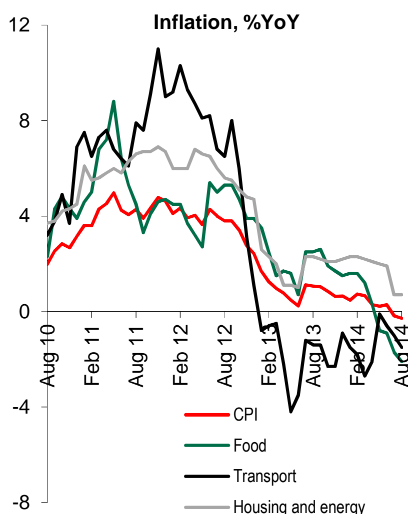
INSTANT COMMENT

15 September 2014

Price drop accelerating

CPI inflation rate fell in August to -0.3%YoY, in line with expectations. The drop was driven mainly by declining prices of food and fuel, and it seems that those two factors (plus lack of clear demand-side pressure) may keep inflation rate in sub-zero territory even until the end of this year. Much longer expected period of CPI remaining below the official 2.5% inflation target will be among reasons that we think will convince the MPC to cut interest rates by 75bp in total in 4Q14.

Current account deficit narrowed in July to -EUR173m and was lower than expected. Export growth slowed to 6.4%YoY, which shows that impact of economic slowdown abroad is still moderate. Meanwhile, import growth decelerated to 4.5%YoY, which may reflect gradual weakening of domestic demand. Data had slightly positive impact on the zloty.



Second (and probably not the last) month of deflation

Inflation dropped in August to -0.3% YoY, in line with our forecast and the market consensus. Just like in the last few months, inflation was pushed lower mainly by the food prices – their annual momentum dropped to -2.1% YoY in August, its lowest for 11 years. This trend is likely to be sustained in the coming months due to high harvest and exports ban to Russia causing the oversupply of food in the European markets. Also the fuel prices declined (-1.9% YoY) and further decline (at even higher pace) is expected also in September even despite notable zloty's depreciation vs. the dollar. On the other hand, communication prices surged for the third month in a row (we mentioned this earlier, it seems that the price war in the communication market is over for now). However, there were no more signs of noticeable price pressures.

According to our estimates, core CPI after excluding food and energy prices moved slightly up in August, to 0.5% YoY.

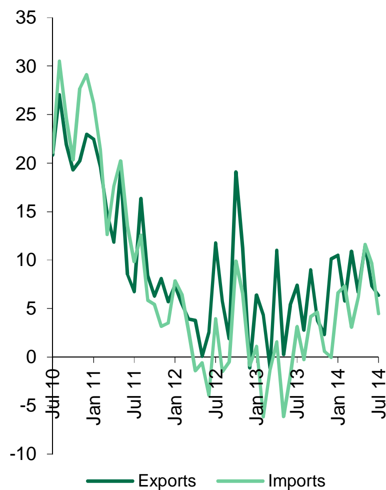
August was the second consecutive month of negative annual CPI (after -0.2% YoY in July) and it seems it may stay below zero even until the end of the year. We expect some rebound of inflation later on, but at a subdued pace (towards 1.5% YoY at the end of 2015), so it is likely to stay well below the NBP target (2.5%) at lease for the next several quarters. Such a scenario (and anchoring of the GDP growth below 3% for a several quarters) shall encourage the MPC to cut interest rates. We expect rates to be cut by 75bps in total in 4Q. Data on the industrial output (due on Wednesday) may be the next argument for the monetary policy easing (we expect a contraction in YoY terms).

Exports still strong, but outlook is getting weaker

In July current account deficit narrowed to €173m, down from €391m in previous month. Better data than our and market forecasts came from higher surpluses on both goods balance (€393m) and current transfers (€351m). Additonally, income deficit also declined to c€1.27bn (versus deficit of €1.5bn in June). While exports volume was in line with our expectations, imports were lower than we forecasted. In July exports reached the level of €14.071bn (increase by 2.6%MoM and by 6.4%YoY), and imports amounted to €13.678bn (increase by 2.2%MoM and by 4,5%YoY). Current environment (Russian ban on import from EU; worsening economic prospects for Germany – the main trading partner of Poland; falling exports orders) suggest that exports outlook is deteriorating. However, in our opinion, this

ECONOMIC ANALYSIS DEPARTMENT:
ul. Marszałkowska 142. 00-061 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400



trend may be weakened slightly by the exchange rate (now EURPLN is at 4.20 and should remain near this level in coming months), which is still favourable for exporters.

At the end of July the 12-months cumulative current account deficit amounted to €3.2bn (or c-0.8% of GDP) and was over two times lower than at the end of July 2013.

On the financing side, there was an increase in foreign direct investments inflow to €420m in July (from €180m in June), while foreign portfolio investments were negative (-€217m) as investors retreated from equity market. At the same time, the narrowing current account deficit is safely financed by wide stream of EU funds – the sum of foreign direct investments and EU funds in the last 12 months covered almost 400% of current account deficit in the same period.

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 22 534 18 88, email ekonomia@bzwbk.pl, http://www.bzwbk.pl.