Bank Zachodni WBK

Weekly economic update

22 – 28 July 2013

Last week the positive market sentiment maintained, among others, thanks to calming comments of the Fed governor, which reduced risk that tapering of asset purchases will be implemented in September already. Temporary appreciation of the zloty by almost PLN0.10 against the euro, dollar or pound, slight strengthening of Polish bonds and new all-time highs on the US equity market are all results of rise in risk appetite. Domestic data on employment and industrial output in June showed some signs of recovery and gave hope for further improvement in the domestic economy in the upcoming quarters. Positive news came also from the US, where more companies surprised to the upside with their quarterly results. Data released in the US were interpreted as a factor, which can prevent the Fed from closing the QE3 too soon (if they were worse than expected) or as a sign of incoming recovery (in case of positive surprises).

The government accepted draft of public finance bill amendment and announced a budget revision. Shortfall in this year's budget revenues will amount to ca. PLN24bn, so the government is ready to raise the deficit by PLN16bn. Spending is to be cut by ca. PLN8bn. Budget revision will be possible thanks to two-year (2013-2014) "suspension" of sanctions triggered after debt surpasses 50% of GDP (relation of deficit to revenues in next year cannot be higher than in last year). Even though the scale of increase in deficit comes as no surprise, the way the changes would be introduced is rather dubious as regards legal issues (retroactive law?). Moreover, suspension of thresholds after surpassing them questions the whole idea of anchoring them in legal system. Maybe next governments will try to "suspend" sanctions or even the spending rule in the following years? More details about the amendment will be shown in August.

This week we will see a row of data on economic activity in the euro zone. In the previous months PMI for euro zone's manufacturing was rising gradually, while indicators for Germany (PMI, Ifo) showed some deceleration of positive tendencies (ZEW index confirmed that last week). As regards domestic data, we are expecting that June's retail sales will join the series of positive surprises (our forecast is above consensus). Meeting of the central bank of Hungary is scheduled for this week and the market will be curious if the expected interest rate cut will be again accompanied by new ideas to stimulate the Hungarian economy. Global moods will be important for the domestic financial market. Yields of 10Y German bonds is close to local low from mid-June at ca. 1.50% and behaviour in regard to this level may set the direction for the domestic debt market also. If positive moods maintain, then EURPLN may test support at 4.23.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 July)					
16:00	US	Home sales	Jun	m	5.27	-	5.18
		TUESDAY (23 July)					
10:00	**PL**	**Retail sales**	**Jun**	**%YoY**	**1.0**	**1.5**	**0.5**
10:00	**PL**	**Unemployment rate**	**Jun**	**%YoY**	**13.2**	**13.2**	**13.5**
14:00	HU	Central bank decision Węgier		%	4.0	-	4.25
		WEDNESDAY (24 July)					
3:45	CN	Flash PMI – manufacturing	Jul	pts	48.5	-	48.2
9:28	DE	Flash PMI – manufacturing	Jul	pts	49.2	-	48.6
9:58	EZ	Flash PMI – manufacturing	Jul	pts	49.1	-	48.8
16:00	US	New home sales	Jun	k	481	-	476
		THURSDAY (25 July)					
10:00	DE	Ifo index	Jul	pts	106.1	-	105.9
10:30	GB	Flash GDP	Q2	%QoQ	0.6		0.3
14:30	US	Initial jobless claims	week	k	340	-	360
		FRIDAY (26 July)					
15:55	US	Flash Michigan	Jul	pts	84.0	-	83.9

Source: BZ WBK. Bloomberg, Reuters, Parkiet

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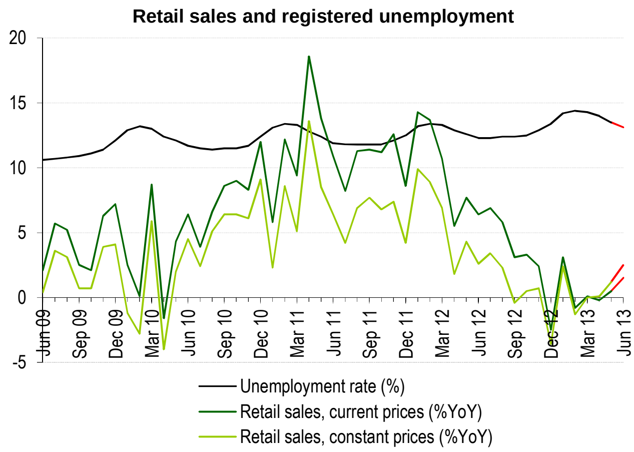
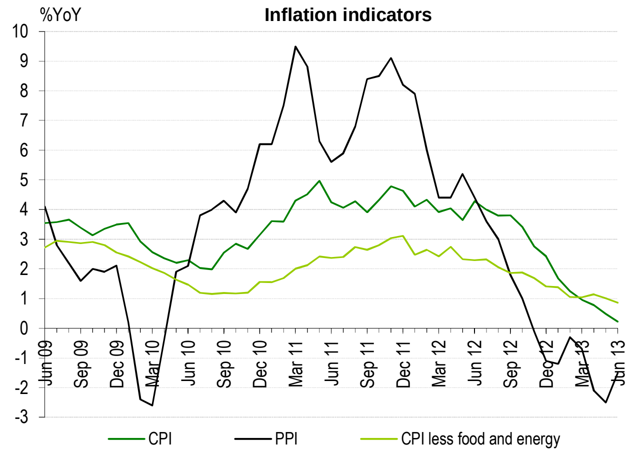
What's hot this week – Retails sales and registered unemployment



▪ We expect some acceleration in growth rate of retail sales, to 1.5%YoY. We think that the data will show a gradual strengthening of signals of recovery (some categories posted even a two-digit increase in the previous months). Higher sales are supported by negative deflator of prices in retail trade (i.e. prices are falling in annual terms).

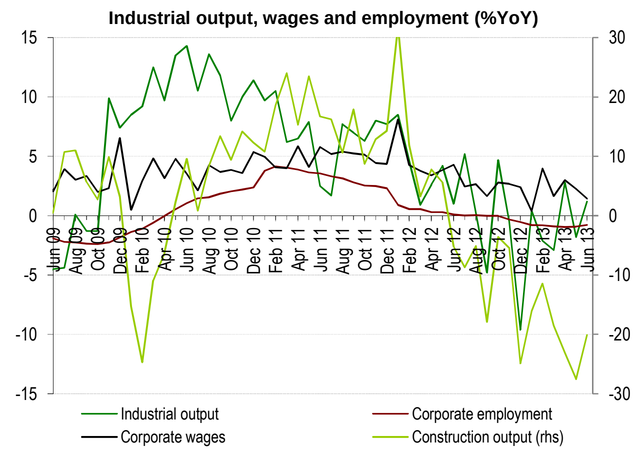
▪ In our view, registered unemployment rate declined in June to 13.2%, up to a certain extent due to interventions of Labour and Social Policy Ministry, similarly as in the previous months. One month ago we noted that pace of growth of new jobless claims slowed down. A continuation of this tendency in June (which was suggested by better-than-expected data on employment in corporate sector) can be interpreted as a sign of recovery on the labour market.

Last week in the economy – CPI lowest ever, budget amendment, symptoms of recovery



▪ In June CPI inflation rate declined to 0.2%YoY, the lowest level in history of Polish economy after 1990. Our forecasts indicate that CPI inflation reached its minimum level in June and in the following months the trend should reverse. Core inflation excluding food and energy prices declined in June to 0.9%YoY (the lowest level since September 2007), while PPI inflation climbed to -1.5%YoY.

▪ The government plans to revise to budget bill, as the economic slowdown undermined state's revenues. According to the government's estimates, shortfall in revenues will amount to ca. PLN24bn this year (i.e. to ca. PLN30bn in tax revenues). This shortfall in revenues is to be offset by cuts in spending worth ca. PLN8.5bn (as compared to the budget bill) and rise in budget deficit by PLN16bn.



▪ In June employment in the corporate sector rose for the second month in a row, this time by 9.4k MoM (-0.8%YoY). We find this a positive sign though it is too early to say for sure whether this was due to higher seasonal activity or some broader revival.

▪ Wage growth in corporate sector slowed to 1.4%YoY.

▪ Industrial output expanded in June by 3.0%YoY, while construction and assembly output plunged by 18.3%YoY. Scale of rebound in industry is suggesting that we are probably dealing with some kind of revival in economic activity. These numbers confirm that our predicted scenario of export-driven recovery begins to materialize.

▪ We are expecting that in Q2 the economic growth accelerated somewhat, to 0.8%YoY (as compared to 0.5%YoY in Q1).

Quote of the week – MPC guilty of budget revision?

Marek Belka, NBP governor, 18.07, Reuters

There are expectations that the economy will be recovering. Some recovery is just around the corner, but it will not be an exceptionally good one (…) the worst is already behind us.

Elżbieta Chojna-Duch, MPC member, 18.07, Reuters

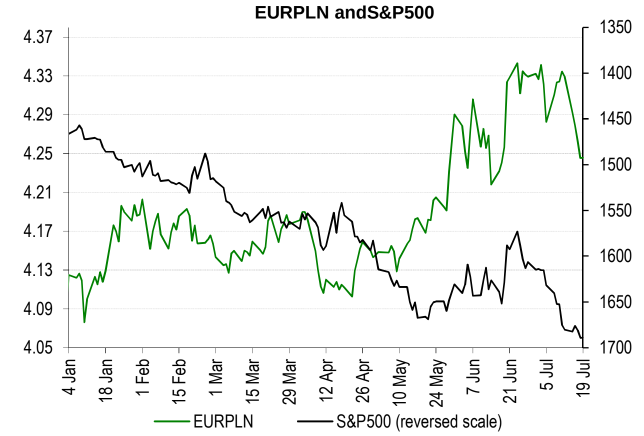
The NBP governor announced that we will not rates until the year-end, as we will be expecting a recovery (…) Thus, we are thinking what can happen in 2015. (…) It seems that recovery is about to come, yet still weak.

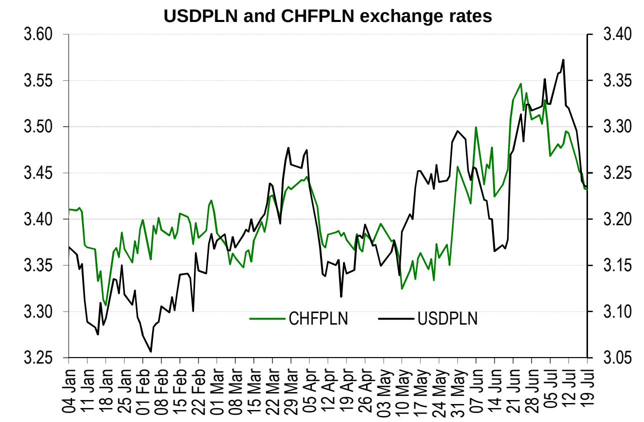
Jacek Rostowski, finance minister, 17.07, Reuters

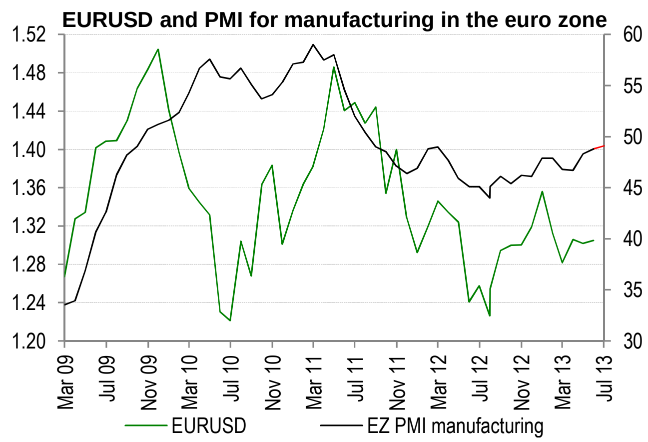
The second factor [undermining budget revenues and causing the budget revision, apart from the crisis in the euro zone] is the insufficient MPC policy, which should have cut rates sooner and deeper.

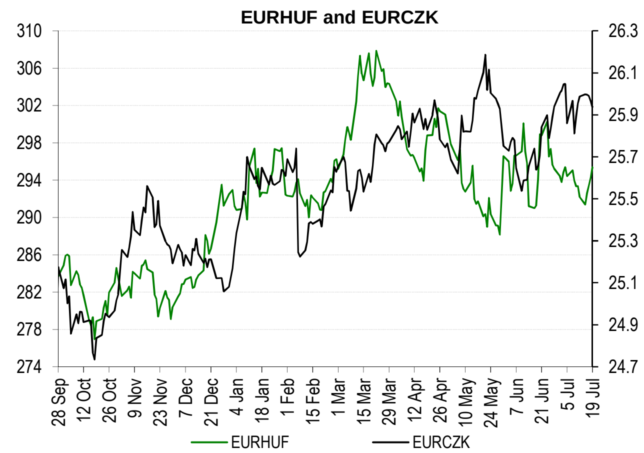
Comments of Marek Belka and Elżbieta Chojna-Duch are confirming that the Council does not want to cut rates any more and is awaiting a recovery, which should provide an impulse to initiate a hiking cycle. Chojna-Duch stated also that hike is more probable in 2Q2014 than in 1Q2014, but we do not think that these words may be treated as an announcement of further moves of the MPC. Minister Rostowski is also awaiting a recovery, as it can improve the budget situation in 2H2013. We agree that the need to revise the budget is partially due to external factors, but in our view blaming the MPC is a bit exaggerated. Even taking into account the delay in cutting cycle, which we underlined repeatedly. It seems to us that the blame is rather to be put on too optimistic macroeconomic budget assumptions.

Foreign exchange market – Zloty driven by domestic and foreign data









Zloty stronger against the main currencies

- Last week brought a gradual zloty strengthening against the main currencies. Demand for domestic currency was supported by „dovish" rhetoric of Fed's governor, but also by better-than-expected domestic data. EURPLN exchange rate easily broke consecutive support levels (including suggested by us 4.26) and temporarily decreased to 4.23 (the lowest level in one month).
- In weekly terms zloty gained by most against the US dollar (2.6%), while in case of other currencies (EUR, CHF, GBP) it strengthened by 1.8% on average.
- Situation on EURPLN chart did not change significantly. The important support level for the rate is at 4.23, but, we think that market needs another crucial factor to break it. This week the last part of domestic macro data for June will be released (retail sales, unemployment rate). It is likely that retail sales reading might be such a factor – we expect some rebound in growth rate to 1.5%YoY, up from 0.5%YoY in May. If our expectations materialize, then EURPLN might break 4.23, which will open the door for further decline towards 4.20. Crucial resistance is at 4.26.

Horizontal trend on EURUSD

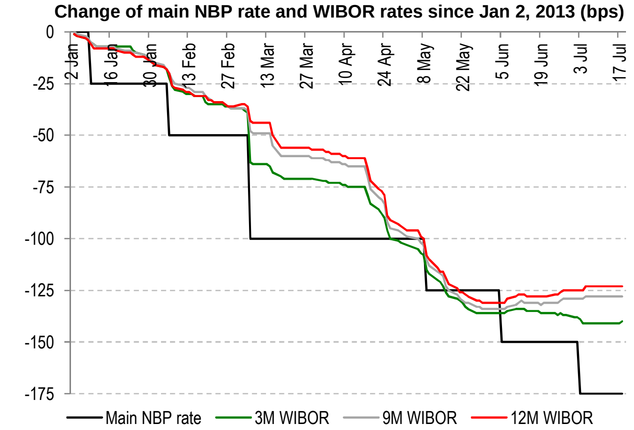
- Last week Fed's governor was in the centre of attention, as he presented his biannual testimony before the Congress. Ben Bernanke reassured markets about plans for ending Fed's policy of easy money, highlighting that it will strongly depend on the US economy conditions. Thus, the risk of tapering asset purchase program in September decreased, supporting the improvement of global market mood. On the other hand, market players nearly ignored information that Moody's rating agency decided to increase the US sovereign outlook to stable from negative. As a consequence the EURUSD was traded slightly above 1.31 at the end of week.
- After recent remarks from the Fed, the market is more aware that any changes in monetary policy will rely on the pace of improvement in the economy. Thus, investors will likely focus on macro releases from the US this week. Data from the euro zone (flash PMI, Ifo) will be also of high importance, but we do not expect them to trigger any breaking changes on the market. We expect the EURUSD to stay in the range of 1.30-1.32.

New plans of Hungarian government hit forint

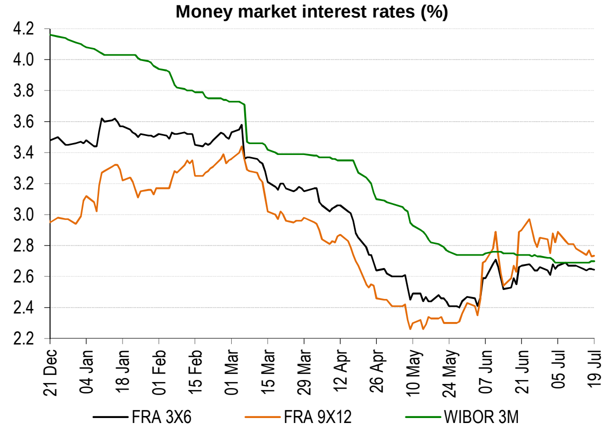
- Forint depreciated versus main currencies during the past week. This was largely driven by announcement made by Hungarian government of plans to further support Hungarian creditors with FX-denominated loans. Consequently, the EURHUF reached temporarily 296 vs. 291 at the beginning of the week. Czech koruna, after weak opening was gaining in the following days – EURCZK declined from 26.04 to 25.9.
- This week meeting of Hungarian central bank is likely to be crucial for forint. The market expects 12th rate cut by 25bps in a row (to 4%) and such a decision should not have much impact on the currency (after June's reduction forint slightly strengthened). However, more ideas to stimulate the Hungarian economy may be negatively interpreted by the market.
- Amid lack of data from Czech Republic, the EURCZK should be hovering around 25.9.

Interest rate market – Situation on Bund market will determine the direction

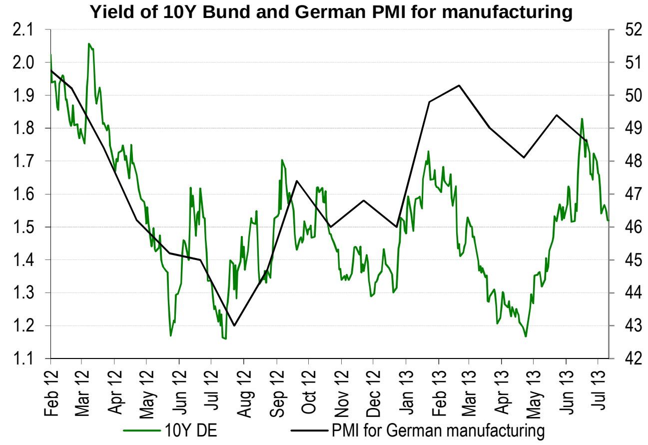
Change of main NBP rate and WIBOR rates since Jan 2, 2013 (bps)



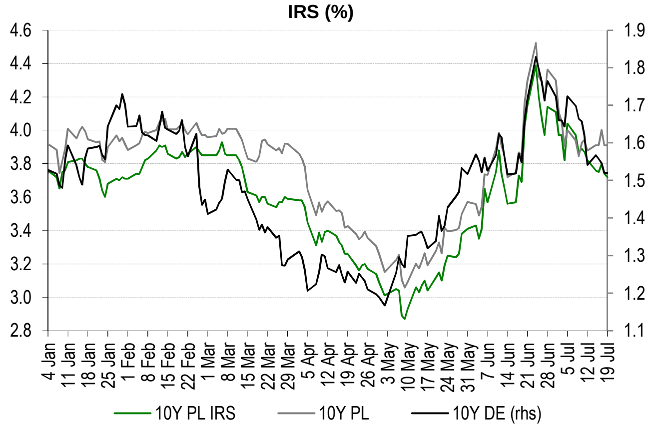
Money market interest rates (%)



Yield of 10Y Bund and German PMI for manufacturing



Yield of 10Y Polish and German bonds and 10Y PLN IRS (%)



WIBOR rates still without big changes

- During the past week only 3M WIBOR out of the 1-12M segment recorded a change, increasing by 1bp. Remaining rates have been stable for already 10 sessions. Last time the 1M WIBOR did not change for longer than 10 sessions in September 2012 and 9M and 12M rates in February 2012.
- We think that given the MPC's announcement of the end of the easing cycle the cost of cash on the interbank market will rather not decline any more. The first chart shows that yet short before June's meeting of the MPC the downward trend of WIBORs halted. Additionally, in the last week some decent macro data were released in Poland and this also should prevent WIBORs from further decline and even initiate some slight increase in coming months. FRA rates price-in stable 3M WIBOR in next 9 months – in line with our forecast.

IRS follow Bund, debt under pressure of amendment

- Strengthening of 10Y Bunds had bigger impact on IRS than on bonds. 2Y, 5Y and 10Y rates declined by 3-8bps, most considerably in case of two last rates. Middle and long term IRS reached lowest levels since ca. mid-June.
- Yields of bonds did not change much on weekly basis. Some pressure on Polish debt was put by the outlook of more debt issuance to cover bigger budget deficit.
- Rise of budget deficit by PLN16bn will raise the gross borrowing needs (at most up to PLN161bn from PLN145bn planned earlier). Taking into account the World Bank loan at the beginning of July, we estimate that gross borrowing needs after amendment will be covered in ca. 82%. Higher needs will be financed both by domestic and foreign issuances. Ministry's liquid financial means denominated in PLN and foreign currencies, worth PLN47.8bn at the end of June, will be limiting the refinancing risk.
- The Ministry of Finance announced it will not conduct the conditional bond auction scheduled for July 23. The Ministry has already suggested earlier that debt supply may be limited in summer months.

Euro zone's and Polish data to determine direction

- This week data on economic activity in the euro zone are due to be released. In recent months PMI for euro zone's manufacturing was rising gradually while in case of Germany (PMI and Ifo) some deceleration of positive tendencies was recorded (confirmed last week also by ZEW). Yield of 10Y Bunds is close to local low from ca. mid-June (1.50%) and data from Europe may determine the direction for coming weeks. Developments on the core debt market will then have an impact on the domestic interest rate market.
- Polish macro data may also trigger some changes. Our forecast of retail sales is above market consensus and the release in line with our expectations may push IRS and bond yields up. On the other hand, on July 25 PLN25bn will inflow on the market from redemption of PK0713 and coupon payments from WZ bond and this may limit the room for weakening.

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