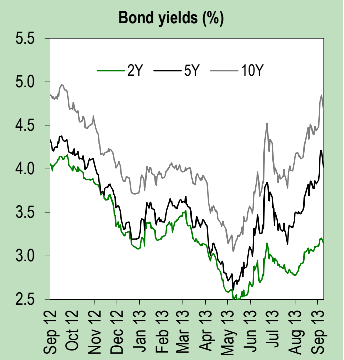
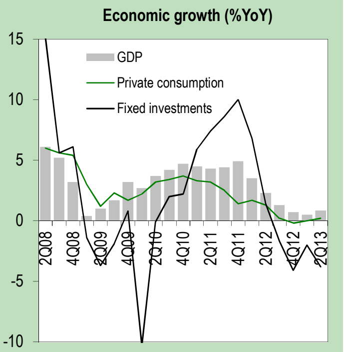
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

September 2013





In this issue:

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(Almost) everything is clear

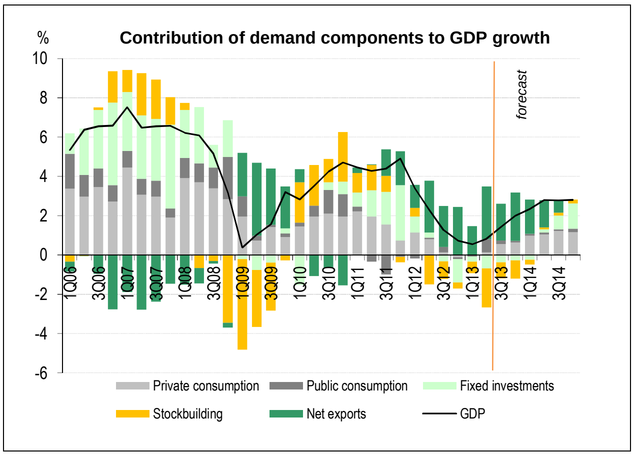
- **As we were supposing in our July-August edition of MACROscope under the title *„Hot summer ahead?"*, during the summer temperatures were high not only outside, but also on the financial markets.** First weeks of the summer brought some stabilisation on the markets, and the zloty temporarily fell below 4.20, but the end of August and the beginning of September were marked by strong sell-offs, both on fixed income and foreign exchange markets. Capital outflow caused a considerable weakening of the zloty and EURPLN returned to 4.30 level forecasted by us. These developments were due to market's expectations about the Fed policy, but geopolitical factor due to situation in Syria proved to be another important element. As regards domestic events, a considerable sell-off was triggered by the government's presentation of open pension funds (OFE) overhaul proposal. Not all details are known yet, but bond and equity markets have already trimmed most of the losses (we elaborate more on changes in OFE on page 5).
- **Data on real economy, released during last two months, proved to be in line with our scenario. Economic growth in Q2 mirrored our forecast, confirming that the economy has bottomed out.** Acceleration was visible also in quarter-on-quarter terms (the slowest pace of growth saw recorded in Q2: 0%), so it is clear now that recession was only an empty threat. The main driver behind the improving economic situation is export, as we expected. However, it is worth noting there are some hopes that domestic demand will join this trend. First data for Q3 were above (or even markedly above) expectations: not only as regards industrial output or PMI, but also retail sales and construction output. Additionally, investments in big companies rose in the first half of the year already. These recent releases encouraged us to slightly revise our GDP forecasts for 2H2013 and 2014 upwards.
- **Communication of the Monetary Policy Council was perfectly clear – after the end of the easing cycle, interest rates will remain stable at least until the year-end.** Some MPC members even suggested in recent interviews that this period of flat rates may be longer than currently expected by the market, but we think that confirmation of economic recovery, combined with further increase of inflation towards the target (above 2% at the beginning of 2014) will make the MPC adjust (real) rates up from low levels. That is why we are expecting that the first hike will take place somewhere in mid-2014. It may seem that after presentation of a *forward guidance* on interest rates the MPC can take a rest and not return until January. However, we think that already November's meeting can prove interesting, as the MPC will see new inflation projection and this might either make it prolong the flat rates period or signal a possible change in monetary bias (if inflation path goes up, and we find it probable).
- **Factors affecting the financial markets, both domestic and foreign, will remain unchanged in the months to come.** It seems there is chance for no escalation of conflict in Syria. If the Fed begins a reduction of asset purchases, the scale will probably be limited. Bond and equity markets may continue a rebound after strong reaction to plans of OFE overhaul, but we stick to our forecast that upward trend in yields will continue in 2014. We do not change our forecasts assuming a decline of EURPLN below 4.20 till year-end.

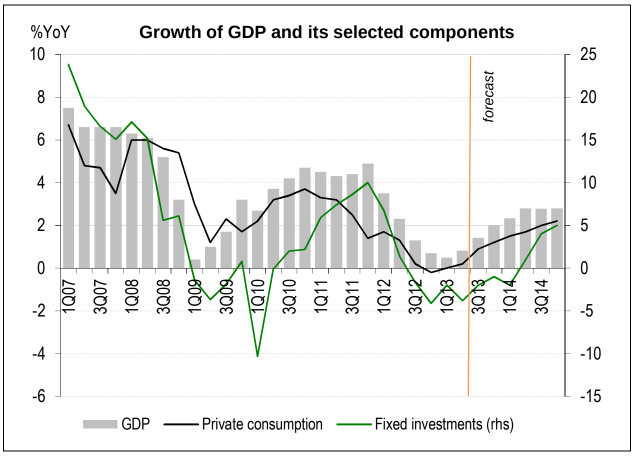
Financial market on 9 September 2013:

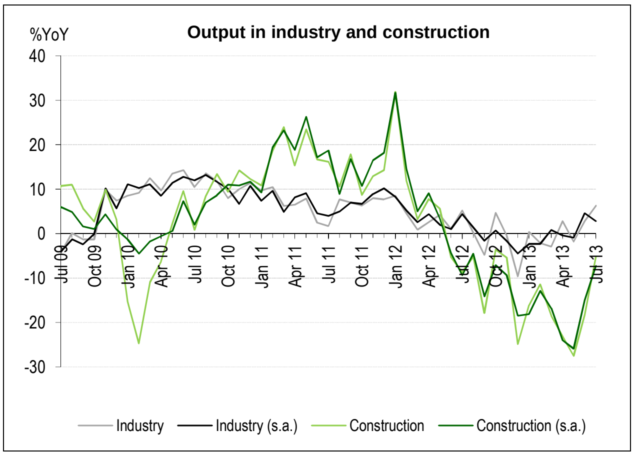
NBP deposit rate	1.00	WIBOR 3M	2.70	EURPLN	4.2700
NBP reference rate	2.50	Yield on 2-year T-bond	3.15	USDPLN	3.2357
NBP lombard rate	4.00	Yield on 5-year T-bond	4.02	CHFPLN	3.4543

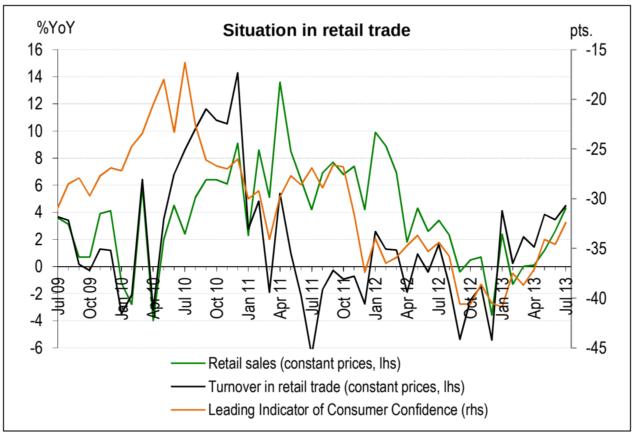
This report is based on information available until 9.09.2013

Economic update









Source: CSO, NBP, BZ WBK

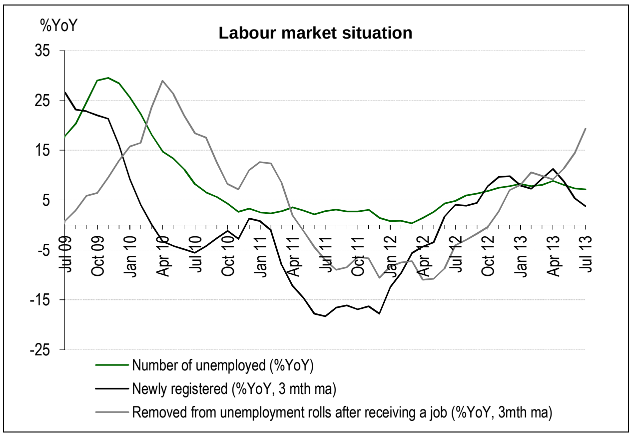
Slightly better outlook for 2H2013 and 2014

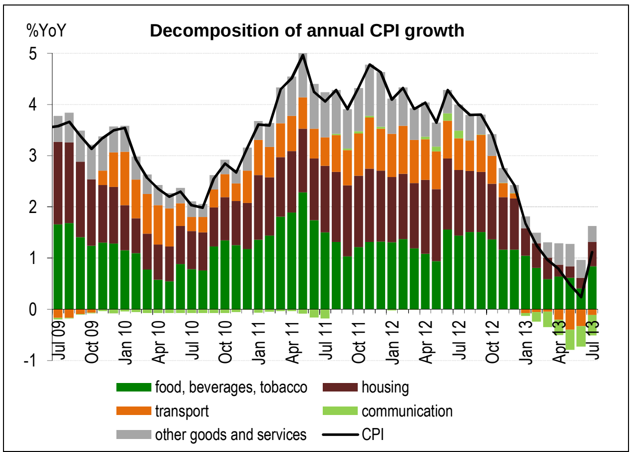
- Data released over the last two months have confirmed our forecasts that the economy has bottomed out. In line with our expectations, recovery is driven by exports, accompanied by weak domestic demand. Domestic business cycle reached a trough at the beginning of the year and in our view will be accelerating gradually in the upcoming quarters. Good data from the real economy encouraged us to revise our GDP forecasts upwards to 1.4%YoY in Q3 and 2.0%YoY in Q4. In 2013 we are expecting 1.2%, in 2014 2.7%. However, it is worth noting that despite higher forecasts we still think that economic recovery will be rather sluggish and gradual.
- GDP growth rate in Q2 amounted to 0.8%YoY as compared to 0.5%YoY in Q1. In QoQ terms (seasonally adjusted data) growth amounted to 0.4% versus 0.2% in Q1. We can say that recession was an empty threat.
- Breakdown of economic growth showed a continued strong weakness of domestic demand – decline by 1.9%YoY, i.e. deeper than in the last four quarters. This was due to stronger decline of investments (-3.8%) and drop in inventories (negative contribution to GDP of 2pp.) The second key element of the domestic demand – individual consumption – posted a paltry recovery (increase by 0.2%YoY, slightly below our forecast and consensus). This was a fourth quarter in a row, when growth of consumption was idle (deviations from zero not far from statistical error). Similarly as in previous quarters, the economy was advancing (and even somewhat accelerating) on the back of net exports (this element contributed 2.5pp to the GDP growth). Real growth of exports of goods and services amounted to 5.1% (the highest pace for 1.5 year), while imports declined.

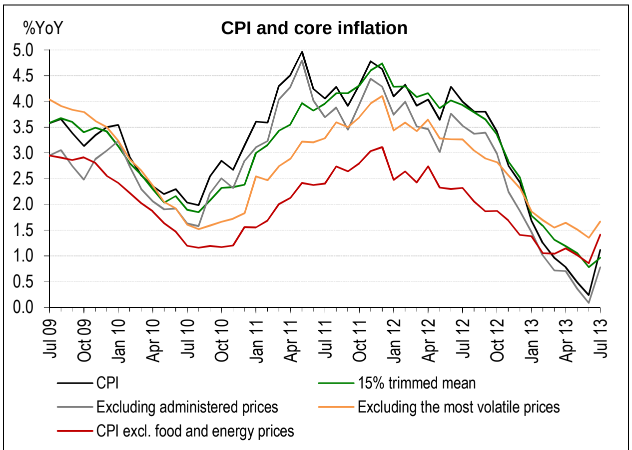
Better situation in industry, construction and retail sales

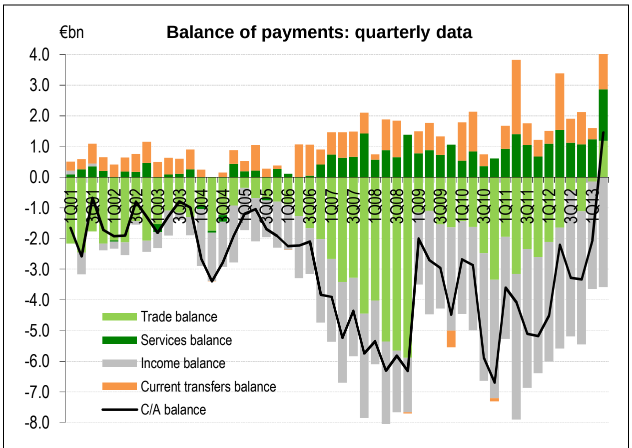
- Industrial output advanced in June by 3.0%YoY and in July by 6.3%YoY. These outcomes were raised by working day effect (it will be less favourable in August), but even adjusted data showed a continuation of recovery in Polish industry. Most considerable rises were recorded in export-oriented branches (like manufacturing of transport vehicles, electrical devices, furniture). Recovery in industry is also suggested by the PMI index, which climbed in July to 51.1pts (return above 50pts after 15 months) and in August to 52.6pts (the highest level in 25 months), and a strong rise was posted by subindices for output, new orders and employment.
- Improvement was posted also by the construction and assembly output, with -18.3%YoY in June and -5.2% in July (until recently construction was plunging by 30%). We are still below levels of output seen in 2011 and 2012, but the fact that this branch is also showing some signs of bottoming-out is quite optimistic news as regards investment. The CSO data from big enterprises showed a positive nominal growth rate of fixed investments already in the first half of the year. Clearly, these tendencies did not find their way through smaller companies, but further improvement in construction can prove that also fixed investments are recovering. However, we are expecting that a positive growth rate of investments will not be seen until 2014.
- Nominal retail sales expanded by 1.8%YoY in June and by 4.3%YoY in July (the fastest growth since August 2012). A similar tendency is shown by data on turnover in retail trade (3.5% and 4.5%). These numbers prove that private consumption is also picking up somewhat. We are expecting that real private consumption will advance by ca. 1%YoY in Q3 and Q4.

Economic update









Source: CSO, NBP, BZ WBK

Slight improvement on the labour market

- Some slight signs of recovery are visible on the labour market, after stagnation lasting since mid-2011. In our view, this market is out of the woods, but pace of improvement is still sluggish and we are expecting no major acceleration, at least until the year-end.
- Pace of decline of employment in corporate sector eased to -0.8%YoY in June and -0.7%YoY in July. These two months added 11k jobs (June and July 2012 shed 1k jobs). Wage growth is still moderate. Although it accelerated from 1.4%YoY in June to 3.5%YoY in July, this acceleration was mostly due to timing of bonus payments in big companies. In June and July the registered unemployment rate amounted to 13.1%. Pace of growth of new jobless claims is declining, while pace of growth of unemployed removed from unemployment rolls due to taking up a job is accelerating. This is a sign of reviving demand for labour.

CPI (temporarily!) at all-time low

- In June CPI inflation declined to 0.2%YoY, i.e. to the lowest level since 1990. This strong fall was due to low inflationary pressure in the economy and to statistical effects – a relatively high reading from June 2012 (when food prices went strongly up) was dropped from 12M CPI indicator.
- In July CPI rebounded strongly, to 1.1%YoY. Inflation picked up due to higher fuel prices, hiked waste management fees after introduction of new bill (this factor added ca. 0.4pp) and slight decline of vegetable prices (they usually fall by 20% in July, this time the drop amounted to a mere 4.1%), which was partially due to a different method of calculation of potato prices. This means that an important part of July's rise was due to changes in regulations and statistical effects and it did not signal inflationary pressure.
- We are expecting that in the upcoming months inflation will be gradually climbing. In our view, CPI will surpass 1.5% at the year-end, will reach 2% at the beginning of 2014 and will be oscillating slightly above this level in 2014. In mid-2014 CPI may even temporarily reach MPC's inflation target at 2.5% (prior to falling in July 2014 after influence of base effect). Last week the government announced that excise duties on spirits will rise by 15% at the beginning of 2014. We are expecting that this will push average prices of alcoholic beverages by ca. 2-3%, which will raise the CPI by 0.05-0.10pp.
- Core inflation excluding food and energy prices amounted to 0.9%YoY in June and 1.4%YoY in July (other core inflation gauges also climbed). Rising waste prices moved this indicator upwards as well, so it is not showing a growing demand-size pressure on prices. We are expecting a further rise of CPI ex food and energy to ca. 2% in 2014.
- PPI amounted to -1.3%YoY in June and -0.8%YoY in July. We are expecting it to remain below zero at least until the year-end.

Surplus of the current account balance in Q2

- In May and June the current account posted a surplus worth €165 and €574m, respectively. The good result was primarily due to a marked improvement in goods balance. Even though exports were developing in line with our forecasts (average growth in these two months amounted to 4.6%YoY), imports surprised to the downside (average drop by 2.9%), which was due to weakness of domestic demand.
- In 2Q2013 current account surplus amounted to €1.5bn and this was the first quarter without deficit, since comparable NBP data are available (2000). Moreover, also goods and services balance posted the highest surplus (€2.9bn) since comparable data are available. In our view, similar tendencies will hold in the upcoming quarters, so the year may be the first one since 1995, when current account balance closes with positive result.

Monetary policy watch

Fragments of MPC communiqué after September's meeting

In 2013 Q2 global economic activity growth was somewhat higher than in Q1, yet, persisted at a moderate level. (...) The incoming data on the economic situation at the beginning of Q3 point to continued gradual recovery in the major developed economies.

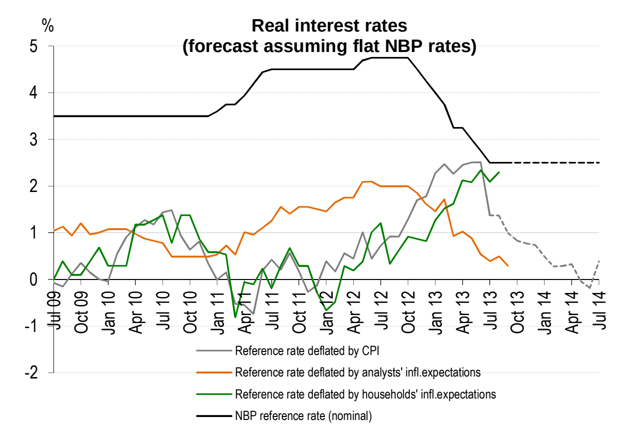
In Poland, in 2013 Q2 economic growth, after a period of strong slowdown, slightly accelerated. Yet, GDP growth remained considerably below its potential. GDP growth was supported by substantial contribution of net exports, which was accompanied by further decline in domestic demand.

CPI inflation in July increased and reached 1.1% y/y, yet remaining markedly below the NBP inflation target (2.5%). The increase in inflation was driven by regulatory factors (i.e. higher waste disposal fees), which also pushed up core inflation, as well as higher growth in the prices of vegetables and fuels. Demand and cost pressures in the economy remained low and inflation expectations of households continued to decline. In the opinion of the Council, gradual economic recovery is likely to continue in the coming quarters, however, inflationary pressure will remain subdued.

The Council decided to keep the NBP interest rates unchanged. Given low inflation pressure and a moderate scale of the expected recovery, in the Council's assessment interest rates should be kept unchanged at least until the end of 2013, which will support return of inflation to the target in the medium term.

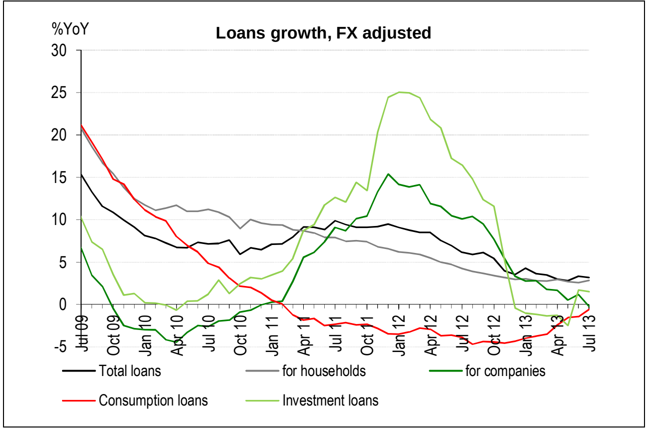
Rates unchanged at least until the year-end

- In line with expectations, the MPC did not change interest rates at its September meeting, keeping the reference rate at all-time low 2.50%. At the same time, the official statement reads that interest rates should remain on hold at least until the end of this year. This means that the communiqué formally repeats a sentence, which was reiterated in comments of many MPC members in recent weeks. According to the NBP Governor Marek Belka, it is difficult to imagine that in the upcoming months the economic situation changes so dramatically that the MPC would be forced to change its monetary policy parameters.
- Tone of the statement itself remained rather dovish. On one hand the Council acknowledged signals of gradual recovery in developed economies and in Poland, but on the other it stressed that pace of economic growth in Poland lays considerably below potential, while higher GDP was mainly due to net exports, with deepening decline of domestic demand. NBP Governor Marek Belka underlined during the press conference that even though the economic improvement will be continuing, it will be gradual and one should not be overoptimistic about the pace of recovery. At the same time, the MPC sees no important threats for the inflation outlook.
- NBP Governor denied to comment on the monetary policy outlook beyond the end of this year. Assuming the inflation behaves just like predicted in recent NBP's inflation projection, interest rates could remain stable for a considerable period of time (NBP's central path for CPI shows inflation at close to 1.5% until 2015). Still, our forecasts show gradual rebound of inflation and thus the MPC may decide to increase interest rates for the first time in around mid-2014.



Low real interest rates will support rising nominal rates

- Comments of MPC members still cover the issue of real interest rates as one of the main indicator taken under consideration when making decision on nominal interest rates.
- Real interest rates are usually interpreted by the MPC members as a difference between nominal rate and current inflation or as a difference between nominal rate and analysts' expectations about CPI in 12 months' time. What is interesting, the latter of these two gauges is currently running very low (0.3% in September), while the former one is relatively high (it fell to 1.4% in July from 2.3% in June).
- We assess that the latter gauge will be stabilising, while the former one will fall to zero in mid-2014 (assuming that NBP rates remain flat), which will be a strong argument for hiking rates, in our view.



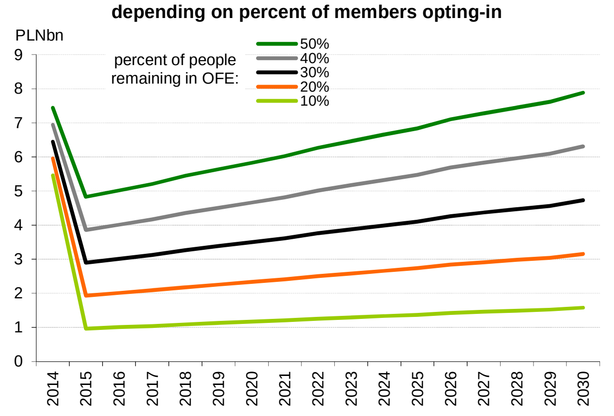
Source: CSO, NBP, Reuters, BZ WBK

Some signs of recovery on the credit market

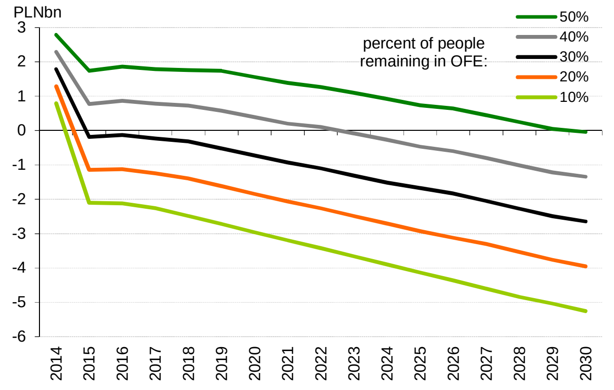
- June's and July's data showed some weak signs of recovery on the credit market, which is in line with earlier results of survey among credit officers.
- Households sector recorded an easing pace of decline of consumer loans – in July they fell by 0.4%YoY (after FX adjustment), which is the slowest decline since February 2011). As regards corporate sector, we saw accelerating investment loans – to 1.7%YoY in June and 1.5%YoY in July (results in earlier months were below zero). However, no signs of improvement are visible in other categories and total pace of growth of loans still remains sluggish
- Improvement in consumer and investment loans gives some hope for recovery of domestic demand, but bear it in mind that it is still fragile.

Fiscal policy watch (OFE overhaul)

Estimated ZUS contribution to OFEs depending on percent of members opting-in



Estimated net inflows to OFEs depending on percent of members opting-in



Fragment of statement of deputy finance minister Wojciech Kowalczyk regarding impact of OFE overhaul on financial markets:

OFE will transfer to ZUS:
- treasury securities,
- state-guaranteed bonds,
- other non-equity assets

in total amount representing 51.5% of assets of each OFE (level 51.5% results from total share of treasuries and state-guaranteed bonds in OFE assets as for the end of 2012).

At the same time, within these 51.5% of total assets of each OFE, the value of transferred by each OFE treasuries and state-guaranteed bonds must not be lower than resulting from share of treasuries and state-guaranteed bonds in assets of each OFE as for 3.09.2013, i.e. the day preceding the announcement of planned pension system overhaul.

Structure of OFEs portfolios at the end of July 2013

Fund	Assets (PLNbn)	Allocation (%) Bonds*	Equities	Deposits	Other
ING	70.3	46.0%	39.3%	9.2%	5.5%
Aviva	62.9	47.2%	39.1%	9.2%	4.5%
PZU	38.0	48.4%	40.2%	6.7%	4.8%
Amplico	22.5	53.5%	39.6%	2.5%	4.5%
AXA	17.6	52.1%	36.7%	5.6%	5.6%
Generali	14.1	53.9%	38.9%	2.5%	4.7%
Nordea	12.7	51.5%	39.5%	2.0%	7.0%
PKO BP	12.3	52.8%	39.6%	6.0%	1.6%
AEGON	11.9	48.2%	39.0%	4.9%	7.8%
Allianz	8.6	52.8%	37.6%	1.5%	8.1%
Pocztylion	5.4	51.7%	39.4%	5.5%	3.4%
Pekao	4.2	51.9%	42.5%	2.0%	3.6%
Warta	3.8	54.9%	39.4%	1.8%	3.9%
Total	**284.2**	**49.1%**	**39.2%**	**6.6%**	**5.0%**

* Treasuries, road bonds and state-guaranteed bonds

Source: MF, KNF, BZWBK, BZ WBK Brokerage

OFE will give away the bond part of their portfolio

▪ The final government's proposal of changes in the pension system assumes that open pension funds (OFE) will have to transfer to public pension fund (ZUS) 51.5% of their assets (the ratio is implied by the share of government and state-guaranteed bonds in total OFE portfolios at the end of 2012). The remaining assets will remain under OFE management. Funds will not be allowed to invest in Polish treasuries, but investment limits for other assets will be relaxed (no details known at this stage).

▪ At the same time, every participant of pension system will be able to decide if his future contributions will go to OFE or to ZUS (3 months for decision since new law comes into force; ZUS is default choice in case of no decision). OFE contribution will amount to 2.92% of gross salary (above current 2.8% but below earlier target level of 3.5%).

▪ Additional element is the "safety buffer" – in order to minimise risk for pensions stemming from stock market volatility, the gradual process of transferring pension savings from OFE to ZUS will start 10 years before retirement. However, assets of those who already have less than 10 years to retirement will be transferred faster (though still proportionally): according to FinMin this will amount to PLN4.4bn in 2014 and in following years ca. PLN2-2.5bn.

▪ Government assumes 3-month vacatio legis, which means that planned changes may become effective more or less in mid-2014.

... which will ease tension in public finances

▪ Transfer of bonds from OFE to ZUS will trim the general government debt level by ca. 8% of GDP and (according to minister Rostowski) by ca. 1.5pp less in the Polish methodology. At the same time, the government wants to reduce accordingly two safety limits for debt (50% and 55% of GDP) in the public finance act. The operation will be also positive for the public sector balance, lowering expenditure on public debt servicing and spending on contribution to OFE (by the amount dependent on how many people decide to opt-in) – according to FinMin savings may reach 0.5% of GDP in 2014.

▪ Transfer of assets will also have a one-off impact on general government balance according to ESA95 (but will be neutral according to ESA2010).

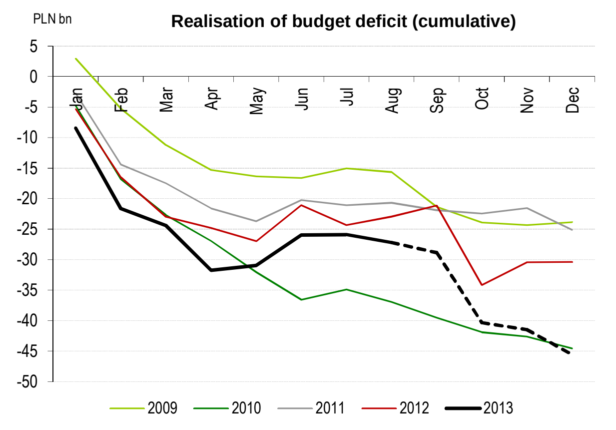
What market impact?

▪ According to FinMin, in 2014 and 2015 OFEs will be still beneficiaries of net inflow of pension contribution. While in 2014 this position does not seem to be endangered (as the new law will come into force only in the middle of the year), the balance of inflows in 2015 and beyond will be heavily dependent on how many participants will opt-in to stay in OFE (charts above present simulations of BZWBK Brokerage). The FinMin assumed that this ratio may reach 50% (probably based on recent opinion polls). However, we think that 20-30% is more realistic outcome. If this is the case, OFEs will see net outflow of funds (due to "safety buffer"), which could have negative impact on the capital market in Poland. It is worth noting that such situation would take place anyway even without OFE overhaul, just later – OFE will have to be net sellers of equities in future to pay pension benefits.

▪ At the moment of transfer each OFE will hand over 51.5% of its asset portfolio. At the same time, the funds will have to maintain adequate share of treasuries in the transferred part. The ratio of treasuries and state-guaranteed bonds in OFE portfolio at the moment of transfer could not be lower than it was on 3.09.2013. Thus, any sharp depreciation of bonds or surge in other assets' prices may imply that OFE will have to buy more bonds before handing assets to ZUS (to keep required share in total portfolio).

▪ Last available data on the OFE portfolio structure show that share of treasuries and state-guaranteed bonds reached on average 49.1% at the end of July (varying between 46% and 54.9%, depending on the pension fund).

Fiscal policy watch



Macroeconomic assumptions to 2014 budget

	2013P	2014	2015	2016	2017
GDP (PLNbn)	1 642.9	1 721.5	1 829.8	1 955.6	2 089.6
GDP (%)	1.5	2.5	3.8	4.3	4.3
Private consumption (%)	1.1	2.1	3.2	3.5	3.5
Fixed investment (%)	-0.7	4.4	7.8	9.2	10.6
Inflation (%, avg)	1.6	2.4	2.5	2.5	2.5
Unemployment rate (%, end-period)	13.8	13.8	13.3	12.8	12.0
EURPLN (avg)	4.15	4.00	3.85	3.70	3.65
Reference rate (%, avg)	2.95	2.54	3.11	3.78	4.00

Main budget parameters 2013-2014 (PLNbn)

	2013 amend. (1)	2014 (2)	change (2) / (1)
Revenue, including:	**275.7**	**276.5**	**0.3%**
Tax revenue	239.2	248.0	3.7%
VAT	*113.0*	*115.7*	*2.4%*
CIT	*22.0*	*23.3*	*5.9%*
PIT	*40.9*	*43.7*	*6.8%*
Non-tax revenue	35.0	26.9	-23.1%
Spending	**327.3**	**324.2**	**-0.9%**
Spending (excl. OFE)	327.3	333.5	1.9%
Budget balance	**-51.6**	**-47.7**	**-**
Balance (excl. OFE)	-51.6	-57.0	-

	Spread vs Bunds (10Y) in bps			CDS (5Y USD)		
	9.09	change since 10.06.13	change since 31.12.12	9.09	change since 10.06.13	change since 31.12.12
Poland	273	40	32	93	12	14
Czech	68	14	14	65	2	2
Hungary	479	31	-13	323	16	54
Greece	869	60	-184	0	0	0
Spain	258	-42	-142	238	-7	-50
Ireland	207	-42	-112	149	-7	-67
Portugal	510	53	-59	504	155	67
Italy	255	-15	-66	250	-6	-24
Germany	-	-	-	29	1	-10

Source: MF, Reuters, BZ WBK

Debt limit suspended, 2013 budget amendment in parliament

- In August the parliament approved the change in the public finance act, suspending for 2013 the so-called temporary spending rule and sanctions resulting from breaching the public debt limit 50% of GDP.
- After this change, the government presented the budget amendment. Revenue shortfall was planned to reach PLN23.7bn, deficit was widened by PLN16bn (to PLN51.6bn), and spending cut by PLN7.7bn. Financing of higher deficit will be mainly on foreign markets (PLN9bn) and to smaller extent on domestic market (PLN6.4bn).
- In our view, shortfall in budget revenue may be even lower than assumed in budget amendment (as the economic recovery goes on), so at the end of the year the budget is likely to close with lower deficit, around PLN45bn.

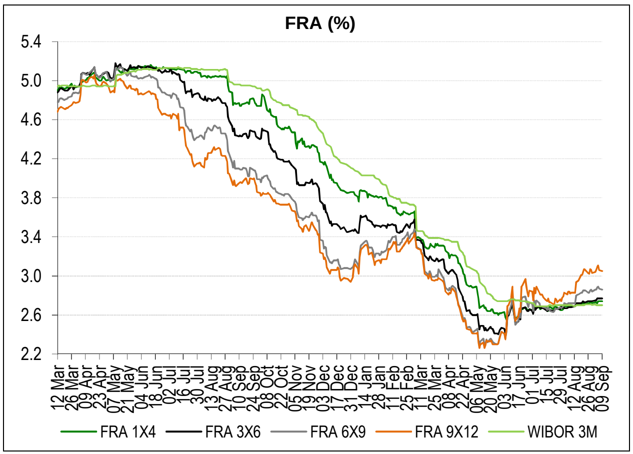
Budget 2014 – reasonable assumptions, OFE impact

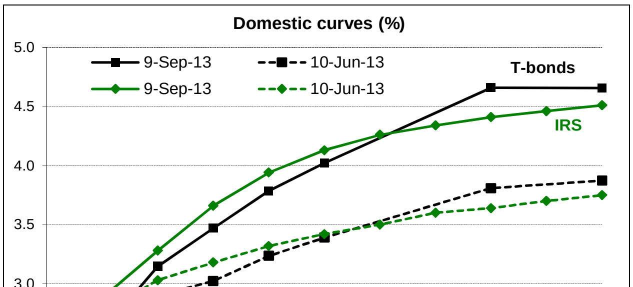
- At the start of September the government approved draft budget for 2014 with revenue at PLN276.5bn, spending at PLN324.2bn and deficit PLN47.7bn.
- Assumed growth in tax revenue (3.7%) seems quite conservative, taking into account macro assumptions (GDP growth 2.5%, inflation 2.4%). Our forecast of GDP is slightly higher (but with lower domestic demand), while inflation slightly below government's forecast, which means lack of major risk for predicted revenues. Tax income will be also helped by major increase in excise tax for spirits (by 15%). Budget draft assumes receipts from dividends at PLN4.6bn and no inflow from NBP profit.
- Expenditure level will be ca. 1% lower than in 2013 (post-amendment). However, this is mainly due to effects of changes in pension system. According to FinMin, changes in OFE will yield savings of ca. PLN9bn: lowering costs of debt servicing by ca. PLN4.8bn and lowering subsidy to ZUS by ca. PLN4.5bn (assuming that changes get into life in mid-2014 and ca. 50% of participants remain in OFE).
- If we exclude savings from OFE overhaul, budget spending in 2014 would be higher by almost 2% (PLN6.2bn) than in 2013 and budget deficit would reach PLN57bn (i.e. would be higher than PLN55bn set as the maximum deficit level for 2014 in the Multi-year Financial Plan). Thus, the path of fiscal consolidation is de facto gradually slowing down. So far, main rating agencies and IMF seemed to have no problem with this.
- Gross borrowing needs in 2014 will amount to PLN131.8bn (vs. PLN166.4bn assumed for 2013, post-amendment), while net requirement would be PLN54/8bn (vs. PLN66.6bn). Thus, relation of gross borrowing needs to GDP in 2014 will decrease by 2.5pp while in case of net needs it will drop by ca. 1 pp. (in net terms this results from changes in OFE).

Fed is on track to start tapering this year

- Expectations that the Fed will trim the scale of QE3 after better-than-expected macro data pushed yields of 10Y German and US bonds up to above 2% and 3%, respectively. Peripheral debt was clearly more sensitive to domestic data. Optimistic releases supported the debt despite rising yields on the core markets. Upward move was halted after weaker-than-expected US non-farm payrolls in August.
- September's FOMC meeting remains in the spotlight. Changes in the scale of easing seem to be inevitable, but the timing and pace of reduction are still unknown. We expect some trimming of QE3 in September, but at a rather small scale. This would support the on-going recovery. Volatility may return on the market later this month as investors will be awaiting results of the German parliamentary elections.

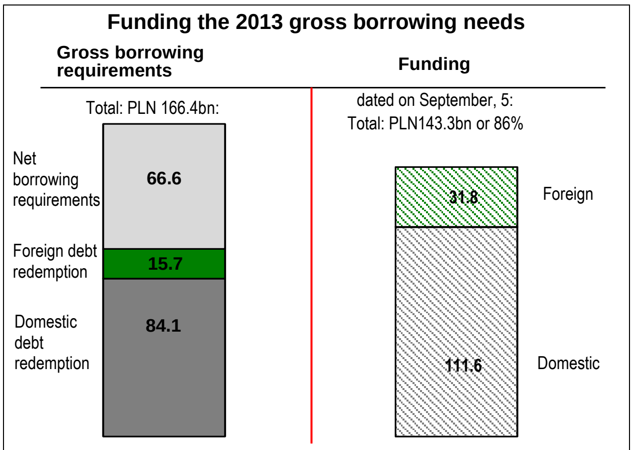
Interest rate market

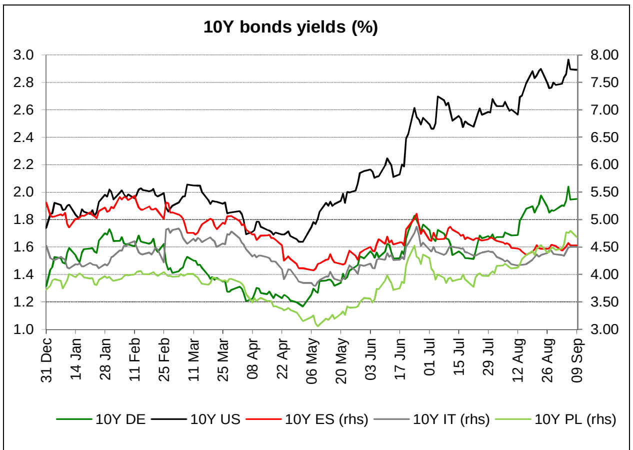




Spread 2-10Y (in bp)

	T-bonds	IRS
10-Jun	97	72
09-Sep	151	123





Source: NBP, Reuters, BZ WBK

FRA rates are pricing-in rate hikes in mid-2014

- During the summer significant changes took place on WIBOR curve. The curve returned to a normal shape as the MPC announced the end of easing cycle, but also due to better than expected data from real economy and surprise in CPI for July. What is more, the curve was flat (before July's MPC meeting), but became steeper due to 1M-12M spread widening (to 16 bp).
- FRA market has remained more volatile, strongly dependent on macro data releases. FRA rates growth (mainly on longer tenors) mainly came from (1) domestic economic rebound and CPI inflation increase, (2) higher risk aversion due to geopolitical uncertainty (situation in Syria and possibility of the US military intervention) and (3) concerns about Fed tapering.
- Current level of FRA rates (FRA9x12 anchored slightly above 3%) clearly suggests the first hike in 9 month period, which is more or less in line with our expectations. We think that the first hike might take place around mid-2014. In our opinion, coming weeks could bring a gradual increase in WIBOR rates.

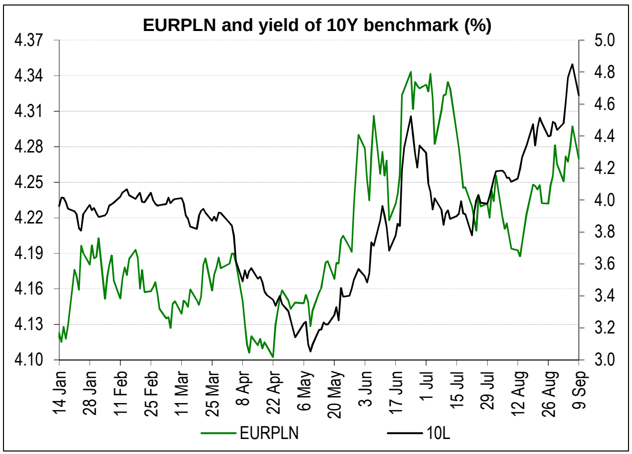
Significant sell-off of T-bonds and IRS

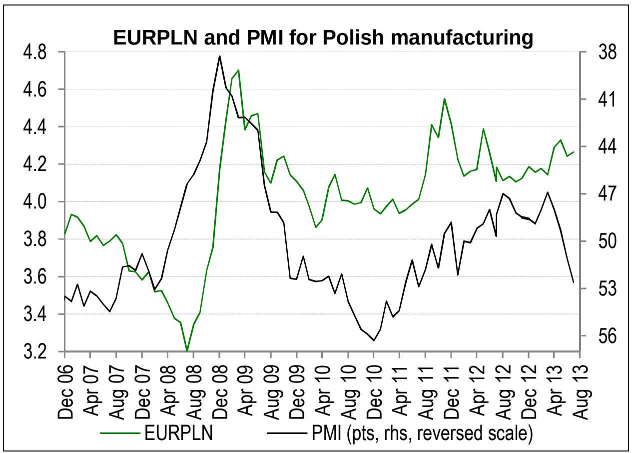
- The summer season on T-bond and IRS markets was characterised by high volatility, resulting mainly from the situation on core markets. The better-than-expected US macro data supported expectations that Fed might start QE3 tapering in September, which caused increase in yields of Bunds and UST and consequently, of domestic bonds. Additionally, the sell-off at the end of August resulted from higher risk aversion due to conflict in Syria.
- At the beginning of September, Polish assets suffered from local factors. Changes in open pension funds (OFE), announced by the government, have negatively affected investors' mood and deepened the sell-off on the debt market, in particular on mid and long end of the curves. Yield of 10Y benchmark increased towards 5%. However, impact of announced changes in OFE on the IRS market was less considerable. What is more, the sharp increase in yields on core markets added to increase in domestic yields/rates.
- Despite unstable market situation, in August-September period Poland's Ministry of Finance launched OK0116 and PS0718 worth PLN11.4bn in total. However, in September auction yields were well above levels on the secondary market. Consequently, after regular auction this month Poland has covered 86% of the 2013 gross borrowing needs after budget amendment. Till end-September, investors will be able to purchase T-bonds through switch tender.

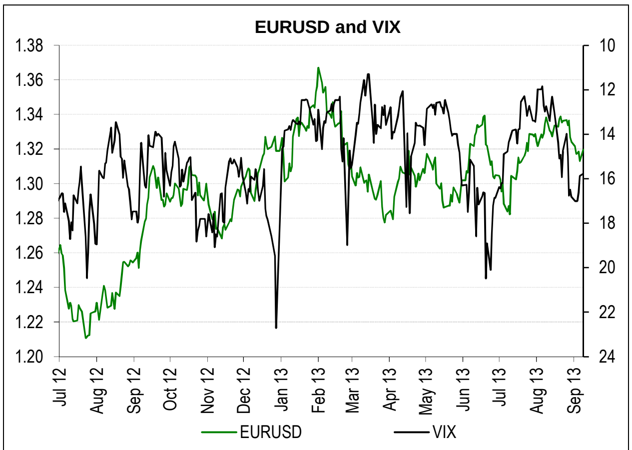
External factors still crucial

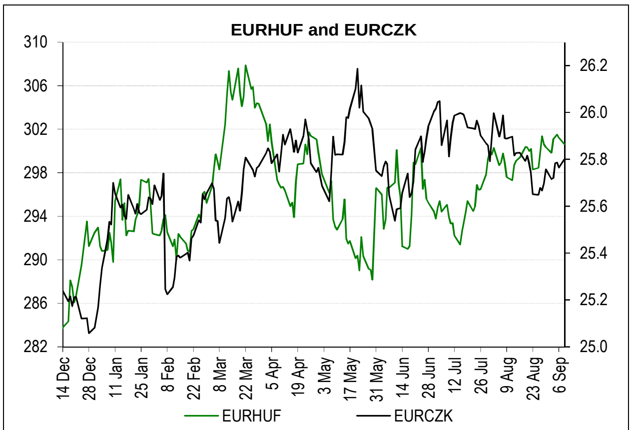
- Recent events on the domestic market show that the front end of curves has remained relatively resistant to changes in investors' mood. As a consequence curves became steeper, with spread 2-10Y widening to 165bp for T-bonds and 124bp for IRS, mainly due to 2-5Y spread increase. Outlook that interest rate path will remain stable in coming months (without any inflationary pressure) should support the front ends of curves.
- The mid and long-end of curves will remain under influence of Fed's decision (18-19 Sep.), any new signals regarding the conflict in Syria and election in Germany (22 Sep.). However, the main focus will be on FOMC meeting – low scale of QE3 tapering or even delay of decision (the latest labour market data surprised negatively) should result in some rebound on core markets and consequently on the Polish one, after sharp increase in yields. Even though we still think that the upward trend of yields/rates will continue in medium term, one should remember that the need of purchasing bonds by OFE might support the market (there will be no need to sell bonds by OFE in the case their share in the portfolio will be too high).

Foreign exchange market









Source: CSO, NBP, Reuters, Bloomberg, BZ WBK

Syria and OFE hit the zloty

▪ Second half of July and first week of August saw a visible appreciation of the zloty. Domestic currency was gaining due to some calming signals from the Fed (which lowered worries over prompt and considerable tapering of the QE3) and much better than expected Polish data on current account. There were also strong data released in the euro zone that fuelled expectations that in 2H economic situation will improve. Consequently, EURPLN declined temporarily to 4.18 vs. 4.37 in late June.

▪ Following weeks brought a fast weakening of the zloty. The currency was under pressure of worries over immediate military intervention in Syria, very good US data (which fuelled worries over QE3 tapering in September) and finally market reaction to planned changes in private pension funds (OFE). EURPLN reached 4.31 temporarily and USDPLN nearly 3.29 (vs. 3.14 in August). Average EURPLN reached 4.25 in July-August.

QE3, Syria and German elections key for the zloty

▪ September's FOMC meeting shall eliminate uncertainty over what will happen with QE3 in the nearest future. We expect that investors will not perceive slight tapering too negatively. To some extent, such a move has already been priced-in during the last wave of the zloty's weakening and in our opinion the announcement of the decision should not trigger any visible depreciation. It is also worth to notice that with some lag, but finally PMI for Polish manufacturing starts to show some recovery. In the past the domestic currency was gaining amid economic rebound. Data showing that domestic economy has bottomed out may also this time provide support for the zloty. Additionally, our forecasts show that surplus on trade account will be maintained and this should also back the domestic currency.

▪ 4.30 level is strong resistance for EURPLN. We do not expect it will be broken in September, the exchange rate should reach 4.24 on average. We still forecast a decline of EURPLN below 4.20 at the end of the year. Risk factors for this scenario are: prolonged military actions in Syria and unfavorable for Angela Merkel results of parliamentary elections in Germany (September 22).

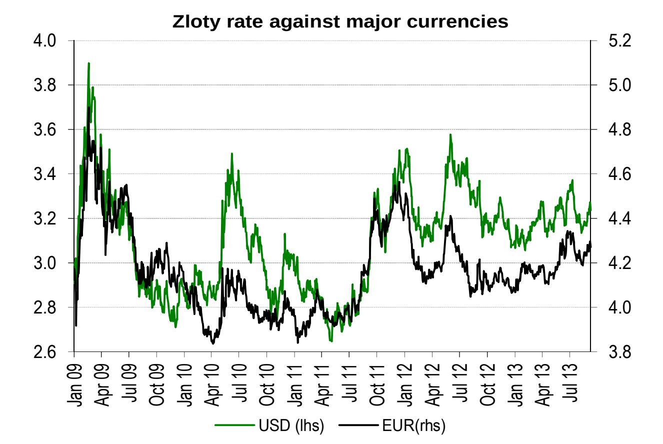
High volatility of EURUSD

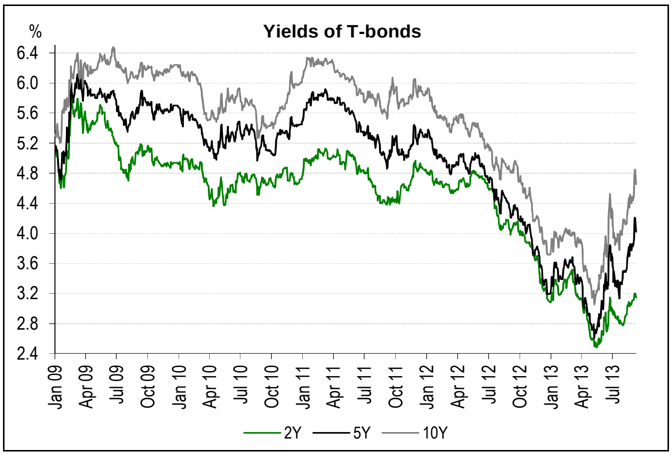
▪ Calming comments from the Fed and optimistic data from the euro zone (manufacturing PMI above 50pts) had a positive impact on the single currency. Just as we expected, EURUSD recovered after a sudden plunge from 1.34 to 1.275 triggered after Bernanke's hint on possible QE3 tapering already this year. However, the exchange rate did not manage to stay longer above 1.34. Worries over military intervention in Syria and strong US data supported the dollar. The downward move of EURUSD halted at 1.31 after weaker than expected monthly data from the US labour market.

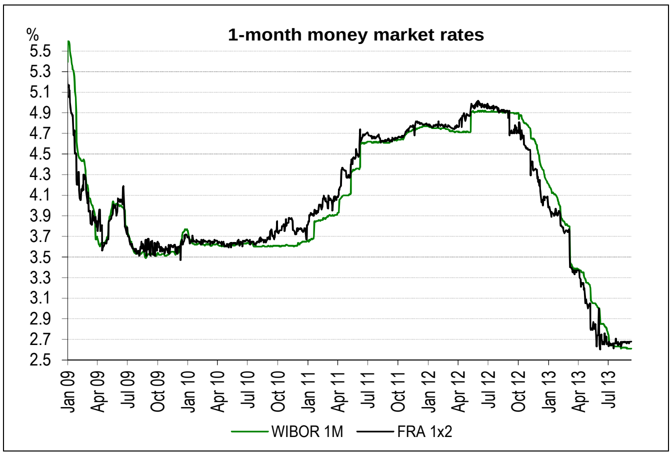
▪ According to Bloomberg survey, investors expect the Fed will trim QE3 in September by $10bn (from current $85bn) and it seems that it is the scale at which stimulus will be reduced by the US central bank is crucial for the market. Tapering at a smaller scale than expected by the market may be positively perceived by investors. We expect the Fed's decision will be at least neutral for the euro. Despite some rebound of EURUSD after weaker nonfarm payrolls, reducing QE3 is to some extent priced in by the market. We forecast EURUSD to rebound back to 1.34 in September. The euro may be additionally supported by hopes for continuation of recovery in the euro zone's economy.

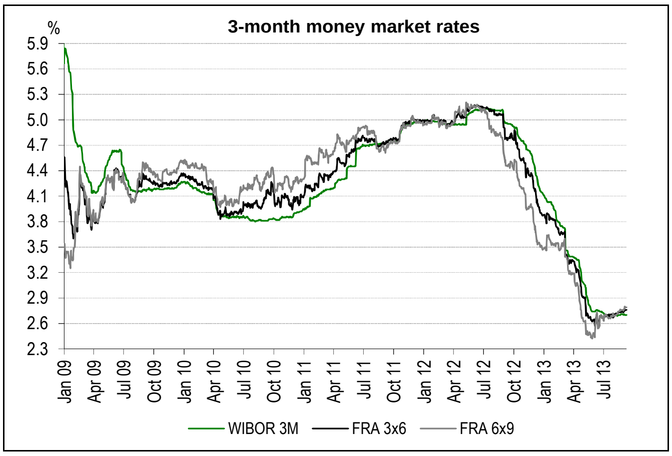
▪ Factor of military intervention in Syria remains vital for the market. If the US decide to take action, the risk for further increase of EURUSD may originate from the possibility that the conflict will be prolonged. Investors will surely follow the German elections that may influence market moods regarding European debt situation.

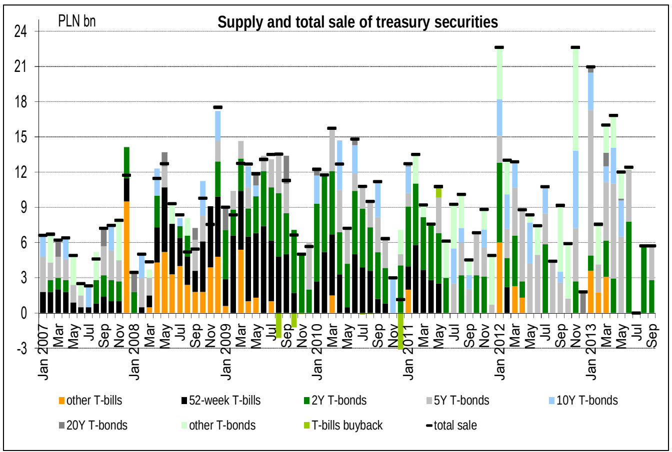
Market monitor











Treasury bill auctions in 2012/2013 (PLNm)

Auction date	OFFER	DEMAND/SALE
09.01.2012	*49-week: 1000-2000*	5402/2223
30.01.2012	*30-week: 1000-2000*	3249/1997
30.01.2012	*51-week: 1000-2000*	4225/1592
27.02.2012	*52-week: 1000-2000*	6711/2190
26.03.2012	*52-week: 1000-3000*	5402/2223
23.04.2012	*31-week*	3116,5/1332,1
07.01.2013	20-week: 2000-3000	10967/3602
04.02.2013	20-week: 1000-2000	7728/1747
04.03.2013	25-week: 2000-3000	7324/3084

* based on data of the Ministry of Finance

Treasury bond auctions in 2012/2013 (PLNm)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
September	19.09	WZ /DS /IZ	2000-4000	3458.8					05.09	OK1012/OK0113	WZ0117/PS0417
October	4.10	WZ /PS	3000-5000	5900.9	23.10	OK0714/DS1023	5000-9000	7840.5			
November	8.11	PS0418	2000-4000	4526.3					21.11	OK0113/PS0413	DS/WZ
December									6.12	OK0113/PS0413	WS
January '13	3.01	DS1023/WS0429	3000-5000	3664.3	23.01	OK0715/PS0418	6000-9000	13693.8			
February	7.02	PS0418/WZ0117	4000-6000	5806.5	13.02	OK0715/WZ0124	3000-5000	4584.7			
March	20.03	OK/PS/WZ	2000-6000						7.03	PS0413/OK0713/DS1013	DS/WS/WZ
April	11.04	DS1023/WZ0124	3000-5000	5029.1	23.04	OK/WZ/PS	5000-10000	11788.6			
May	9.05	PS0718	3500-5500	6498.0	16.05	DS/WZ/WS	2000-6000	5505.4			
June	6.06	PS0718/WZ0119	3000-5000	4606.5					19.06	OK0713/DS1013	OK0116
July	-	-	-	-	-	-	-	-	-	-	-
August	9.05	OK0116	3000-5000	5695.0							
September	5.09	OK0116/PS0718	5000-7000	5706.8					25.09	DS1013/OK0114	

** with supplementary auction, ** primary auction, *** demand/sale,*

Source: MF, Reuters, BZ WBK

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
9 September CZ: CPI (Aug)	**10**	**11** ***PL: Balance of payments (Jul)***	**12** EZ: Industrial output (Jul)	**13** ***PL: CPI (Aug)*** ***PL: Money supply (Aug)*** US: Retail sales (Aug) US: Flash Michigan (Sep)
16 ***PL: Core inflation (Aug)*** EZ: HICP (Aug) US: Industrial output (Jul)	**17** ***PL: Wages and employment (Aug)*** DE: ZEW index (Sep) US: Core CPI (Aug)	**18** ***PL: Industrial output (Aug)*** ***PL: PPI (Aug)*** US: House starts (Aug) US: Building permits (Aug) US: Fed decision	**19** US: Philly Fed index (Sep) US: Home sales (Aug)	**20** EZ: Consumer confidence index (Sep)
23 DE: Flash PMI – manufacturing (Sep) EZ: Flash PMI – manufacturing (Sep) CN: Flash PMI – manufacturing (Sep)	**24** ***PL: Retail sales and unemployment rate (Aug)*** DE: Ifo index (Sep) US: S&P/Case-Shiller (Jul) US: Consumer confidence index (Sep)	**25** US: Durable goods orders (Aug) US: New home sales (Aug)	**26** US: Final GDP (Q2) US: Pending home sales (Aug)	**27** US: Personal income (Aug) US: Consumer spending (Aug) US: Core PCE (Aug) US: Flash Michigan (Sep)
30 ***PL: Inflation expectations (Sep)*** ***PL: Balance of payments (Q2)*** CN: PMI – manufacturing (Sep) EZ: Flash HICP (Sep)	**1 October** ***PL: PMI – manufacturing (Sep)*** DE: PMI – manufacturing (Sep) EZ: PMI – manufacturing (Sep) US: ISM – manufacturing (Sep)	**2** ***PL: MPC decision*** EZ: ECB decision US: ADP report (Sep)	**3** DE: PMI – services (Sep) EZ: PMI – services (Sep) EZ: Retail sales (Aug) US: Industrial orders (Aug)	**4** US: Non-farm payrolls (Sep) US: Unemployment rate (Sep)
7 EZ: Sentix index (Oct)	**8** DE: Exports (Aug) DE: Industrial orders (Aug)	**9** DE: Industrial output (Aug) US: Minutes Fed	**10** GB: BoE decision	**11** ***PL: Balance of payments (Aug)*** US: Retail sales (Sep) US: Flash Michigan (Oct)
14 ***PL: Money supply (Sep)*** EZ: Industrial output (Aug)	**15** ***PL: CPI (Sep)*** DE: ZEW index (Oct)	**16** ***PL: Wages and employment (Sep) PL: Core inflation (Sep)*** EZ: HICP (Sep) US: Core CPI (Sep) US: Fed Beige Book	**17** ***PL: Industrial output (Sep)*** ***PL: PPI (Sep)*** ***PL: MPC minutes*** US: House starts (Sep) US: Building permits (Sep) US: Industrial output (Sep) US: Philly Fed index (Oct)	**18**

MPC meetings and data release calendar for 2013

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
ECB meeting	10	7	7	4	2	6	4	1	5	2	7	5
MPC meeting	8-9	5-6	5-6	9-10	7-8	4-5	2-3	20	3-4	1-2	5-6	3-4
MPC minutes	24	21	21	25	23	20	-	22	19	17	21	19
GDP*	-	-	1	-	29	-	-	30	-	-	29	-
CPI	15	15[a]	14[b]	15	15	13	15	14	13	15	14	13
Core inflation	16	-	15	16	16	14	16	16	16	16	15	16
PPI	18	19	19	18	21	19	17	20	18	17	21	18
Industrial output	18	19	19	18	21	19	17	20	18	17	21	18
Retail sales	24	25	22	23	24	25	-	-	-	-	-	-
Gross wages. employment	18	18	18	17	20	18	16	19	17	16	19	17
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	28	-	-	28	-	-	30	-	-	-
Balance of payments	18	12	14	15	15	17	12	12	11	11	12	-
Money supply	14	14	14	12	14	14	12	14	13	14	14	-
Business climate indices	22	21	22	22	22	21	22	23	20	22	22	20

* quarterly data. [a] preliminary data for January. [b] January and February

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

Economic data and forecasts

Monthly economic indicators

		Aug 12	Sep 12	Oct 12	Nov 12	Dec 12	Jan 13	Feb 13	Mar 13	Apr 13	May 13	Jun 13	Jul 13	Aug 13	Sep 13
PMI	pts	48.3	47.0	47.3	48.2	48.5	48.6	48.9	48.0	46.9	48.0	49.3	51.1	52.6	52.9
Industrial production	%YoY	0.2	-4.8	4.7	-0.5	-9.6	0.4	-2.1	-2.9	2.8	-1.8	2.8	6.3	0.5	6.7
Construction production	%YoY	-5.1	-17.9	-3.6	-5.4	-24.9	-16.1	-11.4	-18.5	-23.1	-27.5	-18.3	-5.2	-9.1	-3.0
Retail sales [a]	%YoY	5.8	3.1	3.3	2.4	-2.5	3.1	-0.8	0.1	-0.2	0.5	1.8	4.3	2.5	3.9
Unemployment rate	%	12.4	12.4	12.5	12.9	13.4	14.2	14.4	14.3	14.0	13.5	13.2	13.1	13.1	13.1
Gross wages in enterprises sector [a]	%YoY	2.7	1.6	2.8	2.7	2.4	0.4	4.0	1.6	3.0	2.3	1.4	3.5	2.9	3.7
Employment in enterprises sector	%YoY	0.0	0.0	0.0	-0.3	-0.5	-0.8	-0.8	-0.9	-1.0	-0.9	-0.8	-0.7	-0.6	-0.5
Export (€)	%YoY	4.8	0.7	17.7	9.2	-2.1	6.4	5.3	-1.2	12.7	2.1	7.1	8.4	0.8	8.7
Import (€)	%YoY	-2.1	-1.8	9.2	4.6	-1.8	1.2	-5.7	-1.6	4.1	-4.9	-0.7	0.7	-3.2	5.4
Trade balance	EURm	-109	57	286	-249	-1 154	-108	452	-484	581	43	561	544	374	484
Current account balance	EURm	-868	-1 448	-729	-1 478	-1 120	-1 335	-620	-104	714	165	574	58	-271	-821
Current account balance	% GDP	-4.1	-4.1	-3.7	-3.7	-3.5	-3.3	-3.1	-2.9	-2.6	-2.4	-2.0	-1.7	-1.5	-1.3
Budget deficit (cumulative)	PLNbn	-22.9	-21.1	-34.1	-30.4	-30.4	-8.4	-21.7	-24.4	-31.7	-30.9	-26.0	-25.9	-27.2	-28.8
Budget deficit (cumulative)	% of FY plan	65.5	60.4	97.5	86.9	86.9	23.7	60.9	68.6	89.3	87.0	73.0	72.9	76.4	81.1
CPI	%YoY	3.8	3.8	3.4	2.8	2.4	1.7	1.3	1.0	0.8	0.5	0.2	1.1	1.1	1.5
CPI excluding prices of food and energy	%YoY	2.1	1.9	1.9	1.7	1.4	1.4	1.1	1.0	1.1	1.0	0.9	1.4	1.4	1.7
PPI	%YoY	3.0	1.8	1.0	-0.1	-1.1	-1.2	-0.3	-0.7	-2.1	-2.5	-1.3	-0.8	-0.9	-1.2
Broad money (M3)	%YoY	9.8	7.6	8.0	5.7	4.5	4.4	5.5	6.6	7.4	6.5	7.0	6.5	5.9	6.6
Deposits	%YoY	9.5	7.9	8.1	5.8	4.7	5.0	5.2	6.6	7.1	6.0	6.5	5.6	5.3	5.6
Loans	%YoY	7.1	5.4	5.4	2.3	2.3	3.6	3.7	3.5	2.3	1.4	3.5	3.7	2.7	2.4
EUR/PLN	PLN	4.09	4.14	4.11	4.13	4.10	4.14	4.17	4.16	4.14	4.18	4.28	4.28	4.23	4,24
USD/PLN	PLN	3.30	3.22	3.17	3.22	3.12	3.11	3.12	3.21	3.18	3.22	3.25	3.27	3.18	3,19
CHF/PLN	PLN	3.41	3.42	3.40	3.43	3.39	3.37	3.39	3.39	3.39	3.36	3.47	3.46	3.43	3,43
Reference rate [b]	%	4.75	4.75	4.75	4.50	4.25	4.00	3.75	3.25	3.25	3.00	2.75	2.50	2.50	2.50
WIBOR 3M	%	5.10	4.95	4.82	4.62	4.26	4.03	3.80	3.48	3.29	2.86	2.74	2.70	2.70	2.70
Yield on 52-week T-bills	%	4.58	4.53	4.42	4.14	3.94	3.62	3.56	3.30	3.06	2.64	2.60	2.92	3.03	3.19
Yield on 2-year T-bonds	%	4.12	4.09	3.94	3.66	3.23	3.25	3.36	3.26	2.89	2.55	2.86	2.87	2.98	3.14
Yield on 5-year T-bonds	%	4.43	4.28	4.12	3.78	3.35	3.46	3.56	3.46	3.03	2.80	3.43	3.36	3.67	3.99
Yield on 10-year T-bonds	%	4.88	4.85	4.59	4.21	3.87	3.91	4.00	3.93	3.50	3.28	3.95	3.97	4.31	4.64

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

Quarterly and annual economic indicators

		2011	2012	2013	2014	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
GDP	PLNbn	1 523.2	1 595.3	1 633.1	1 705.3	377.8	395.5	404.2	455.6	393.9	414.7	422.2	474.5
GDP	%YoY	4.5	1.9	1.2	2.7	0.5	0.8	1.4	2.0	2.3	2.8	2.8	2.8
Domestic demand	%YoY	3.6	-0.2	-0.9	1.8	-0.9	-1.9	-0.5	-0.5	0.6	1.5	2.2	2.9
Private consumption	%YoY	2.6	0.8	0.6	1.8	0.0	0.2	0.9	1.2	1.5	1.7	2.0	2.2
Fixed investments	%YoY	8.5	-0.8	-2.0	2.8	-2.0	-3.8	-2.0	-1.0	-2.0	1.0	4.0	5.0
Industrial production	%YoY	7.7	1.0	2.8	4.6	-2.0	1.2	4.5	6.9	6.3	5.4	3.9	3.1
Construction production	%YoY	12.3	-1.0	-10.8	9.7	-15.6	-22.9	-5.8	-2.6	5.2	15.0	10.4	7.8
Retail sales [a]	%YoY	11.2	6.0	2.1	3.5	0.9	0.8	3.7	2.7	3.0	4.1	1.7	5.2
Unemployment rate [b]	%	12.5	13.4	13.7	13.2	14.3	13.2	13.1	13.7	14.3	13.9	13.3	13.2
Gross wages in national economy [a]	%YoY	5.2	3.7	3.2	4.5	2.6	3.3	3.3	3.5	3.9	4.7	4.8	4.7
Employment in national economy	%YoY	0.6	0.0	-0.6	0.4	-0.7	-1.1	-0.5	-0.2	0.2	0.4	0.4	0.5
Export (€)	%YoY	12.1	4.6	6.7	11.0	3.5	7.3	6.0	10.0	11.0	11.0	11.0	11.0
Import (€)	%YoY	12.2	1.1	0.6	8.9	-1.9	-0.6	1.0	4.0	7.0	8.0	9.5	11.0
Trade balance	EURm	-10 059	-5 313	3 574	7 135	-139	1 185	1 401	1 127	1 332	2 430	2 123	1 251
Current account balance	EURm	-17 977	-13 332	-2 277	1 234	-2 055	1 453	-829	-846	12	2 067	-30	-815
Current account balance	% GDP	-4.9	-3.5	-0.6	0.3	-2.8	-1.9	-1.2	-0.6	-0.1	0.1	0.3	0.3
General government balance	% GDP	-5.0	-3.9	-4.2	-3.5	-	-	-	-	-	-	-	-
CPI	%YoY	4.3	3.7	1.2	2.2	1.3	0.5	1.2	1.7	2.1	2.5	2.1	2.0
CPI [b]	%YoY	4.6	2.4	1.8	2.1	1.0	0.2	1.5	1.8	2.2	2.7	2.0	2.1
CPI excluding food and energy prices	%YoY	2.4	2.2	1.3	2.1	1.2	1.0	1.5	1.7	2.2	2.3	1.9	2.0
PPI	%YoY	7.6	3.4	-1.2	0.6	-0.7	-2.0	-1.0	-1.0	-0.5	0.7	0.5	1.7
Broad money (M3) [b]	%YoY	12.5	4.5	6.2	5.5	6.6	7.0	6.6	6.2	5.4	4.8	5.7	5.5
Deposits [b]	%YoY	11.7	4.7	5.1	6.7	6.6	6.5	5.6	5.1	4.8	4.8	6.5	6.7
Loans [b]	%YoY	14.4	1.2	3.7	4.4	3.5	3.5	2.4	3.7	4.0	2.9	4.3	4.4
EUR/PLN	PLN	4.12	4.19	4.20	4.06	4.16	4.20	4,25	4.20	4.14	4.08	4.04	3.99
USD/PLN	PLN	2.96	3.26	3.17	2.97	3.15	3.22	3,21	3.12	3.04	3.00	2.95	2.89
CHF/PLN	PLN	3.34	3.47	3.41	3.28	3.38	3.41	3,44	3.39	3.34	3.29	3.26	3.22
Reference rate [b]	%	4.50	4.25	2.50	3.25	3.25	2.75	2.50	2.50	2.50	2.75	3.00	3.25
WIBOR 3M	%	4.54	4.91	3.04	3.09	3.77	2.96	2.70	2.73	2.78	2.97	3.18	3.42
Yield on 52-week T-bills	%	4.51	4.48	3.13	3.52	3.49	2.77	3.05	3.21	3.23	3.38	3.62	3.83
Yield on 2-year T-bonds	%	4.81	4.30	3.04	3.47	3.29	2.77	3.00	3.11	3.18	3.33	3.57	3.78
Yield on 5-year T-bonds	%	5.44	4.53	3.54	4.07	3.49	3.09	3.67	3.90	3.90	4.00	4.15	4.23
Yield on 10-year T-bonds	%	5.98	5.02	4.10	4.77	3.95	3.58	4.31	4.57	4.60	4.70	4.85	4.93

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

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