Bank Zachodni WBK

Weekly economic update

9 – 15 July 2012

The optimism connected with the EU summit has decreased slightly last week. The statements of Dutch and French representatives contributed to this limitation. They questioned the possibilities of using the ESM to purchase the government bonds on the secondary market in order to limit the costs of financing. It caused higher uncertainty whether the arrangements from the last EU summit would be implemented and consequently if the important step towards controlling the situation in the euro-zone would be taken. The ECB, in line with the expectations, cut the main interest rate by 25bp do the lowest level in the history (0.75%). Additionally the deposit rate was also cut (to 0.0% from 0.25%), what was not broadly expected. In reaction to this, EURUSD rapidly fell. The Polish zloty appreciated as a result of expectations that, as a result of deposit rate's cut, banks in Europe will be more willing to invest money in domestic assets. Polish bonds didn't benefit from the increase of demand for risky assets because of large supply on the switching auction. However, this wave of optimism in the Polish FX market connected with the ECB decision proved only temporary. Mario Draghi said during the press conference that the risks for the growth which were pointed out in previous months has materialised and that one should wait to assess the results of two LTRO. It was interpreted by the market as the decrease of chances for another round of long-term loans. At the end of the week, slightly weaker than expected US payrolls data also had impact on deterioration of global market sentiment.

Interest rate cut in the euro-zone will come into effect on Wednesday. The ECB data about the amount of money that will be deposited by banks overnight will be interesting. In last weeks this sum was close to €800bn. Meanwhile, overseas the season of quarterly companies' financial results will be opened by the release of Alcoa's report and the following news will draw investors' attention. The release of minutes of the last Fed's meeting, at which it was decided to lengthen the Operation Twist, will be significant. At the ended of the week d the number of domestic data (especially CPI inflation) will be released. We expect that the higher price growth may negatively surprise the market. Waiting for the inflation release we expect some stabilisation in yields on the short-end of the curve. However, the materialisation of our inflation scenario may be an impulse for profit taking after recent gains. Long-end will remain under influence of global factors. Last week EURPLN was testing the important support zone at 4.20. Prospect for further dollar strengthening versus euro suggests that this area should not be broken.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (9 July)					
3:30	CN	CPI	Jun	%YoY	2.3	-	3.0
8:00	DE	Exports	May	%MoM	0.3	-	-1.7
10:00	EZ	Sentix index	Jul	pts	-26.6	-	-28.9
		TUESDAY (10 July)					
		No important data releases					
		WEDNESDAY (11 July)					
14:30	US	Trade balance	May	$bn	-48.7	-	-50.1
20:00	US	Fed minutes					
		THURSDAY (12 July)					
11:00	EZ	Industrial output	May	%MoM	-0.1	-	-0.8
14:30	US	Import prices	Jun	%MoM	-1.5	-	-1.0
14:30	US	Initial jobless claims	Week	K	-	-	374
		FRIDAY (13 July)					
3:30	CN	GDP	Q2	%YoY	7.6	-	8.1
14:00	**PL**	**CPI**	**Jun**	**%YoY**	**4.1**	**4.4**	**3.6**
14:00	**PL**	**Money supply**	**Jun**	**%YoY**	**11.5**	**11.6**	**11.4**
14:00	**PL**	**Exports**	**May**	**€m**	**12 076**	**12 196**	**11 582**
14:00	**PL**	**Imports**	**May**	**€m**	**12 605**	**12 811**	**12 001**
14:00	**PL**	**Balance of payments**	**May**	**€m**	**-258**	**-246**	**-573**
15:55	US	Flash Michigan index	Jun	pts	-	-	73.2

Source: BZ WBK, Reuters, Parkiet

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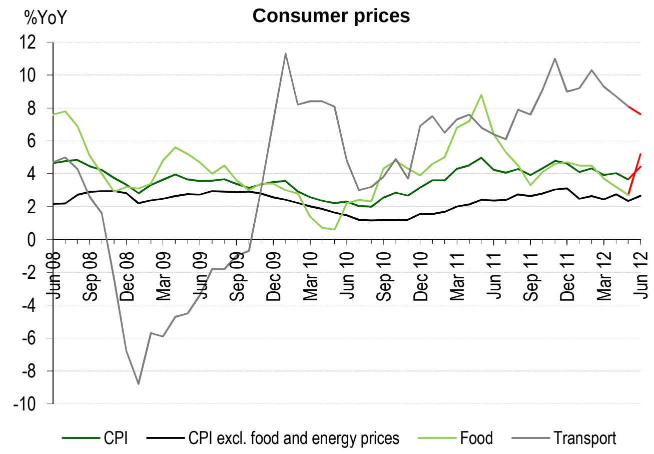
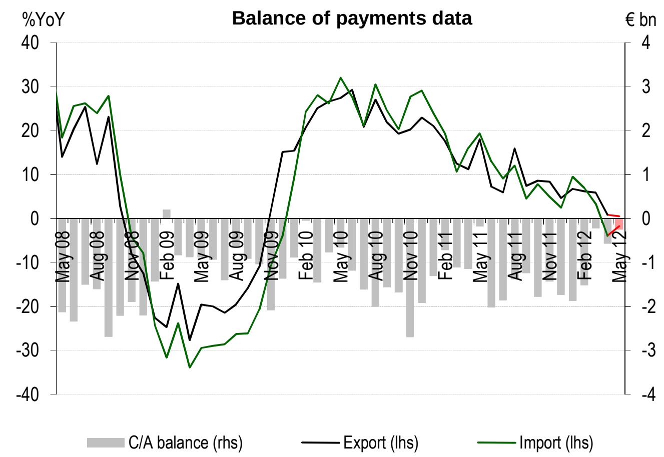
What's hot this week – CPI inflation sharply up, but the economy is slowing down



- The June's CPI inflation data may be impulse for the correction of short-term interest rates. In our opinion the CPI indicator increased to 4.4%YoY (with the risk on the upside), clearly exceeding the market consensus at the level of 4.1% (the range of analysts' forecasts is wide: 3.7-4.6%).
- Food prices were the main factor pushing the CPI inflation up – the data about prices of agricultural produce released by the Ministry of Agriculture show that in June the prices of fruits, vegetables and meat increased strongly. Consequently instead of seasonal fall of food's prices the increases occurred.
- The growth of services prices, connected with EURO2012 and the effect of low base from previous year were additional factors boosting (temporarily) the inflation rate. On the other hand, fuel prices at gas stations went down in June.



- The May's NBP data about balance of payments will show the continuation of trend of decelerating activity in foreign trade, which is caused by weakening inflow of new orders from Europe, being affected by the crisis. Last PMI reports confirmed that the fall of activity in Polish industry to the lowest level in last three years resulted mainly from the decreasing export orders, "particularly from western countries".
- However, the current account deficit should be low in May, among others because of inflow of large sum of EU funds, classified in current transfers.
- The data on M3 money supply will be as usually less important for the market. We expect further slowdown on the loan growth for both households and enterprises.

Last week in the economy – Easing by foreign central banks, Polish MPC in (less) hawkish mode

Inflation and GDP projections in the subsequent *Inflation reports*

	GDP growth			
	Jul 11	**Nov 11**	**Mar 12**	**Jul 12**
2012	1.9-4.5	2.0-4.1	2.2-3.8	2.3-3.6
2013	1.5-4.3	1.5-4.0	1.1-3.5	1.0-3.2
2014	x	x	1.9-4.4	1.7-4.2
	CPI inflation			
	Jul 11	**Nov 11**	**Mar 12**	**Jul 12**
2012	2.1-3.4	2.5-3.9	3.6-4.5	3.6-4.2
2013	1.8-3.4	2.2-3.7	2.2-3.6	2.0-3.4
2014	x	x	1.2-3.0	1.0-2.7

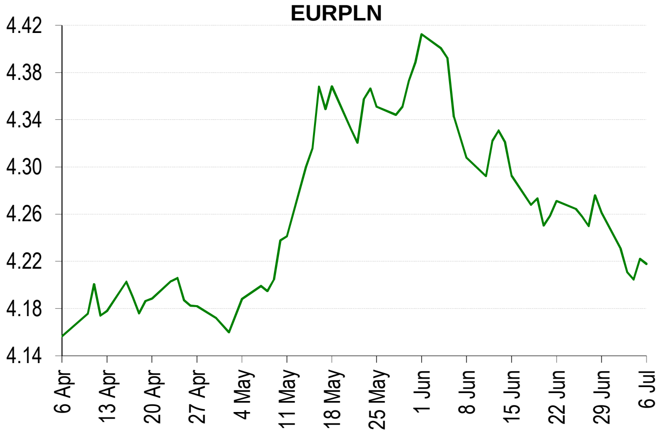
- The MPC kept the interest rates unchanged in July and although "the Council does not rule out the possibility of further monetary policy adjustment, should the outlook for inflation returning to the target deteriorate", but we don't think that it will happen.
- The economic scenario which is presented in new NBP projection (the table on the left-hand side) as well as recent data and other central banks' actions support our expectations that the NBP's interest rates will be kept unchanged at least until the year's end. It seems to us that in 2013 the interest rates' cut will be possible in the scenario of economic slowdown to about 2%.
- In contrary to the MPC, other central banks react quite actively to deteriorating prospects for world economy – the ECB and the Bank of China cut the interest rates, while the Bank of England increased the program of quantitative easing.

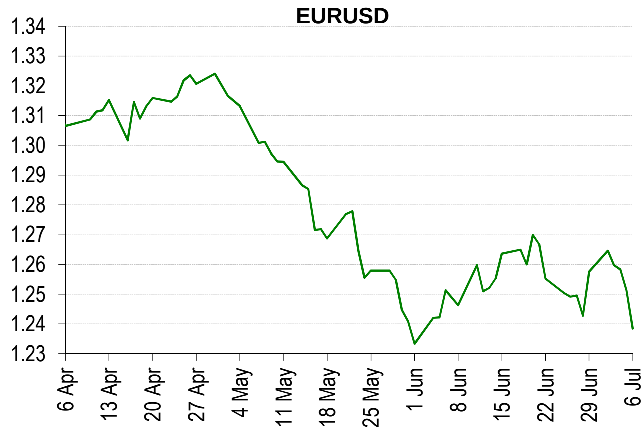
Quote of the week – Higher concerns about growth, lower about inflation

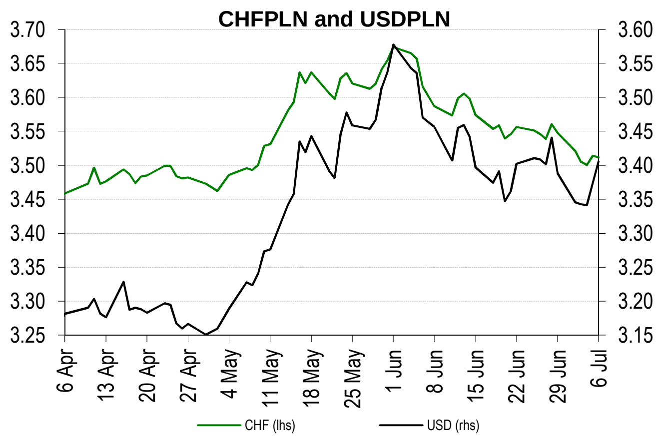
Marek Belka, NBP President, 04.07, MPC's press conference
I can't rule it out (change in bias) because we are not blind to what is happening. Last hike was the step towards the normalisation. Probably, we lack something to achieve this normalisation, but we are not blind to the situation. Prospects for reaching the target improve, so we can wait with the normalisation. (...) If we compare the today's situation with the situation from two months (when the MPC increased the rates), I have more fears about the economic growth tempo and less about the inflation.
Andrzej Kaźmierczak, MPC member, 04.07, MPC's press conference
We don't change the bias. If the inflation's fall has permanent character, the rate cuts will be possible. But we must find the fall permanent.

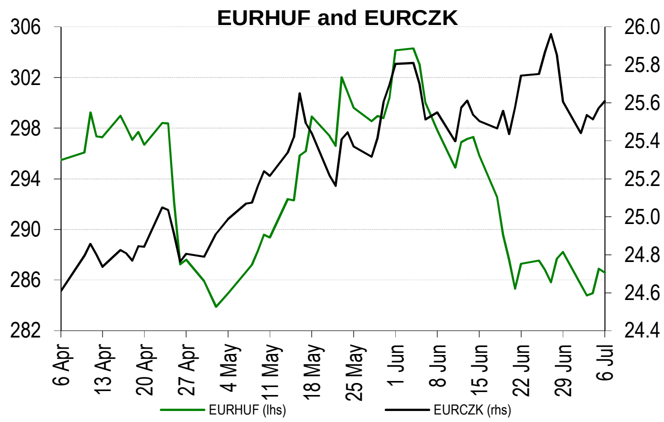
In spite of some "hawkish" elements still present in the MPC's rhetoric (the suggestion in the MPC's statement about potential further monetary policy adjustment, NBP President's sentence that full rates' normalisation hasn't been achieved yet), it seems that the recent pieces of information from the domestic and global economy are gradually changing the MPC's point of view. It is showed among others by the Belka's statement that currently there is less worry about inflation and more about growth. Meanwhile, the statement of Kaźmierczak points out that the rate cuts shouldn't be considered until the MPC is sure that downward trend of inflation is permanent (i.e. at least for few months the CPI should be clearly falling).

Foreign exchange market – EURPLN should not brake 4.20









EURPLN the lowest since May

- During the past week the EURPLN was twice falling below 4.20 level. First, the appreciation of domestic currency was fuelled by relatively positive market sentiment persisting after the EU summit and expectations for further actions from the ECB. Such circumstances dragged the EURPLN to nearly 4.18, lowest since first half of May. After short correction to 4.22 the exchange rate declined again, this time after the decision of the ECB to cut deposit rate to 0%. Finally, amid some disappointment of not announcing more nonstandard measures by the ECB the EURPLN rebounded at the end of the week to ca. 4.22, level seen just after the EU summit. It is worth to notice, that regarding the scale and volatility of movements of the EURUSD, the zloty was relatively stable and domestic currency did not depreciate much during the periods of deterioration of global moods. Perhaps the zloty was supported by the outlook of inflow of fresh cash after cutting ECB deposit rate.
- Appreciation versus the dollar was also temporary. The USDPLN tested during the week 3.31, but amid plunge of the EURUSD after the ECB at the end of the week dollar was worth more than PLN3.40, slightly more that just after the EU summit.
- The EURPLN tested during the past week vital area of support at ca. 4.20. The outlook of further euro's depreciation versus the dollar suggests that area will not be broken. Still, last few weeks showed that there has to be some important negative factor to make zloty's weakening more long-lasting and more visible. First resistance is at 4.24, next at 4.30.

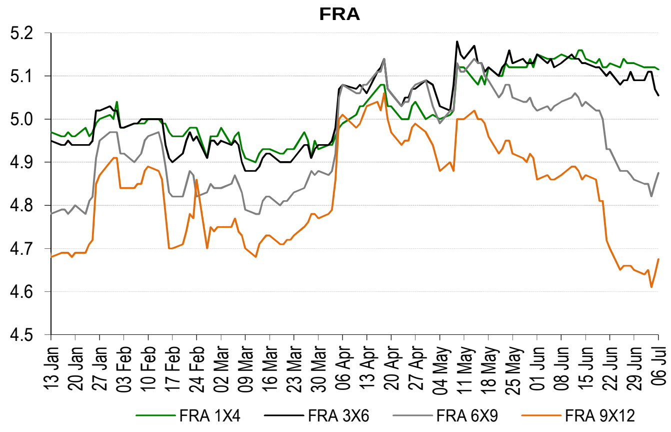
EURUSD plunges after the ECB decision

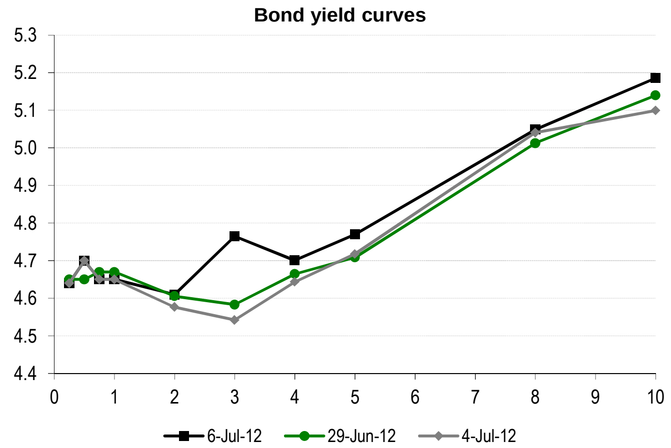
- The euro did not manage to maintain gains recorded after the EU summit, and last week the EURUSD stayed in a downward trend. The tendency was fuelled by comments from Finland and Netherlands being not in favor of using ESM to support peripheral bond market. Euro's depreciation was further backed by the decision of cutting the ECB deposit rate. The trend was continued after slightly weaker than expected monthly US pay-rolls data. Consequently, during the week the EURUSD plunged from 1.27 reached after the EU summit to nearly 1.23, the lowest level since early June.
- This week market attention will focus partly on quarterly financial statements of US companies and on minutes of the last Fed meeting. Some impact on the exchange rate may be also but by data on overnight deposits at the ECB after cutting deposit rate to 0%.
- Technical analysis suggests that if the exchange rate stays below 1.24 for a longer period of time (which is quite realistic after recent drops), then in the coming weeks it may decline further to 1.215. Assuming that the relationship with the EURPLN persists, that would not be a good omen for the domestic currency.

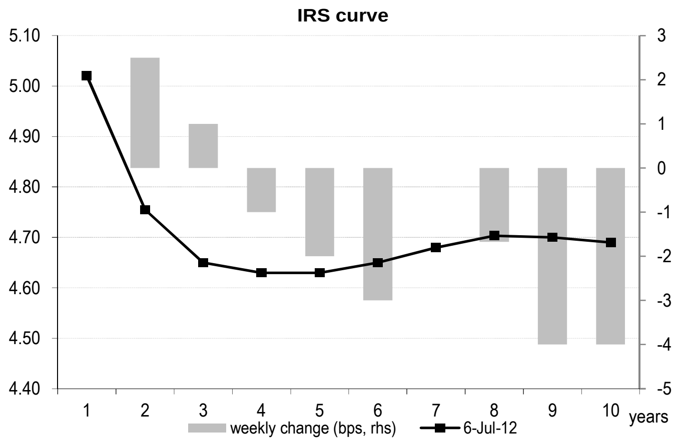
EURCZK still in the upward trend

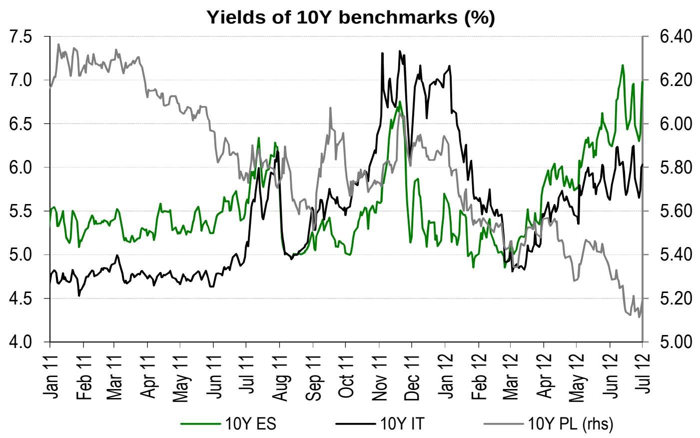
- There was no breakthrough on the Czech FX market, the currency depreciated together with the zloty at the end of the week. EURCZK stays in the upward trend since March.
- EURHUF trading range narrowed in the past week. The exchange rate is still close to 285, lowest level since early May. Hungarian parliament approved changes in law on central bank that we mentioned a week ago. That is vital step towards restart of talks with IMF and the EU on financial aid and that may support forint versus the euro.

Interest rate market – Correction on bond market, waiting for CPI









FRA rates slight increased after the MPC's meeting

▪ The key event of last week was the MPC's meeting. The Council's decision to keep interest rates unchanged was in line with expectations. However, statement and press conference were more crucial, especially that the MPC has remained its hawkish rhetoric. It highlighted the possibility of further adjustment "should the outlook for inflation returning to the target deteriorate". It slightly cooled interest rate cuts expectations later this year.

▪ During the week WIBOR rates were relatively stable, but WIBOR for 6 months and longer maturity moved up by 1bps on weekly basis to 5.16%. As for FRA, rates growth after the MPC were relatively muted (by 1-2bps). FRA 9x12 at 4.67% clearly suggests that market has expected interest rate cuts in 9 months horizon by 50bps in total, with the first cut at the turn of the year.

Correction move on the bond market

▪ The beginning of the week brought further decrease in yields across the curve. Yields reached a new this year lows, including yield of 10Y benchmark at ca. 5.07%. It came mainly from strong demand from foreign investors.

▪ Statement and the MPC's press conference caused some profit taking. Correction upward move has continued in next sessions and as a results yield curve in weekly terms moved up by 4-7bps on mid and long end of the curve, in which the highest scope of change was in case of 5Y benchmark, which increased to 4.77%. In the same time the front end of the curve was relatively stable.

▪ Poland's Ministry of Finance successfully launched 5Y and 10Y benchmarks during switch tender. The MF bought back OK0712 and OK1012 worth PLN5.2bn in total, selling PS0417 and DS1021 worth PLN4.9bn in total. As a consequence after switch tender the 2012 borrowing requirements completion has exceeded 80%. Therefore, the MF is in comfortable situation offering wholesales T-bonds at next auctions. However, after auction yields slightly moved up across the curve.

▪ High volatility was observed on the IRS market. But the week is ended with lower rates compared with rates at the end of previous week. One should notice that IRS rates for 3-5Y were nearly flat, slightly above 4.60%, while IRS 10Y stayed below 4.70%.

CPI inflation will give direction to market

▪ This week macroeconomic data releases have started. Investors will mainly focus on the June CPI data (Friday 13th). Ahead of the release we foresee yields to oscillate around current levels.

▪ In our opinion, CPI inflation for June can surprise on the negative side. Our forecast at 4.4%YoY is above market consensus (4.1%). We think that if our scenario materialises, it will negatively affect FRA rates and short end of the curve, with yield of 2Y increase towards 4.70%. As for 5Y, we also do not rule out some upward move.

▪ The long end of the curve remains under pressure of global factors. One should notice that polish bond curve is relatively resistant changes in yields of the peripheries debt (especially Spanish one – yield of Spanish 10Y benchmark again increased towards 7.0%, while yield of 10Y Italian bonds again increased above 6.0%). As for domestic 10Y benchmark DS1021, important support is at 5.10%, while first resistance level is at 5.20%.

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