

Weekly economic update

23 – 29 September 2013

As we expected, domestic data releases remained in the background last week, as all investors were awaiting FOMC meeting. The Fed's decision to continue pumping money into the US bond market at a pace of \$85bn per month proved to be a big surprise. It gave a strong, yet short-lived impulse for gains in world equity markets, strengthening of bonds and appreciation of emerging markets' currencies. Nevertheless, investors are aware that QE3 tapering will probably take place, sooner or later. Thus, publications of next macro data from the USA, or comments of Fed officials (there is plenty of them in this week's agenda) may have significant impact on market moods in coming days. Risk appetite may well disappear should the data confirm that economic recovery is gaining strength or central bankers' comments suggest that "QExit" will start soon anyway. Another risk factor is the US debt ceiling (negotiations on rising debt limit stalled) and possible consequences of parliamentary election in Germany. Although no breakthrough change in German political scene is expected (Angela Merkel likely to remain the Chancellor for the third term), but the election result may determine the shape of ruling coalition and thus the shape of German policies in various important matters (incl. support for indebted countries). Domestic events will remain in the background. We expect to see stabilisation of Polish unemployment rate in August at 13.1% and some slowdown in retail sales growth (to 2.5%YoY). Nevertheless, these data are not likely to change expectations regarding economic scenario for Poland.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (23 September)							
3:45	CN	Flash PMI – manufacturing	Sep	pts	50.9	-	50.1
9:28	DE	Flash PMI – manufacturing	Sep	pts	52.0	-	51.8
9:58	EZ	Flash PMI – manufacturing	Sep	pts	51.6	-	51.4
TUESDAY (24 September)							
10:00	PL	Retail sales	Aug	%YoY	2.8	2.5	4.3
10:00	PL	Unemployment rate	Aug	%	13.1	13.1	13.1
10:00	DE	Ifo index	Sep	pts	108.0	-	107.5
14:00	HU	Central bank decision		%	3.60	-	3.80
15:00	US	S&P/Case-Shiller home price index	Jul	%MoM	0.8	-	0.9
16:00	US	Consumer confidence index	Sep	pts	80.3	-	81.5
WEDNESDAY (25 September)							
11:00	PL	Bond switch auction					
14:30	US	Durable goods orders	Aug	%MoM	-0.1	-	-7.4
16:00	US	New home sales	Aug	k	425	-	394
THURSDAY (26 September)							
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Final GDP	Q2	%YoY	2.7	-	1.1
14:30	US	Initial jobless claims	week	k	-	-	309
16:00	US	Pending home sales	Aug	%MoM	-1.0	-	-1.3
FRIDAY (27 September)							
14:30	US	Personal income	Aug	%MoM	0.4	-	0.1
14:30	US	Consumer spending	Aug	%MoM	0.3	-	0.1
14:30	US	Core PCE	Aug	%MoM	0.1	-	0.1
15:55	US	Michigan index	Sep	pts	78.0	-	82.1

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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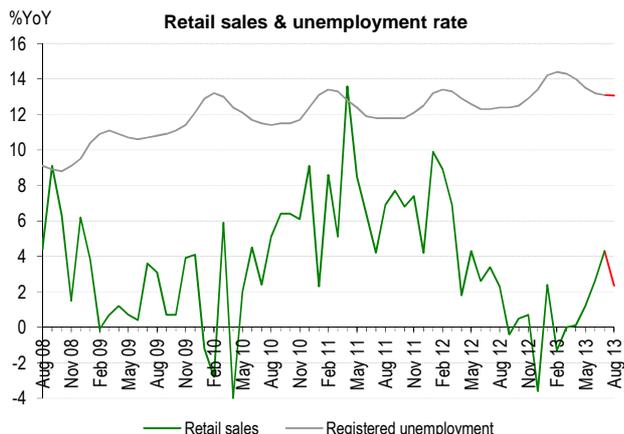
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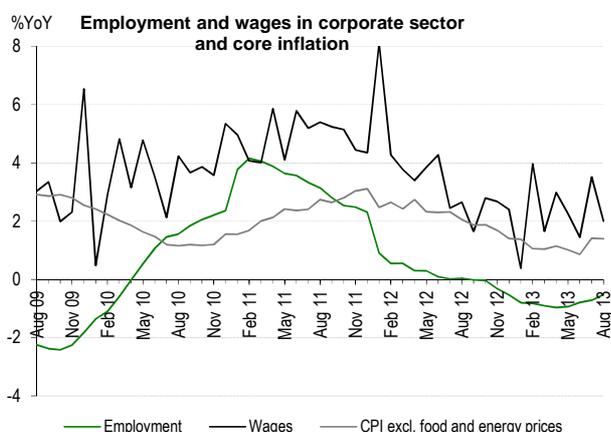
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What's hot this week – Another positive surprise from the labour market?

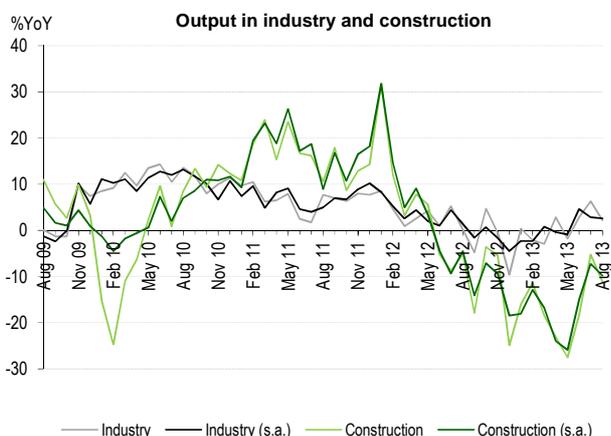


- After several months of decline, unemployment rate is expected to stabilise at 13.1% in August (our forecast is the same as market consensus). However, the Ministry of Labour is slightly more optimistic and estimates it may drop to 13.0%. After better than forecast data about corporate employment, chances for next positive surprise from the labour market have increased.
- Retail sales growth probably slowed down in August, after exceptionally fast growth recorded in July. This was suggested, among others, by SAMAR data about number of new car registrations. Still, our forecast still represents a decent increase in sales, reflecting gradual recovery of private consumption demand in Q3.
- More important than domestic data, which are not likely to change outlook for Polish economy, will be data releases abroad and results of German election.

Last week in the economy – Employment bottoming out, no sign of wage pressure



- Pace of employment contraction decelerated in August more than expected, to -0.5%YoY, but on the other hand, wage growth disappointed showing only 2%YoY. Another positive surprise from the employment data confirms our view that negative trends on the labour market are reversing and further improvement should be expected amid continuation of the economic recovery. Still, companies seem to be reluctant in rising wages, which means there is no threat of rising inflationary pressure.
- Lack of inflationary pressure was confirmed by core inflation data. Main measure (CPI excluding prices of food and energy) reached 1.4% in August (the same as in July), while other measures declined slightly (by 0.1pp). PPI growth remains below zero (-1.1%YoY in August), reflecting lack of cost pressure on producers.



- Pace of growth of industrial output decelerated in August to 2.2%YoY, but this was mainly due to seasonal factors (working days effect). The release was above our forecast, but we saw an upward risk after data on PMI for manufacturing and production of autos (indeed, this sector showed the highest pace of growth). Construction-assembly output was roughly in line with expectations (it contracted by 11.1%YoY). We expect further improvement of economic situation will take place in September, which will be additionally supported by positive working days effect. Consequently, 2Q13 will show a considerable acceleration of pace of GDP growth (to ca. 1.5%YoY).
- Indices of consumer climate showed continuation of upward trend in September. Both current and leading indicators soared to highest levels since October 2011.

Quote of the week – It is very likely we will do nothing until the middle of next year

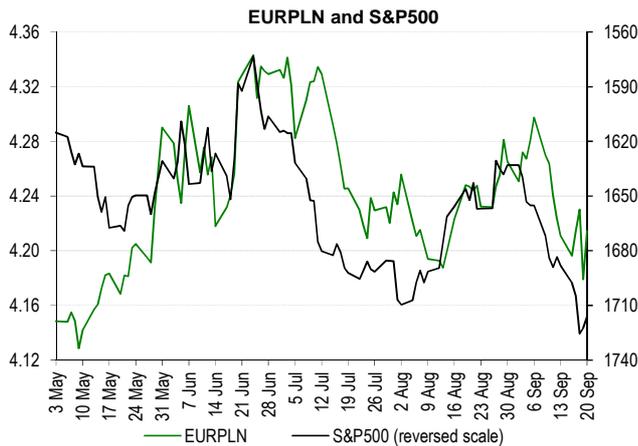
Andrzej Bratkowski, MPC member, 19.09, PAP

In fact it is obvious that we will do nothing (with interest rates) until year-end. I think it is very likely we will do nothing until the middle of next year. At there is some probability that also in the second half (of 2014) we will do very little, or nothing. In my opinion there is higher probability of rate hike in 4Q2014 than in 3Q. I would attach 50% probability to the scenario when we do not change interest rates until the end of next year.

Jacek Rostowski, finance minister, 19.09, Reuters

There is still room for interest rate cuts; it results from significant reduction of structural (fiscal) deficit.

The finance minister's opinion that there is still room for interest rate cuts in Poland is currently rather isolated. The time horizon of Polish MPC's version of "forward guidance" is currently quite short (pledge to keep rates on hold until the end of this year), but recent comments of some MPC members, including the latest from Bratkowski, are suggesting that some of them see chances for longer stabilisation of monetary policy parameters. In our view, the Council may extend the scope of rate stability in November, after receiving the update of NBP projections. We still expect that the first rate hike will take place in mid-2014, when inflation returns to 2.5% target, while signals of economic recovery keep strengthening.

Foreign exchange market – Fast correction after the Fed, market waits for news from Germany and Italy**Strong appreciation and fast correction of the zloty**

▪ Range trading of the zloty's exchange rate was pretty wide last week – it reached PLN0.08-0.09 in case of EURPLN and CHFPLN and PLN0.11-0.13 for USDPLN and GBPPLN. During first days of the session the zloty was under pressure due to nervousness before the Fed decision and weakening of Polish bonds. EURPLN broke 4.23 temporarily. Decision on leaving the size of QE3 unchanged had clear positive impact on the zloty – EURPLN plunged very fast to nearly 4.14. However, a correction was observed in the following days and the zloty pared all gains versus the euro recorded thanks to the Fed.

▪ EURPLN again did not manage to stay below 4.20 for longer. Some time ago we argued that this level – that has been preventing the zloty from any bigger depreciation for 10 months until June – may now be quite strong support that will not be broken for good easily. First attempt to do this – in mid-August when EURPLN temporarily declined to 4.18 – ended with a rebound above 4.31.

▪ Though we expected even before that EURPLN will decline below 4.20 in 4Q, now it seems that the path for this exchange rate for coming months may be even below our forecast (average EURPLN at 4.20 in 4Q). However, it is worth to remember that in the past market attention switched rather quickly from important Fed decisions to euro zone's debt crisis. And here we have political crisis in Italy still unresolved (last week one of Italian Senate's committees rejected the motion for halting the debate on Berlusconi's expulsion from the parliament and now the discussion may be held in the whole Senate) and we are awaiting results and consequences of parliamentary elections in Germany (September 22).

▪ Due to high volatility observed last week, range trading for the EURPLN is now quite wide (4.14-4.25, next resistance at 4.31).

Euro gains thanks to Fed

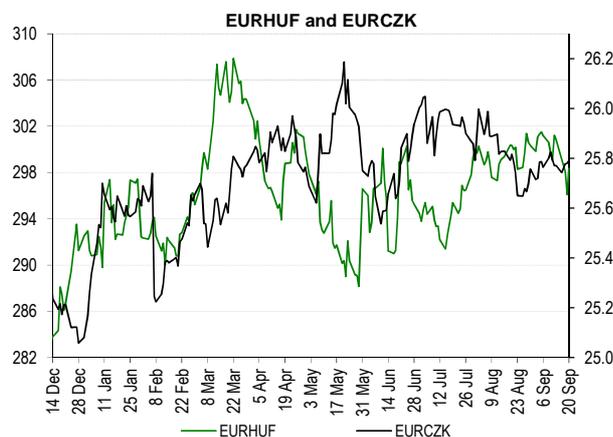
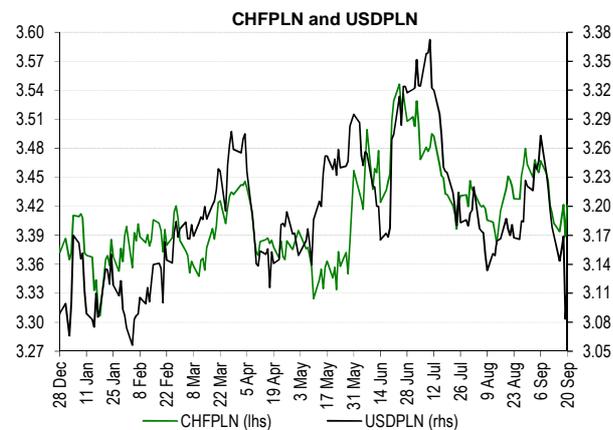
▪ High volatility was recorded also in case of EURUSD. The exchange rate was rising gradually since the beginning of the week. The closer was the Fed's decision, the narrowest was the range trading. This led to the situation, when starting from Asian session until the end of European session, the range trading for EURUSD rate was the narrowest since July 2007 (according to Reuters, excluding 1 Jan 2010 and 25 Dec 2007). Fed's decision ended this stabilization – EURUSD surged from 1.335 to 1.36.

▪ This week as much as five voting Fed members will give speeches. Together with results of German parliamentary elections this may have a visible impact on the market. Additionally, we have rich calendar of US data publications that may change market expectations regarding future Fed's actions.

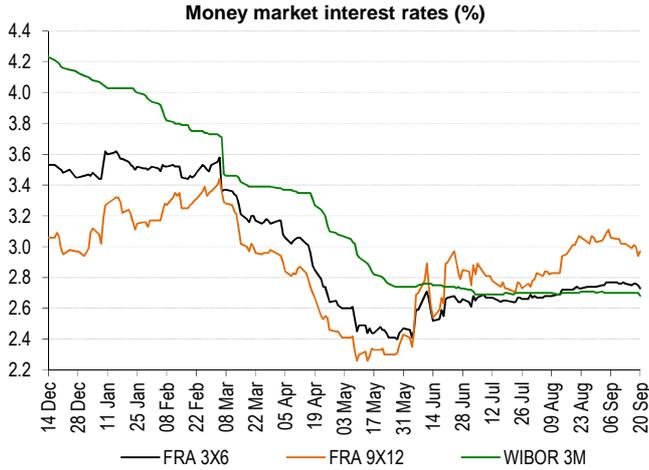
EURHUF and EURCZK follow wide markets

▪ Reaction of forint and koruna to Fed's decision was similar to what happened on the Polish FX market. EURHUF plunged to 294.3 and EURCZK to 25.68 only to rebound amid world-wide correction. EURHUF approached 300 while EURCZK broke 25.8.

▪ Next to global events (comments of Fed members, news from Italy and results of German elections) also domestic factors may prove important as Czech and Hungarian central banks have meetings. In case of CNB, investors will try to assess the risk of FX intervention while regarding the MNB, the fact whether it sees room for further easing will be most important.



Interest rate market – High volatility may persist

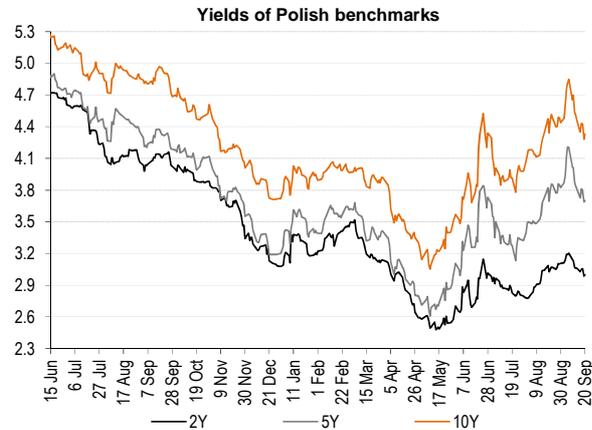
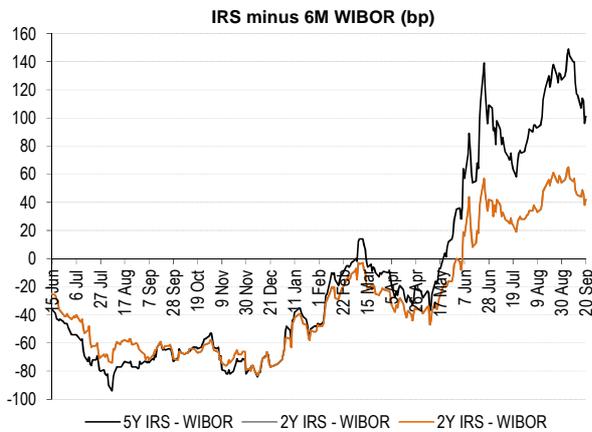


Slight decline of WIBOR and FRA...

- Stabilization period of 1-12M WIBOR rates was interrupted during the past week. 3M rate declined by 2bp, remaining ones by 1bp. Some impact on this market might have been provided by Fed's decision, meaning continuation of liquidity supply at current level. However, the scale of a decline was limited and it seems the rhetoric of the MPC is still crucial factor for this market.
- High volatility of IRS and bond yields had an impact on FRA rates – a decline by 2-6bp on weekly basis was recorded.
- This week data on domestic unemployment rate and retail sales in August is due to be released. We do not think they will change the outlook for monetary policy. FRA may still react to changes on the IRS and bond curves.

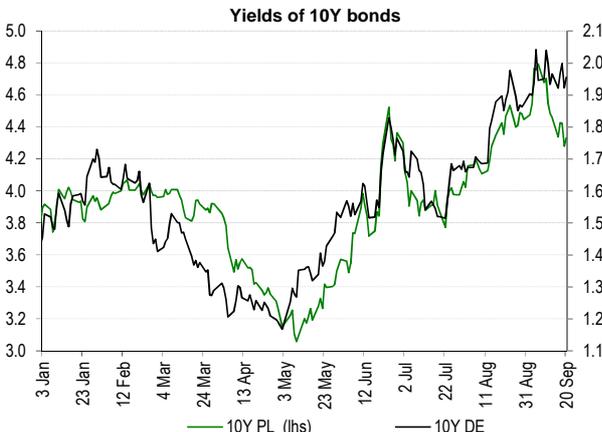
... but high volatility of IRS and bond yields

- Strengthening of global assets in response to surprising Fed decision had clear impact on IRS rates and bond yields. IRS were even falling by more than 20bp in 5Y and 10Y tenors one day after the most important event of the week. However, due to the correction that occurred later, 2Y rate ended the week 5bp lower vs. level seen last Friday while 5Y and 10Y rates plunged by ca. 15bp. On the other hand, even after this correction, 5Y and 10Y rates are 45-50bp below the peak from early September established after the government announced its plans of pension system overhaul. 2Y rate is lower by ca. 25bp. The spread of these rates and 6M WIBOR declined last week to the lowest levels since mid-August.
- Similar dynamic changes were recorded on the debt market. All in all, the curve flattened due to bigger strengthening recorded on the middle and long end of the curve (yields down by 10-15bp) than on the short end (yields down by 5bp).



High volatility may persist

- Coming week will be full of events that may keep high volatility on the market. Just after the weekend investors will focus on results of German parliamentary election and flash PMI for the euro zone. Also five Fed members will give public speeches in the following days. When in June first suggestions emerged that QE3 may be tapered already this year, some calming comments were presented in the following weeks that calmed investors. Upcoming speeches may also have an impact on the market. Many US data is due to be released this week and it may influence market perception of when the Fed will finally taper QE3. We do not expect Polish data to have any vital impact on the market.
- Last official statement from the Ministry of Finance on the Wednesday's auction (from August 30) says the ministry will repurchase DS1013 and OK0114 bonds. Most recent data (from July) show that foreign investors held 42% of DS1013 outstanding (of nominal value of PLN9.4bn) and 60% of OK0114 (of nominal value of PLN13bn). Foreign investors were pretty active during past switch auctions (they rolled debt holdings) but when in June Bernanke suggested QE3 tapering is looming, as much as over PLN2.5bn outflow from Polish debt market (biggest monthly withdrawal since July 2011). Uncertainty regarding when the Fed will taper QE3 makes us wait for the Wednesday's auction will cautious optimism.



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