Bank Zachodni WBK

Weekly economic update

9 – 15 September 2013

Wednesday was a breaking day for Polish market when PM Donald Tusk announced changes in functioning of private pension funds (OFE). Transfer of the debt assets from OFE to public social security fund (ZUS) and voluntariness of paying future contributions to OFE triggered massive sell-off on Warsaw Stock Exchange and sharp weakening of domestic bonds. Market participants worried that second biggest player (after foreign investors) on the debt market will disappear which will trim liquidity. Decline of stock prices (WIG20 was temporarily recording a nearly 10% of 2-day drop) was driven by risk that OFE will now have smaller buying power on the stock exchange (it is unknown how many people will decide to stay in private pension funds, additional uncertainty regarding the gradual transfer of funds from OFE to ZUS 10 years prior to reaching a retirement age). Lack of details of presented changes was surely also one of factors fuelling selling of assets. Only after these sudden movements the Ministry of Finance presented estimates of expected net effect on inflow of funds from OFE to the stock market next year. Developments on bond and stock markets put visible pressure on the zloty – EURPLN temporarily broke 4.31.

Meetings of the MPC and the ECB did not bring any new information. The MPC included in the statement a verbal declaration from July (and repeated several times by its members in recent weeks) that interest rates will remain unchanged at least until the year-end. The ECB maintained dovish tone of its communiqué and forward guidance that interest rates will remain at current level or lower as long as necessary. Data from the US labour market proved weaker than expected and tamed worries that at the nearest meeting FOMC will start withdrawing monetary stimulus. This triggered a recovery on domestic debt and interest rate markets.

This week will see a start of new domestic macro releases. Balance of payments data should be positive for the zloty, while inflation (provided that it does not surprise) will be rather neutral for interest rates market. In the upcoming days the US Congress will vote on the support for intervention in Syria and this issue may be again the key driver of global sentiments. One week ahead of the Fed meeting, expectations about its decision may come to the fore. US macro calendar is light, but the market may be speculating about impact of weaker labour market data and possible intervention in Syria on possible delay in decision about QE3 tapering. This can be supportive for the core debt markets and for the domestic debt market.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (9 September)					
9:00	CZ	CPI	Aug	%YoY	1.4	-	1.4
		TUESDAY (10 September)					
7:30	CN	Industrial output	Aug	%YoY	9.9	-	9.7
		WEDNESDAY (11 September)					
9:00	HU	CPI	Aug	%YoY	1.6	-	1.8
14:00	**PL**	**Exports**	**Jul**	**€m**	**13 000**	**13 240**	**12 735**
14:00	**PL**	**Imports**	**Jul**	**€m**	**12 678**	**12 696**	**12 174**
14:00	**PL**	**Current account**	**Jul**	**€m**	**58.0**	**58.0**	**574**
		THURSDAY (12 September)					
11:00	EZ	Industrial output	Jul	%MoM	0.3	-	0.7
14:30	US	Initial jobless claims	week	k	330	-	331
		FRIDAY (13 September)					
14:00	**PL**	**CPI**	**Aug**	**%YoY**	**1.1**	**1.1**	**1.1**
14:00	**PL**	**Money supply**	**Aug**	**%YoY**	**6.3**	**5.9**	**6.5**
14:30	US	Retail sales ex autos	Aug	%MoM	0.3	-	0.5
15:55	US	Flash Michigan	Sep	pts	82.0	-	82.1

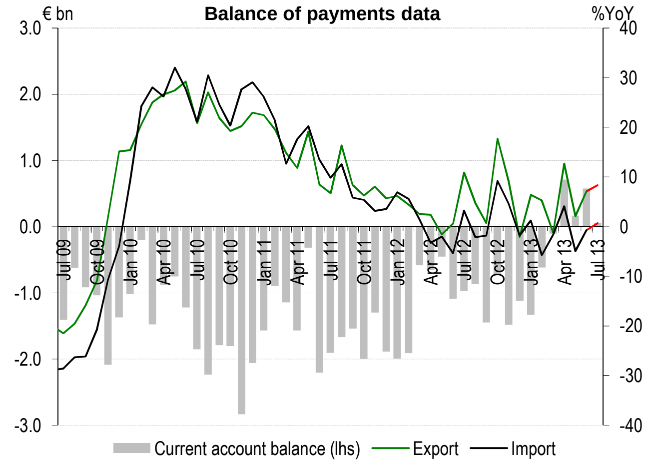
Source: BZ WBK. Bloomberg, Reuters, Parkiet

Maciej Reluga Chief economist +48 22 586 8363 e-mail: ekonomia@bzwbk.pl

Piotr Bielski +48 22 586 8333 **Marcin Sulewski** +48 22 586 8342

Agnieszka Decewicz +48 22 586 8341 **Marcin Luziński** +48 22 586 8362

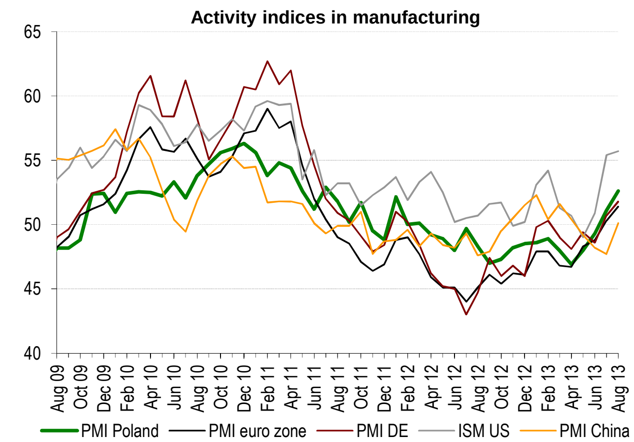
What's hot this week – Stable inflation, strong exports



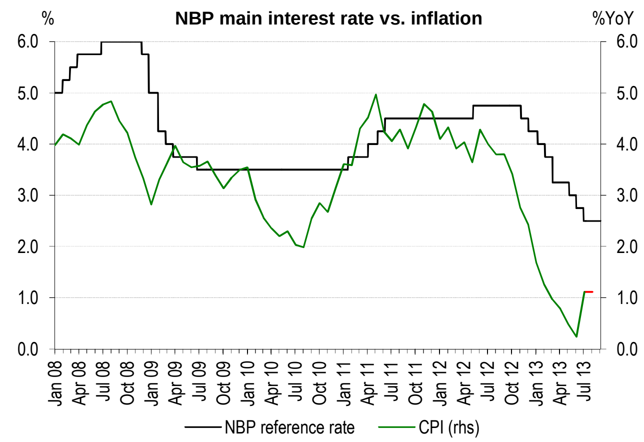
▪ In our view, Wednesday's data on balance of payments will be a positive signal, showing that Polish economy is rebounding. Information about further acceleration of exports and fourth in a row month of surplus in current account should, at least temporarily, help in recovering after recent significant correction on the FX market.

▪ After strong surprise with July's CPI, investors will take under scrutiny August's inflation numbers. Change in the CSO' methodology for seasonal prices generates some risk for another surprise this month. Still, our forecast and market consensus are suggesting a stabilization of CPI growth at July's level, i.e. 1.1%YoY. Apart from seasonal decline of food and clothing/footwear prices, prices of other goods and services should remain rather unchanged, in our view.

Last week in the economy – PMI surprised, while the MPC did not



▪ PMI for Polish manufacturing increased in August much more than expected, to 52. Thanks to fourth increase in a row, the index reached the highest level since July 2011. The biggest impact on further improvement was put by rising output (strongest gain since April 2011), orders (rose at the fastest pace since March 2011, including exports orders which increased by most since April 2011) and employment (first increase in 11 months). Data show that the widely expected scenario of economic recovery in 2H is actually materializing. Improvement seen abroad is beginning to be accompanied by rebound on the domestic market (orders and employment). We expect that further acceleration of growth of our main trading partners will encourage Polish entrepreneurs to increase employment. After PMI data we see some upward risk to our forecast of August's industrial output – lowest on the market according to Parkiet Daily survey (0.5%YoY).



▪ MPC kept the interest rates unchanged and decided to include in its official statement a declaration stating that interest rates may remain on hold at least until the year-end. This means that really exceptional circumstances would be needed to trigger change in Polish monetary policy before the end of December. Our base-case scenario assumes stable interests rates until mid-2014, which is roughly in line with scenario priced-in by the money market.

▪ Government's proposal of OFE overhaul assumes that bond part of portfolio (51.5% of total assets) will be transferred to ZUS and fund members will have choice about destination of their future contributions – they can go either to OFE or to ZUS. Assets of these people, who have 10 years left to pension age, will be gradually transferred to ZUS. OFE will be prohibited to invest in domestic T-bonds, but will be free to invest in foreign bonds.

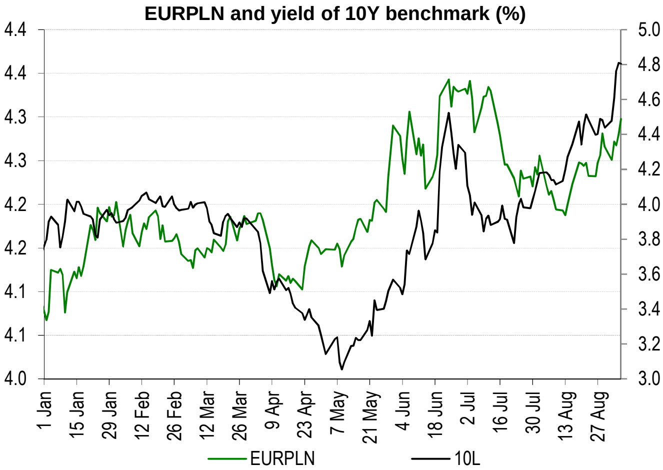
Quote of the week – OFE will be benefactors of net inflows in 2014-2015

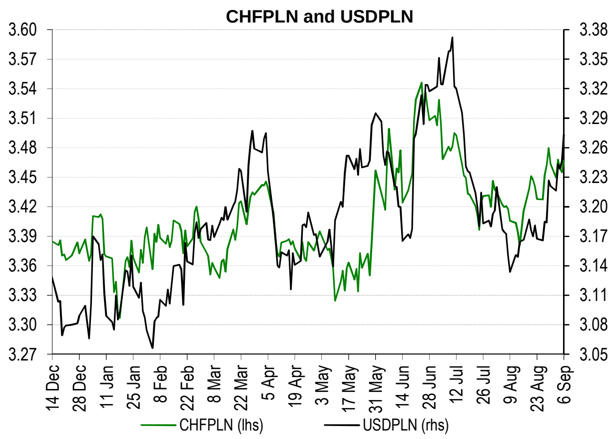
Wojciech Kowalczyk, deputy finance minister, 06.09, RTRS

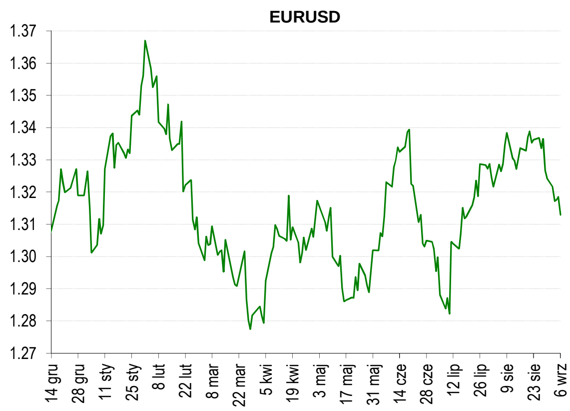
After 51.5% of OFE's assets will be transferred to ZUS in 2014, the prior-to-retirement transfers from OFE to ZUS will amount to ca. PLN4.4bn. This number will amount to PLN2.3bn in 2015, according to our estimates. Until mid-2014 there will be no changes, so OFE will surely acquire PLN6bn [out of PLN12bn of OFE contribution]. In mid-2014 fund members will be making their choice. If 50% decide for OFE, then the whole inflow to funds will amount to PLN9bn, so more than prior-to-retirement outflow. [In 2015] if 50% choose OFE, then contribution inflow will amount to PLN6bn and prior-to-retirement outflow to PLN2.3bn. Thus, OFE will be benefactors of net inflows in 2014 and 2015.

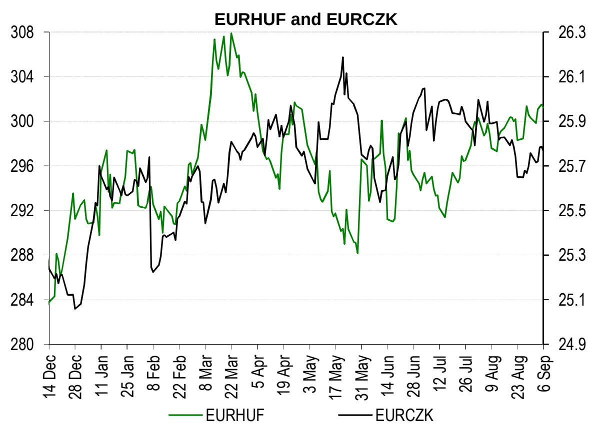
According to words of deputy finance minister Kowalczyk, in 2014 and 2015 OFE will be still receiving net inflows of cash. In 2014 this position is not threatened (as bill will come into force in the middle of the year), but inflow of contributions in 2015 and in the following years will depend on the share of fund members, who decide to stay in OFE. Opinion polls suggest that this may by 50-60%. However, we think that 20-30% is a more probable number. If our expectations come true, then in the following years outflow from OFE will be higher than inflow of contributions, which can translate into negative impact on the equity market. Let us remind that the same effect would take place even without the reform, but later, as OFE would be selling stocks in order to pay out pensions.

Foreign exchange market – Zloty under pressure until US data release









Slight strengthening after weaker data from the US

▪ Last week the zloty remained under strong pressure. This was due to a couple of factors, including: (1) bond and equity market turmoil due to government's announcement of changes in OFE; (2) rising expectations that Fed will taper QE3 already this month (due to better US figures); (3) situation in Syria, as US military attack on this country is still possible. A combination of these factors pushed EURPLN temporarily above 4.30. Prior to data from the US labour market EURPLN stabilized close to 4.295. The weaker-than-expected reading from the US labour market was an impulse for zloty strengthening, so EURPLN slid below 4.28.

▪ In course of the week the zloty lost most considerably in relation to pound (2.15%) and dollar (1.62%). The zloty lost less considerably against the franc (only 0.12%). Loss versus the euro amounted to 0.75%.

▪ Scale of the zloty depreciation versus the single currency was not that significant, taking into account the massive sell-off on the Warsaw Stock Exchange and scale of rise in yields of 10Y bond. Prior to auction of T-bonds the state-owned BGK bank appeared on the market, which suggests that reaction of FX market was limited due to this factor. No important changes occurred on the EURPLN chart. 4.30 is still a strong resistance, effectively preventing the rate from further rises. Currently there is a strong support at 4.25. As regards data due for release this week, balance of payments will be most important. Surplus in trade will be supportive for the zloty.

Macro data supporting the dollar

▪ Inflow of increasingly good data from the US economy fuelled expectations that FOMC will declare the beginning of QE3 tapering at its meeting in September (17-18). This, combined with still dovish ECB statement, caused a weakening of the single currency. In due course, prior to US monthly labour market data EURUSD approached 1.31 after breaking support at 1.32. These data proved weaker than expected, which was a support for the euro. EURUSD climbed to 1.315.

▪ Despite weaker reading of US labour market data, expectations that the Fed will start QE3 tapering already this month are still in place. Incoming macro data will be interpreted in their relation to further Fed actions. Expectations about results of Congress vote about Syria may stabilize EURUSD close to support at 1.31.

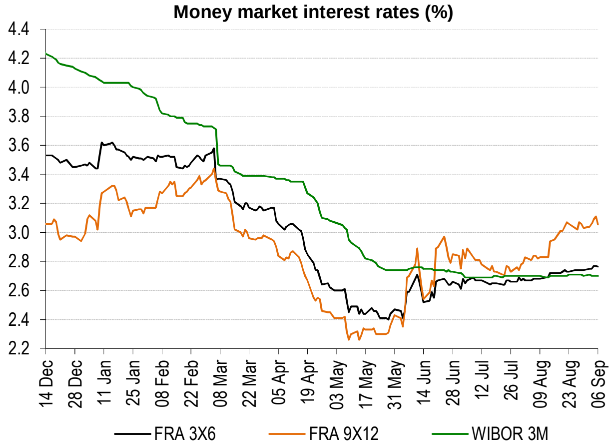
Czech koruna stable in uncertain period

▪ During the past week Czech koruna was the most stable currency in the CEE3 region. EURCZK hovered in the range of 25.45-26.1 while forint – just like the zloty – was under pressure. Hungarian currency was hit, next to global factors, also by domestic events. EURHUF approached a peak from the previous week (303.3) after head of Fidesz ruling parliamentary group said that if banks do not show their solution to situation with FX loans until the beginning of November, then the Hungarian government will implement its own plan.

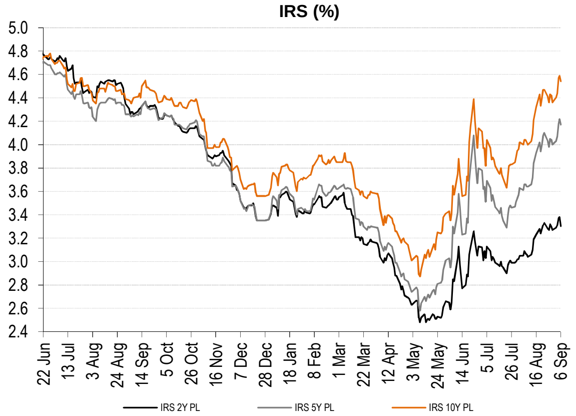
▪ Uncertainty on the market shall persist. EURCZK is likely to stay in the range of 25.45-26.1, forint may be more volatile. Level of 303 may be tested again.

Interest rate market – Chances for a rebound

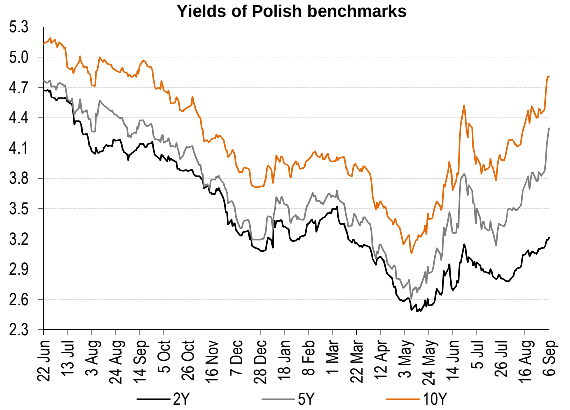
Money market interest rates (%)



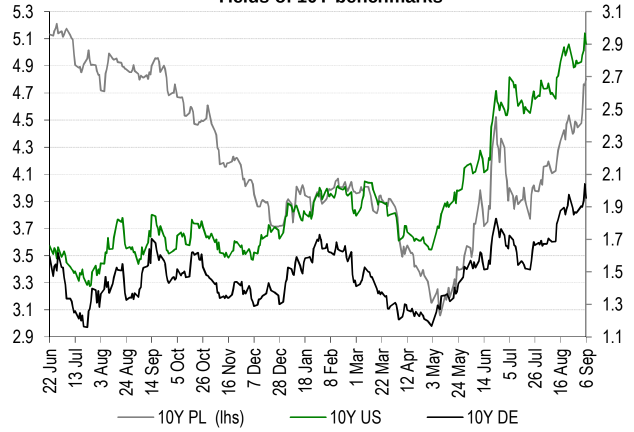
IRS (%)



Yields of Polish benchmarks



Yields of 10Y benchmarks



WIBOR rates still without big changes

▪ 1-12M WIBOR rates did not change on weekly basis. It seems the market believes the MPC that interest rates will remain unchanged until the end of the year. On the other hand, room for a decline is limited by next strong data showing a recovery in the economy.

▪ Longer FRA reacted to clear increase of IRS and weakening of bonds. 6x9 and 9x12 increased by 5bp and 8bp, respectively.

OFE overhaul push IRS upwards and weigh on bonds

▪ The debt market reacted negatively to proposed OFE overhaul, assuming that the second biggest buyer of government bonds will vanish. Prospect of lower liquidity triggered a massive sell-off of bonds. Yield of 10Y bond rose temporarily to almost 5.0%, i.e. by 55bp higher than last week's close. On Friday in the afternoon we saw some rebound after weaker-than-expected data on US employment.

▪ 5Y yield climbed by ca. 40bp, 2Y yield by ca. 10bp. 2-10 spread widened by ca. 30bp – from 133 to 165bp. Correction on the domestic market was backed also by strong rise in core debt yields.

▪ IRS rates also posted considerable gains, yet lower than bond yields – 10bp for 2Y (this swap reached the highest level since March) and ca. 20bp for 5 and 10Y (first one was at the highest level since September 2012, the second one since July 2012). At the end of the week a correction took place, but still 2Y IRS is 80bp above all-time low from May, while 5 and 10Y are 160-170bo above.

▪ Finance Ministry sold yesterday OK0116 bond worth PLN2.8bn by demand at PLN6.2bn and yield 3.474% and PS0718 worth PLN2.9bn by demand at PLN3.5bn and yields 4.219%. Yields were above secondary market levels. In total debt worth PLN5.7bn was sold, while offer was planned at PLN5-7bn. After yesterday's auction gross borrowing needs for this year (PLN166.4bn after revision) are covered in 86%.

Moderate rebound possible

▪ Last week saw very high volatility in the domestic fixed income market. Such strong changes were possibly partially due to activation of stop-loss orders and general panic on the market. Also the strong sell-off in core debt markets is to blame. After so strong movements one can expect that at some point of time the market will stabilize and reverse a part of these changes. This can be triggered by lower worries about tightening of Fed monetary policy due to weaker data on US employment. One week ahead of the FOMC meeting, expectations about QE3 may come to the fore. US macro calendar is light, but the market may be speculating about impact of weaker labour market data and possible intervention in Syria on delay in decision about QE3. This can be supportive for the core debt markets and for the domestic debt market.

▪ After strong sell-off of bonds, OFE may be interested in buying them, as they have to remember that they will have to keep an adequate level of T-bonds in 51.5% of their assets eligible for transfer to ZUS.

▪ Even though Moody's and S&P rating agencies stated that changes in OFE will be neutral for Polish rating, global investment banks are perceiving the government's decision as unfavourable. This is suggesting that potential for a more marked rebound seems limited.

This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. Information presented in the publication is not an investment advice. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Forecasts or data related to the past do not guarantee future prices of financial instruments or financial results. Bank Zachodni WBK S.A.. its affiliates and any of its or their officers may be interested in any transactions. securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.
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