

Weekly economic update

14 – 20 October 2013

Second week of US government shutdown is behind us and talks on the new budget and the debt ceiling still brought no conclusion. While initially there were no signs of approaching agreement between Democrats and Republicans, later in the week hopes for at least temporary solution emerged. If politicians agree for increasing the debt limit only for several weeks, the short-term market reaction may be positive, but the uncertainty will persist. At the same time, the market may be stabilized by the fact that such political situation makes the start of QE3 tapering less likely.

In Poland, the government published the draft bill on changes in OFE (roughly in line with earlier propositions). The bill is expected to come into force on January 31, 2014 and already on February 3, 2014 OFE will have to transfer 51.5% of assets to ZUS. OFE will not be allowed to invest in Polish or foreign government bonds but other investment constraints are to be relaxed. Stocks will have to constitute at least 75% of assets, percentage of funds invested abroad will increase gradually. Citizens will decide whether their wage contributions will be paid to OFE or ZUS between April 1 and 30 June. There will be a possibility to change the decision after 2 years and then every 4 years. In line with earlier announcement, there will be a safety mechanism assuming gradual transfer of funds from OFE to ZUS starting 10 years before the retirement. According to government estimates, OFE overhaul will lower the public debt (in domestic methodology) in 2014 by 8.4% of GDP. Borrowing needs will be lower by PLN20-25bn.

Due to a partial government shutdown in the USA, this week we will not see some important data from this country. According to estimates, on Thursday the world's biggest economy may reach the debt ceiling, so the market will be scrutinizing talks of the US policymakers. Four voting FOMC members are scheduled to speak (including Ben Bernanke on Tuesday), which can affect market expectations about further decisions on QE3. We will see a row of Polish data. We are more optimistic than the market as regards wage growth in companies and industrial output. These variables were mentioned by MPC's Bratkowski as key to watch, so the readings may potentially push IRS and bond yields up. Data on industrial output may also positively affect the zloty.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (14 October)							
11:00	EZ	Industrial output	Aug	%MoM	0.8	-	-1.5
14:00	PL	Money supply	Sep	%YoY	6.7	6.6	6.2
TUESDAY (15 October)							
11:00	DE	ZEW index	Oct	pts	49.6	-	49.6
14:00	PL	CPI	Sep	%YoY	1.1	1.2	1.1
WEDNESDAY (16 October)							
11:00	EZ	HICP	Sep	%YoY	1.1	-	1.3
14:00	PL	Wages in corporate sector	Sep	%YoY	3.0	3.2	2.0
14:00	PL	Employment in corporate sector	Sep	%YoY	-0.3	-0.3	-0.5
14:00	PL	Core inflation	Sep	%YoY	1.5	1.6	1.4
20:00	US	Fed Beige Book					
THURSDAY (17 October)							
14:00	PL	Industrial output	Sep	%YoY	7.1	7.9	2.2
14:00	PL	Construction and assembly output	Sep	%YoY	-6.0	-3.4	-11.1
14:00	PL	PPI	Sep	%YoY	-1.5	-1.6	-1.1
14:00	PL	MPC minutes					
16:00	US	Philly Fed index	Oct	pts	15.0	-	22.3
FRIDAY (18 October)							
4:00	CN	GDP	Q3	%YoY	7.8	-	7.5
4:00	CN	Industrial output	Sep	%YoY	10.2	-	10.4

Source: BZ WBK, Bloomberg, Reuters, Parkiet

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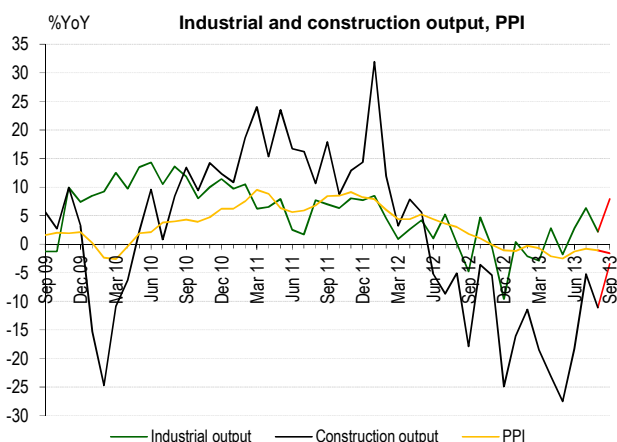
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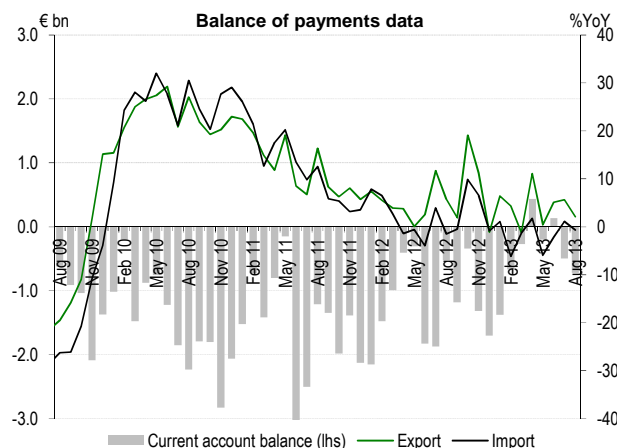
What's hot this week – Politics and new data



- US government may run out of money on 17 October and prior to this date the US policymakers should reach an agreement on lifting debt ceiling in order to avoid technical default of this country. However, it cannot be ruled out that the limit will be raised only temporarily in order to gain more time for negotiation.
- We are expecting a slim increase of CPI and core inflation in September. Rise in inflation will be caused mainly by end of sell-offs of clothes and footwear. Our forecasts are slightly above market consensus in both cases.
- In our view there was a further improvement of labour market conditions in September. We are expecting that employment increased for the fifth time in a row, so annual pace of decline in employment will slide to the lowest level this year. Wage growth will be still moderate (3.2%YoY).

- We are expecting that growth rate of industrial output in September will be highest since January 2012. Polish industry is supported by economic recovery in Poland and abroad (as confirmed by the PMI index) and by favourable working days effect. Similar factors will be underpinning the construction and assembly output, which will show the best results since May 2012. In both cases we are more optimistic that the market consensus.
- This week we will see minutes of October's MPC meeting. In our view they will show nothing interesting, as the Council is waiting with decisions and serious discussion for the November's GDP and inflation projection.
- As regards data on money supply, signals of revival on the credit market will be most important. We have already seen some signals of improvement, e.g. in consumption loans, but this trend still needs to be confirmed.

Last week in the economy – Still surplus in foreign trade, draft bill on OFE overhaul is ready



- The current account deficit reached €719m in August. Still, the trade surplus was maintained (€264m) and pace of growth of exports and imports was roughly in line with forecasts. We anticipate exports to remain crucial engine fuelling the economic recovery in coming months. Current account deficit may narrow to close to 1% of GDP at the end of the year.
- Polish government presented draft bill on changes in OFE. On 03.02.2014 OFE will have to transfer 51.5% of their assets to ZUS. OFE will not be allowed to invest in Polish or foreign government bonds. Citizens will decide on destination of their wage contributions between 01.04 and 30.06. There will be a possibility to change the decision after 2 years and then every 4 years. There will be a safety mechanism assuming gradual transfer of funds from OFE to ZUS starting 10 years before the retirement.

Quote of the week – Flat rates for how long?

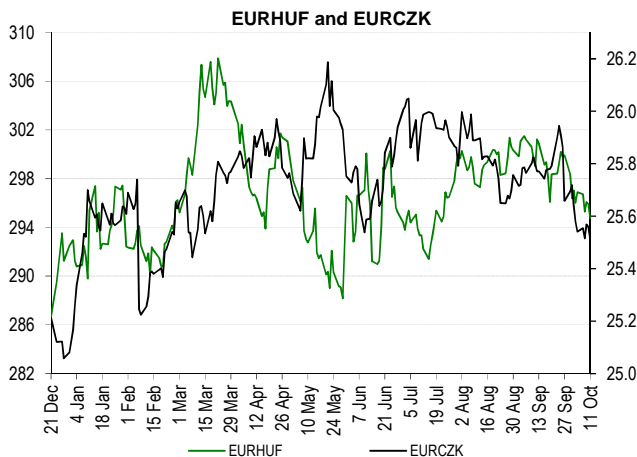
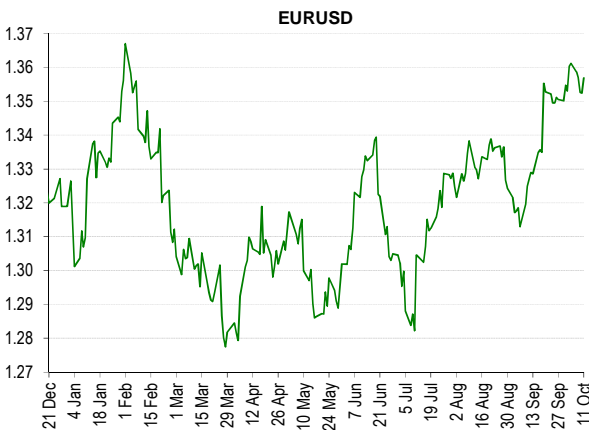
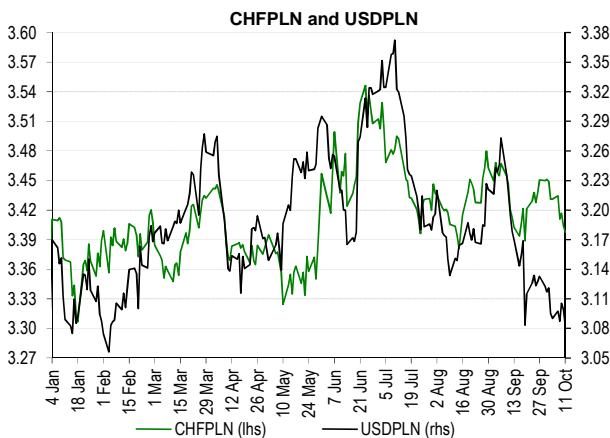
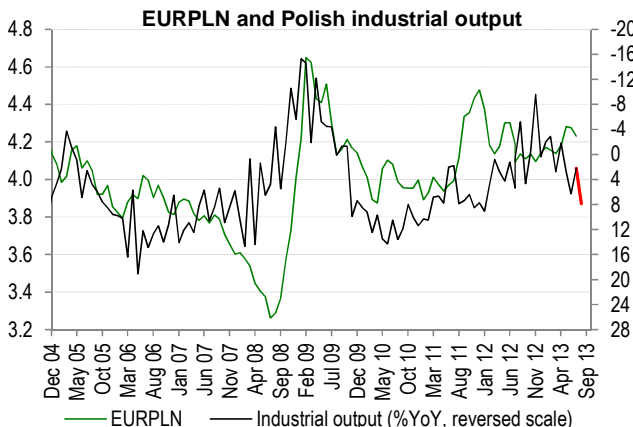
Andrzej Bratkowski, MPC member, 10.10, Dow Jones
Interest rate hikes possible in 4Q 2014, maybe later

Elżbieta Chojna-Duch, MPC member, 07.10, Reuters
There are expectations that economic growth in 2014 will be stronger than currently, but it seems that it still will be sluggish and gradual and this means we can return to discussion on monetary policy easing, or at least on dovish bias.

Adam Glapiński, MPC member, 07.10, Reuters
We can see symptoms of economic recovery, but they are sluggish. I do not expect any strong rise in prices. I think that most likely rates will not change this year, and it is very likely they will remain flat in Q1.

Comments of the MPC members increasingly often include suggestions that the period of stable interest rates can last longer than until end of 2013. However, there are some differences in these opinions. According to Adam Glapiński, rates may remain stable until end of 1Q2014. Marek Belka and Jerzy Hausner think this may be mid-2014, while Andrzej Bratkowski says that rates should be flat until 4Q2014. On the other hand, Elżbieta Chojna-Duch suggested recently that in 2014 the Council may return to discussion on interest rate cuts (sic!), or at least change monetary policy bias to dovish. However, MPC members differ in their expectations about economic growth. In general at least five MPC members are not ruling out that stable rates period will be extended. Discussion on this issue will be supported by November's NBP projection of inflation and GDP.

Foreign exchange market – EURPLN slightly lower, waiting for stronger impulse



Zloty gains despite vital risk factors

- Despite the prolonging US talks the zloty gained during the past week versus the euro and remained roughly unchanged versus the dollar. Taking a broader glance on the market, the domestic currency was performing quite well amid the uncertainty over further developments in the US or during the temporary political crisis in Italy.
- When we consider the period of time since the beginning of September (when USDPLN was at 3.29 after the government has announced plans in OFE changes) until the second week of October, the zloty is world 5th strongest currency vs. the dollar (it gained 6.1%). The domestic currency was also best performer against the euro amongst CEE currencies (it gained 2.8% vs. 2.2% for the forint and 0.9% for Czech koruna). At the same time the US S&P500 pared nearly all gains recorded in the first half of September.
- Negative impact of partial government shutdown on the US economy supports views that in such circumstances the FOMC will not hurry with QE3 tapering (moreover, offices responsible for publication of important data are closed and this makes it even more difficult to assess the situation in the US economy). Additionally, decent performance of the zloty may be also explained by strong domestic data (September's PMI). This week data on Polish industrial output is due to be released. Our forecast is above market consensus and such release may have some positive impact on the zloty.
- Appreciation of the domestic currency halted at 4.18 per euro during the past week – this level is now the first support (next one is the local minimum established after the surprising decision of the FOMC – at nearly 4.14). Resistance is at 4.23.

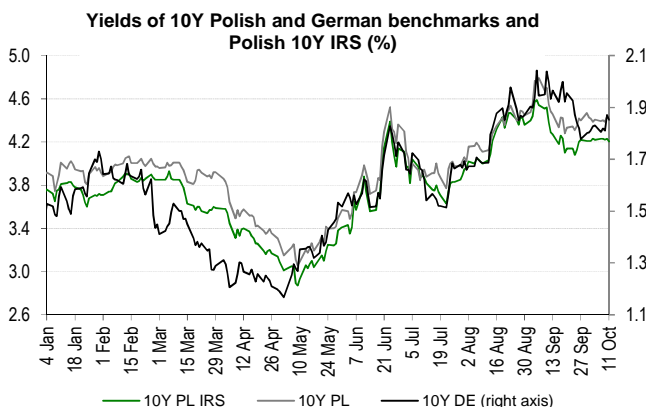
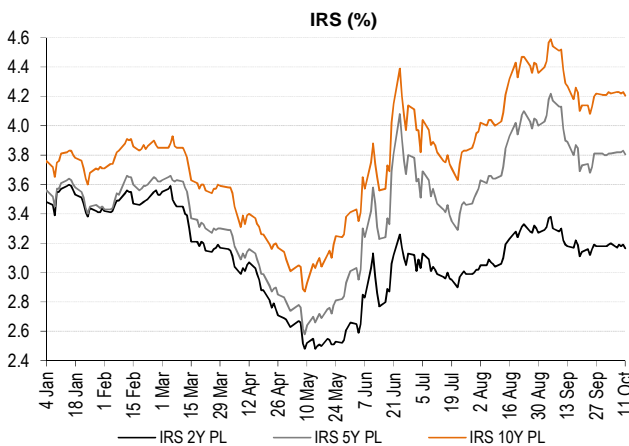
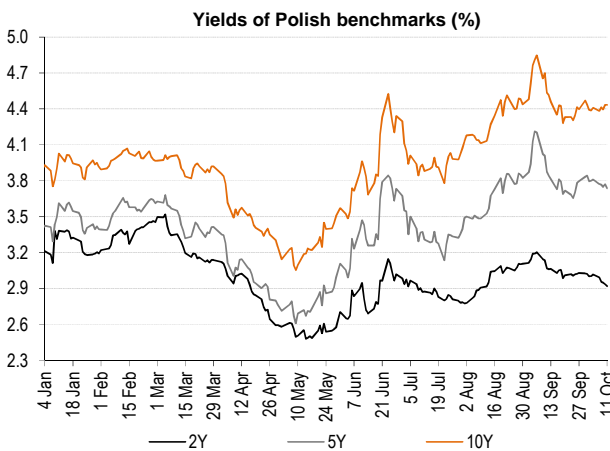
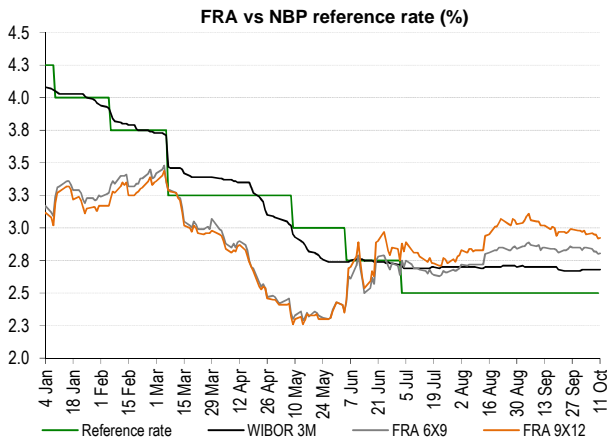
EURUSD without big changes, awaits news from the US

- EURUSD hovered during the past week just below the peak established in early September at nearly 1.365. Lack of breaking decisions in negotiations carried by the US politicians (leading also to fewer data releases from the world's biggest economy) constrains the potential for any stronger move.
- Situation may change this week if Democrats and Republicans agree on more ambitious solution than lifting the debt ceiling only for a few weeks. Minutes from the last FOMC meeting showed its member still consider tapering of the QE3 this year. In the following days four voting members of the FOMC (including Ben Bernanke) and the market will wait for hints whether the US shutdown had any impact on their attitude.
- Vital levels for EURUSD are at 1.343 and 1.365.

Koruna under the impact of Czech data

- EURCZK stayed close to 25.55 during the past week, some impact on the exchange rate was put by Czech data. Better than expected released of industrial output supported the currency as market interpreted it as a factor that diminishes chances for intervention of Czech central bank in order to weaken the koruna. In the following days data on lower than anticipated inflation was published and it had the opposite effect than industrial data.
- The past week was second in a row when forint was gaining versus the euro. EURHUF broke slightly the minimum from the second half of September (at 294.3) and reached 239.9.

Interest rate market – Under influence of news flow from the US and domestic macro data



The MPC members' words support money market ...

▪ It was another week in a row of stable WIBOR rates between 1M and 12M. Market was supported by statements from the MPC's members, who suggested that rates might remain stable for a longer time than till year-end (as assumed in statement after October's MPC meeting). The shape of the WIBOR curve has remained normal. It clearly shows that market participants do not expect further rates cuts (despite some suggestion by MPC's Elżbieta Choina-Duch).

▪ Dovish signals from the MPC brought impulse to FRA rates decline, starting from rate 6x9. In our opinion it means that normalisation on the domestic money market might be slower, while market has started to adjust its expectations on future interest rates path to the Council's members comments.

▪ This week domestic macro calendar is heavy, with releases among others CPI inflation, labour market data and industrial output. In our opinion these data should confirm lack of inflation pressure (despite that CPI has bottomed out from record-low) and more visible signals of economic activity rebounding. Final figures for September might affect market sentiment in short-term.

... and front end of the curves

▪ Last week T-bonds and IRS were under influence of both domestic (mainly MPC members' comments) and external factors. Dovish signals from the MPC (its members suggest longer period of stable official rates) supported the front ends of curves. Yield of 2Y benchmark declined to 2.92%, the lowest level since mid-August.

▪ Mid and long ends of curves suffered from global factors. Yields of T-bonds and IRS rates, in particular in 10Y sectors, increased due to Bunds weakening. T-bonds underperformed IRS rates, which resulted in asset swap spread widening in this sector to 23 bp (up from 19 bp at the end of previous week). What is more, yield curve has become more steep (with 2-10Y spread widening above 150 bp). On the other hand draft bill of changes in pension system (OFE) confirmed earlier government's suggestion and it was rather neutral for the debt market.

All eyes on the US

▪ This week will be very interesting. Market participants are waiting for positive outcome of political talks in the US and avoidance of technical default, which requires decision on increasing debt limit before October, 17. Agreement in the US might bring impulse to further increase in yields on core markets (it was observed last week), and consequently put pressure on the long ends of curves.

▪ Important macro data will be released in Poland: inflation, labour market statistics, industrial output. Recently inflation numbers were less important for the market than industrial output. This may be the case also this time. Our prediction of output growth by 7.9%YoY is one of the highest market forecasts. Realization of such a scenario can give an impulse for profit-taking in the short term (after recent quite considerable strengthening) at the shorter end of the curve. Inflation data (CPI and PPI) should confirm the lack of inflationary pressure in the economy.

▪ For this week (16 Oct) the Finance Ministry is planning buyback auction of euro-denominated bonds maturing in February 2014 (EUR20140203). Planned buyback is equal to €500m. Final information about the offer will be given by the Ministry on Monday

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