Bank Zachodni WBK

Weekly economic update

5 – 11 August 2013

The uncertainty regarding the tone of the FOMC statement was present on the market since the beginning of the week and resulted in higher volatility of currency exchange rates. Investors hoped that signals from the Fed (and the ECB) will be dovish and their expectations were met. Clearly bigger impact on the market than the central banks' rhetoric was provided by much better than expected July's indices of activity in manufacturing in the euro zone and in the US (ISM highest since June 2011). The increase above even the most optimistic forecasts was recorded also in case of the Polish PMI for manufacturing. Foreign data triggered appreciation of the dollar versus the euro, weakening of the zloty and other CEE currencies and surge of yields of German and US bonds (and consequently also Polish yields - 10Y benchmark reached 4.30%). Earlier during the week, we saw another attempt of EURPLN exchange rate to break the support at 4.20, but due to the above-mentioned releases this was not successful. Monthly US nonfarm payrolls data did not fit the series of optimistic data from the US economy. This fuelled hopes that the Fed will not end QE3 soon and triggered a sudden correction, mainly in the interest rate market.

Last week market attention focused on the US data while in coming days German numbers may be particularly awaited. PMI for manufacturing in the biggest euro zone's economy increased last month to the highest level since January 2012 and this supported market expectations that the broadly expected scenario of economic revival in 2H 2013 will materialise. In data on industrial output and industrial orders, due to be released this week, the market will look for confirmation of signals seen in survey publications on economic activity. Last week the court in Italy confirmed the conviction on tax fraud of Silvio Berlusconi and this issue may become important in European markets. This sentence may shake the coalition governing in Italy. Many FOMC members are due to have a speech this week but only one of them – Charles Evans speaking on Tuesday – has a voting right. Furthermore, his comment should not have much impact on the market given the statement from last FOMC meeting is still fresh.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (5 August)					
9:53	DE	PMI – services	Jul	pts	52.5	-	50.4
9:58	EZ	PMI – services	Jul	pts	49.6	-	48.3
11:00	EZ	Retail sales	Jun	%MoM	-0.5	-	1.0
16:00	US	ISM – services	Jul	pts	53.0	-	52.2
		TUESDAY (6 August)					
9:00	CZ	Industrial output	Jun	%YoY	-2.5	-	-2.2
12:00	DE	Industrial orders	Jun	%MoM	0.9	-	-1.3
		WEDNESDAY (7 August)					
12:00	DE	Industrial output	Jun	%MoM	0.4	-	-1.0
		THURSDAY (8 August)					
	CN	Trade balance	Jul	$bn	26.0	-	27.1
8:00	DE	Exports	Jun	%MoM	0.9	-	-2.4
14:30	US	Initial jobless claims	week	k	335	-	326
		FRIDAY (9 August)					
3:30	CN	CPI	Jul	%YoY	2.8	-	2.7
7:30	CN	Industrial output	Jul	%YoY	9.0	-	8.9
9:00	CZ	CPI	Jul	%YoY	1.6	-	1.6

Source: BZ WBK. Bloomberg, Reuters, Parkiet

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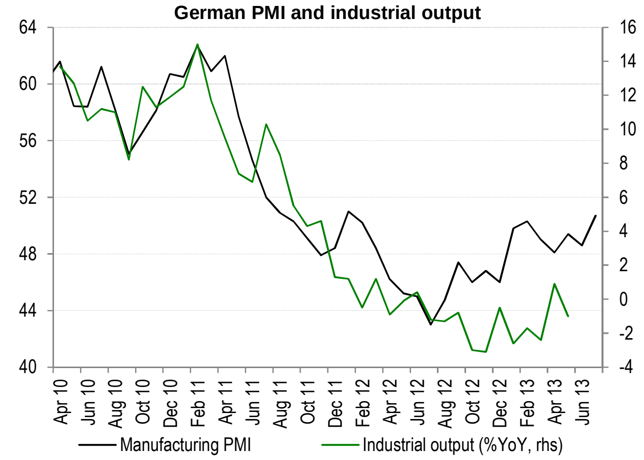
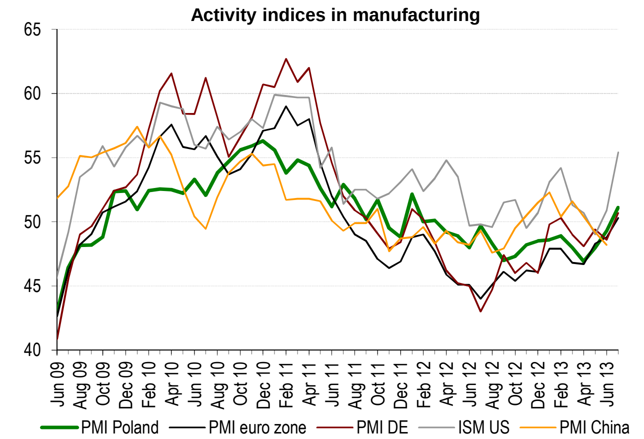
What's hot this week – Will data confirm signals from PMI?

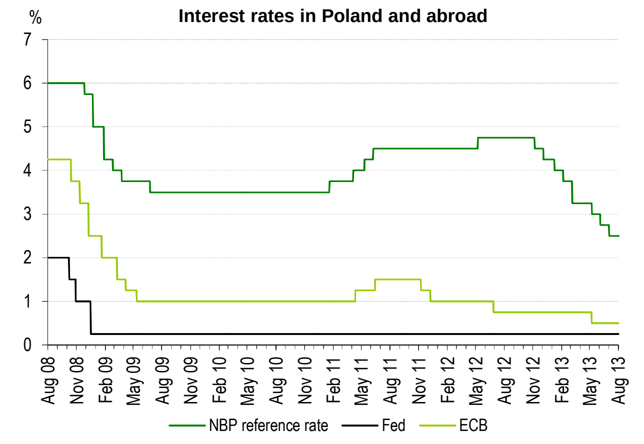


- Similarly as the last week, also the upcoming one will bring a row of data releases important for the assessment of euro zone's economic outlook.
- Positive surprises from manufacturing PMIs (details below) support expectations for decent readings also in services indices. Services PMI for the euro zone did not suggest any revival recently and thus breaking the neutral level of 50pts would be a strong sign of improvement.
- Despite clear increase of PMI, hard data from Germany (industrial output and orders, exports) have rather disappointed recently. The German economy, that has been a driver of revival in the euro zone earlier, recently has decelerated. Therefore, any rebound in the output data would fit the picture of some improvement in the economic outlook.

Last week in the economy – Clear signs of revival in manufacturing



- PMI for Polish manufacturing surged in July to 51.1pts, above even most optimistic expectations (range of forecasts 49.5-50.9pts). Monthly increase and the level reached last month were both the highest since January 2012. In line with our expectations, further improvement was recorded in new orders and new export orders. This resulted in breaking the series of 15 month-long of contraction in output. According to the survey, in July output expanded at the fastest pace since January 2012 and the pace was above the long-term average. On the other hand, employment continued to decline, but at a moderate pace.
- Indices for the US, Germany and the euro zone also surprised to the upside. Four out of eight sub-indices comprising the manufacturing index for the euro zone are already above 50pts and the remaining four are getting closer to this level. This shows the recovery is accelerating.



- The Fed did not change interest rates and keep the size of QE3 unchanged. The tone of the statement was more dovish than the June's one. This suggests the Fed will not taper QE3 soon unless the situation in the economy improves faster than it is currently expected.
- The ECB left interest rates unchanged. Mario Draghi underlined that 0.50% is not the lowest level at which the main refinancing rate might be. This suggestion was coherent with dovish tone of the statement and the press conference. It was claimed for the second time that interest rates will remain at current or lower level as long as needed on condition low expected inflation and slow growth.
- Bank of England and Czech National Bank also kept rates unchanged. During the meeting of the CNB the motion to undertake FX interventions was voted, but did not find support of majority.

Quote of the week – Longer period of stable interest rates ahead

Andrzej Bratkowski, MPC member, 30.07, Reuters

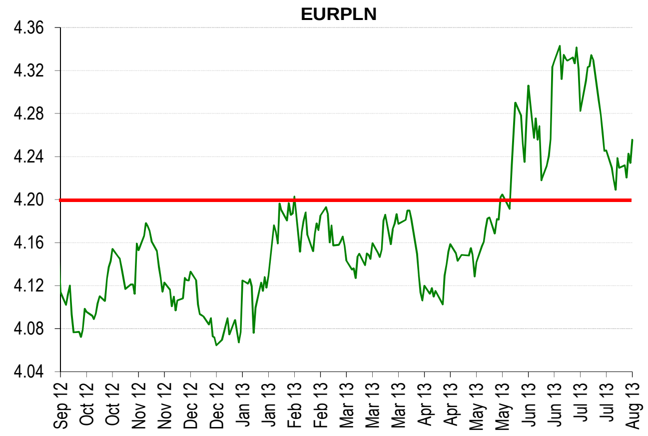
I think that Q2 will be similar to the Q1 as regards economic growth. It does not matter for the monetary policy if the difference will be 0.1-0.2 pp. (…) Q3 will be probably slightly better than Q2 and the economy will be accelerating further (…) Until the end of this term of the MPC, the economic situation will be improving slowly (…) We are entering a longer period of stable interest rates.

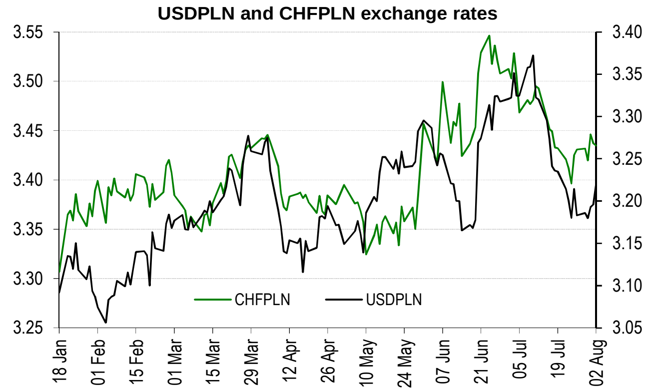
Jan Winiecki, MPC member, 01.08, TVN CNBC

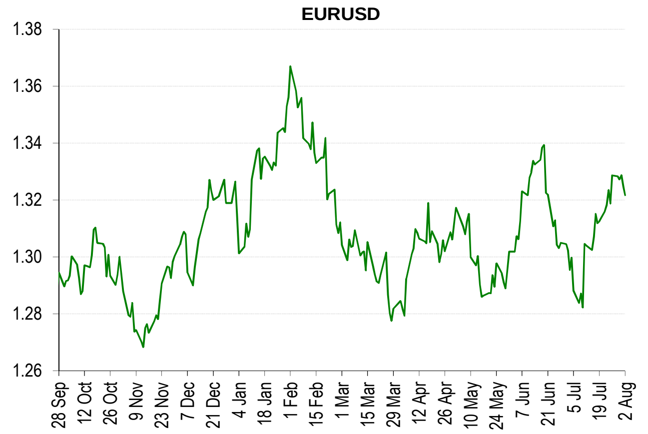
Two-three quarters is a period, when entrepreneurs will be changing their attitude towards investments. Decline of interest rates to all-time lows was not supportive for them, given economic situation.

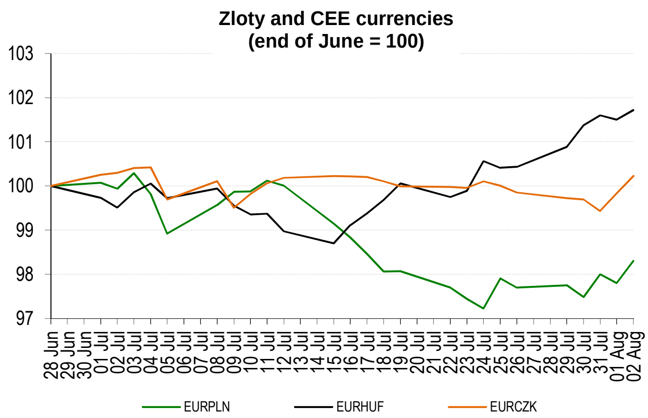
The comment of Andrzej Bratkowski, another one in this tone, confirms that the camp of rate cut supporters is diminishing. According to Bratkowski, rates may remain stable for a longer time. Another MPC member, Jan Winiecki (known for his unwillingness to cut rates) defined the period when interest rates should be stable. Currently, he sees no need to tighten monetary policy and in his view NBP rates may be stable for 2-3 quarters. These comments are supporting our base-case scenario, assuming lack of further interest rate cuts and first hike in ca. one year. Such a scenario is also priced-in by the market.

Foreign exchange market – High volatility, 4.20 strong support for EURPLN









The second test of breaking 4.20 also failed

▪ Zloty strengthened in relations to euro on the wave of optimism ahead of central banks meetings. Consequently, EURPLN tested 4.20, but it did not break this level effectively. All in all the last week of July and the first days of August brought zloty weakening. Zloty's reaction to the main central banks' statements (both Fed and ECB, which at the end were in line with expectations) clearly suggest that positive outcome was pricing-in. As a consequence, market players use the opportunity to take profit. Zloty was more sensitive to PMI figures for July, but a stabilisation of EURPLN near 4.23 was only short-lived. At the end of week the exchange rate again made an attempt to break 4.26 (the upper limit of fluctuation channel), but it failed. Additional factors, which added to zloty weakening was situation in region, in particular the Hungarian forint weakening (see the last paragraph below). The Polish zloty gained after weaker-than-expected non-farm payrolls in the US, trimming earlier losses. At the end of the week the EURPLN declined below 4.24.

▪ Last week the zloty depreciated in relations to the Swiss franc and the US dollar (due to EURUSD decline). Against the latter the zloty lost 1.2% in weekly terms. On the other hand, the zloty slightly gained in relation to the British pound (by 0.4% in weekly terms).

▪ Situation on the EURPLN chart did not change significantly in last week. Fluctuation channel between 4.20-4.26 is still valid for EURPLN. The last changes in the exchange rate clearly suggest that 4.20 has become strong support level. This week there are no important domestic data or events. Therefore, EURPLN will stay under influence of global investors' mood, mainly data releases from Germany and China. Amid low investors activity (due to holiday period), zloty's volatility will probably stay high.

EURUSD moves downward again

▪ The beginning of the week was relatively promising for the euro. The European currency strengthened against the US dollar on the wave of optimism from previous week; EURUSD temporary increased above 1.33. Central banks' decisions were in line with expectations, but better than expected readings from the US economy supported the US dollar. EURUSD stabilised around 1.32, waiting for the US labour market data. Unexpectedly, the figures were weaker than forecasted, which caused EURUSD to increase towards 1.33.

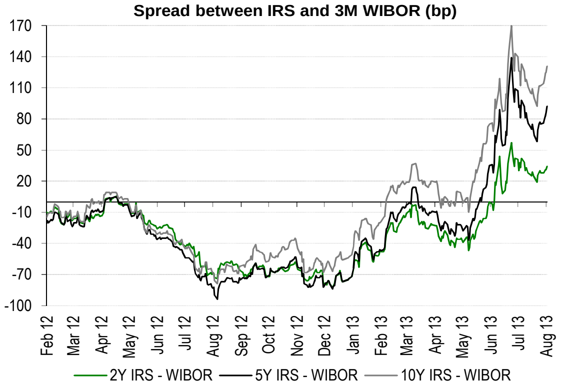
▪ We expect EURUSD to fluctuate between 1.32 and 1.335. Macroeconomic data from Germany, which will be published this week might support upward move of the rate towards the upper limit of fluctuated band.

Relatively weak mood in the region

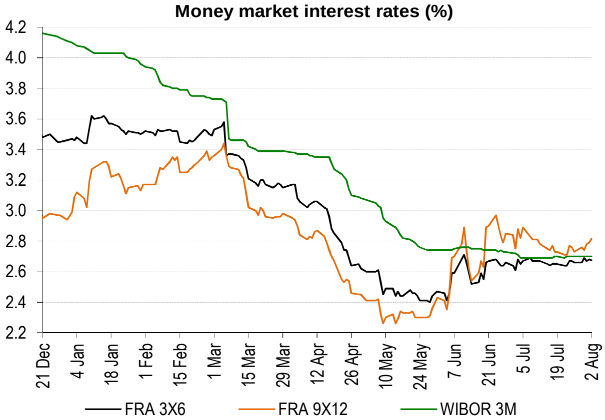
▪ Last week the weakest exchange rate in the CEE3 region was the Hungarian forint. Forint depreciation came from worries about the government's actions concerning foreign currency loans and weaker than expected PMI reading (below 50 pts). Consequently, EURHUF temporary increased above 300 (reaching weekly maximum at 300.5). In the same time the Czech koruna was under influence of outcome after the Czech central bank (CNB) meeting. Information that CNB voted a motion about intervention on the FX market gave impulse to koruna weakening. However, EURCZK increase above 26 was only short-lived and the rate ended the week close to 25.95.

▪ This week forint and koruna, like Polish zloty, will remain under influence of global factor. But July's readings of CPI and industrial output might affect the Czech koruna quotations.

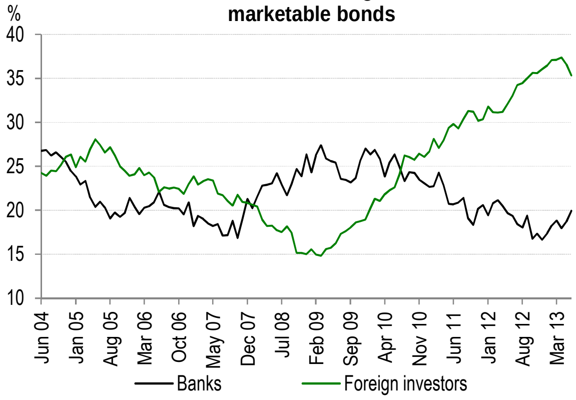
Interest rate market – Continuation of correction, if German data disappoint



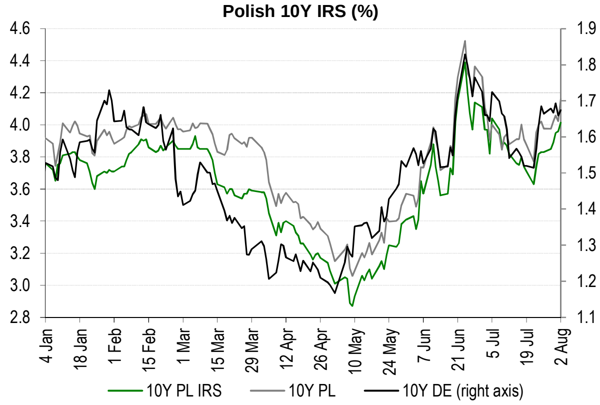
Spread between IRS and 3M WIBOR (bp)



Money market interest rates (%)



Shares of Polish banks and foreign investors in Polish marketable bonds



Yields of 10Y Polish and German benchmarks and Polish 10Y IRS (%)

Still no changes on the shortest curve

▪ The only change, which occurred in WIBORs last week, was a rise of 12M rate by 1bp. Other rates in 1-9M segment were flat. Also in case of FRA more considerable changes took place on the longer end (9x12 up by 9bps, 6x9 by 4bps). This was due to strong weakening of bonds and rise in IRS.

▪ Stabilisation of the shortest FRA rates is suggesting that the market believes in the MPC's declaration that NBP interest rates will fall no more. On the other hand, FRA12x15 at ca. 3% after last week's upward move shows that the market sees risk of the first hike in one year's time (in line with our scenario). We are expecting that another impulse supporting higher FRA can appear in the second half of this month, when new domestic macro data will be released. We think these numbers will underpin expectations for economic revival in H2.

IRS and bond yields go up after manufacturing data

▪ Releases of July's indices on economic activity in manufacturing in Europe and in the USA as well as US monthly labour market data were the main drivers of changes in the Polish bonds and IRS last week. The better-than-expected readings of PMI and ISM triggered the weakening of debt and rise in IRS. Yield of 10Y bond jumped temporarily above 4.30% and of 10Y IRS above 4.10%. This move was not stopped even by dovish statements of FOMC and ECB. Only worse-than-expected US July's non-farm payrolls managed to cause a marked correction by 10bps on the longer end of curves. Shorter end was doing quite well throughout the week, which resulted in a considerable steepening of bond and IRS curves. 2-10Y spread rose from 117 to 136bps and from 84bps to 97bps, respectively.

▪ Data from the Ministry of Finance showed that in June foreign investors reduced their holdings of Polish zloty-denominated marketable bonds by over 2.5%MoM to PLN201.8bn. This is the lowest level since January 2013 and was mainly due to selling of Polish government debt by non-bank financial sector (-PLN6.1bn). Domestic banks increased their engagement by over PLN8bn, which is the strongest nominal monthly increase since February 2012. Other domestic holders (among others, pension funds and mutual funds) did not change their holdings significantly.

▪ The director of Debt Department in the Ministry of Finance, Piotr Marczak, said that June's outflow has been more than offset in July. He added that higher borrowing needs (due to budget amendment) will be covered with currencies collected by the Ministry (at the end of July the Ministry held PLN48bn liquid means in domestic and foreign currencies), loans from foreign institutions and possible debt sale on the foreign market. Domestic auctions will depend on market conditions.

▪ On Monday the ministry will announce whether the conditional auction scheduled for Wednesday will be held. After sudden surge of yields observed in recent days it should not be surprising if no new debt is issued this week (unless the correction initiated after US nonfarm payrolls intensifies).

Watch for next German data

▪ This week next data from Germany are due to be released. Hard data from biggest euro zone's economy have rather disappointed in recent months. After strong signals from the past week, the market will want to see a confirmation that situation in the German economy is improving in second half of the year, as suggested by PMI readings. However, if data disappoint again, then there will be room for continuation of the correction initiated at the end of the past week.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Rates Area, Economic Analysis Department, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl