	53.4	54.4	53.2	55.4	55.9	54.0	52.0	50.8	50.3	49.4	49.0	49.5	51.2	50.8
Industrial production	% YoY	4.6	2.9	6.7	4.2	5.3	5.5	5.5	4.4	1.8	2.4	-1.9	4.2	2.1	-3.1
Construction production	% YoY	-3.2	-2.9	5.8	-3.9	14.4	17.4	12.2	10.0	8.0	1.1	-3.6	5.6	1.6	-3.0
Retail sales [a]	% YoY	3.2	3.8	5.8	4.8	7.0	3.1	8.4	3.8	1.2	2.1	1.7	1.6	3.1	2.9
Unemployment rate	%	13.0	13.2	13.4	13.9	13.9	13.5	13.0	12.5	12.0	11.8	11.7	11.5	11.4	11.5
Gross wages in corporate sector	% YoY	3.1	3.1	2.7	3.4	4.0	4.8	3.8	4.8	3.5	3.5	3.5	3.4	3.3	4.0
Employment in corporate sector	% YoY	-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	0.7
Exports (€)	% YoY	4.3	3.0	11.6	8.4	7.3	9.5	4.1	9.2	5.2	6.2	-1.8	7.4	5.0	5.0
Imports (€)	% YoY	3.7	-1.7	0.7	5.8	6.9	4.1	8.0	10.8	5.9	4.8	-1.1	6.3	8.2	8.2
Trade balance	EUR mn	80	206	-150	105	-79	132	29	-178	222	71	-64	797	-370	-201
Current account balance	EUR mn	-92	-584	-652	-1,100	-651	345	421	-237	-746	-681	-986	28	-973	-960
Current account balance	% GDP	-1.7	-1.5	-1.3	-1.3	-1.3	-1.2	-1.1	-1.1	-1.2	-1.3	-1.4	-1.2	-1.4	-1.5
Budget deficit (cumulative)	PLN bn	-39.5	-38.5	-42.2	-2.6	-11.7	-17.5	-21.3	-22.5	-25.4	-26.4	-24.6	-22.4	-29.9	-31.6
Budget deficit (cumulative)	% of FY plan	76.5	74.7	81.8	5.6	24.7	36.8	44.8	47.3	53.4	55.5	51.9	47.1	63.0	66.4
CPI	% YoY	0.8	0.6	0.7	0.5	0.7	0.7	0.3	0.2	0.3	-0.2	-0.3	-0.3	-0.5	-0.3
CPI excluding food and energy	% YoY	1.4	1.1	1.0	0.4	0.9	1.1	0.8	0.8	1.0	0.4	0.5	0.7	0.3	0.7
PPI	% YoY	-1.4	-1.5	-1.0	-1.0	-1.4	-1.3	-0.7	-1.0	-1.8	-2.0	-1.5	-1.6	-1.1	-0.6
Broad money (M3)	% YoY	5.9	5.7	6.2	5.4	5.2	5.2	5.4	5.2	5.2	6.0	7.4	7.8	8.1	8.2
Deposits	%YoY	5.9	5.2	6.0	4.9	4.7	4.7	5.4	5.5	5.5	6.7	7.8	7.4	8.2	8.6
Loans	%YoY	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	6.8
EUR/PLN	PLN	4.19	4.19	4.18	4.18	4.18	4.20	4.18	4.18	4.14	4.14	4.19	4.19	4.21	4.20
USD/PLN	PLN	3.07	3.10	3.05	3.07	3.06	3.04	3.03	3.04	3.04	3.06	3.15	3.25	3.32	3.34
CHF/PLN	PLN	3.40	3.40	3.41	3.39	3.42	3.45	3.43	3.42	3.39	3.41	3.46	3.47	3.48	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	2.00	2.00
3M WIBOR	%	2.67	2.65	2.67	2.70	2.71	2.71	2.72	2.72	2.69	2.68	2.65	2.45	2.07	2.00
Yield on 2-year T-bonds	%	2.90	2.80	2.94	2.99	3.06	2.99	2.94	2.79	2.54	2.45	2.30	2.02	1.77	1.75
Yield on 5-year T-bonds	%	3.62	3.64	3.65	3.67	3.79	3.68	3.60	3.36	3.10	2.89	2.73	2.40	2.12	2.10
Yield on 10-year T-bonds	%	4.28	4.38	4.41	4.42	4.47	4.26	4.10	3.80	3.54	3.34	3.23	2.98	2.63	2.65

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	1,696.9	1,758.3	397.4	413.5	419.3	466.7	403.5	426.2	437.1	491.5
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	3.1	2.9	4.9	3.7	1.8	1.9	1.6	2.4	3.4	4.2
Construction production	% YoY	-1.0	-10.3	5.3	6.6	9.8	9.9	1.1	3.9	4.3	4.0	8.7	7.8
Retail sales [a]	% YoY	6.0	2.6	3.7	6.6	5.1	4.6	1.9	3.3	4.3	5.1	8.2	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	4.0	4.2	3.5	3.1	3.3	3.6	3.7	4.7	4.6
Employment in the national economy	% YoY	0.0	-1.1	0.1	0.3	-0.3	0.1	0.4	0.4	0.3	0.3	0.2	0.3
Exports (€)	% YoY	6.5	5.7	5.9	7.5	8.4	6.1	4.2	5.0	6.0	7.0	8.0	9.0
Imports (€)	% YoY	2.2	0.2	6.4	9.9	5.6	8.2	3.5	8.2	9.0	10.0	10.0	10.5
Trade balance	EUR mn	-7,146	635	-57	-3,792	159	71	804	-1,091	-985	-1,087	95	-1,816
Current account balance	EUR mn	-13,697	-5,245	-6,466	-11,062	-1,403	-553	-1,639	-2,871	-2,957	-1,587	-3,032	-3,487
Current account balance	% GDP	-3.6	-1.3	-1.6	-2.6	-1.2	-1.2	-1.2	-1.6	-2.0	-2.2	-2.5	-2.6
General government balance	% GDP	-3.9	-4.3	5.7	-2.9	-	-	-	-	-	-	-	-
CPI	% YoY	3.7	0.9	0.1	0.6	0.6	0.3	-0.3	-0.4	-0.2	0.5	0.8	1.4
CPI [b]	% YoY	2.4	0.7	-0.4	1.6	0.7	0.3	-0.3	-0.4	-0.1	0.6	1.0	1.6
CPI excluding food and energy	% YoY	2.2	1.2	0.7	1.1	0.8	0.8	0.5	0.6	0.9	1.1	1.2	1.4
PPI	% YoY	3.4	-1.3	-1.2	0.7	-1.2	-1.2	-1.7	-0.7	0.1	0.9	0.9	0.8
Broad money (M3) [b]	% YoY	4.5	6.2	6.6	5.3	5.2	5.2	7.8	6.6	6.3	6.0	5.6	5.3
Deposits [b]	%YoY	4.7	6.0	6.5	6.5	4.7	5.5	7.4	6.5	6.5	6.5	6.5	6.5
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	4.18	4.13	4.19	4.17	4.18	4.20	4.18	4.15	4.11	4.06
USD/PLN	PLN	3.26	3.16	3.14	3.24	3.06	3.04	3.15	3.31	3.24	3.26	3.26	3.19
CHF/PLN	PLN	3.47	3.41	3.44	3.30	3.42	3.42	3.45	3.46	3.40	3.35	3.29	3.17
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	2.50	1.92	2.71	2.71	2.59	1.99	1.90	1.91	1.92	1.94
Yield on 2-year T-bonds	%	4.30	2.98	2.45	1.79	3.01	2.76	2.26	1.76	1.75	1.75	1.78	1.87
Yield on 5-year T-bonds	%	4.53	3.46	2.96	2.13	3.71	3.35	2.67	2.11	2.10	2.10	2.13	2.18
Yield on 10-year T-bonds	%	5.02	4.04	3.51	2.76	4.38	3.82	3.18	2.64	2.65	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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