Bank Zachodni WBK

Weekly economic update

13 – 19 August 2012

Last week did not bring many new pieces of information and events that would be critical for markets. This was partially connected with quite poor agenda of economic data releases as well as with the beginning of August holiday period, which means significant decrease of activity on many markets. Notwithstanding, domestic market saw a correction of both zloty and Polish bonds. Positive moods seen at the start of the week, which resulted from positive US labor market data from last Friday, gave way to risk aversion, which appeared in connection with increasing doubts in future stabilizing actions of the ECB as well as data that clearly suggested a slowdown of global economy at the beginning of H2 (poor outcomes of US, Chinese and German exports). A correction resulted also from profit taking by investors.

In spite of holiday on Wednesday, following week on Polish market may be quite interesting because of the list of important data releases in Poland and abroad. Domestically, July's CPI inflation indicator will be in the foreground. Once again our forecast is above market consensus and its realization may be impulse for continuation of correction on FI market. On the other hand, labor market data at the week's end should confirm continuation of stagnation, decreasing possibility of second round effect. The market will certainly follow every MPC members' statements and their comments to new data, which will indicate the attitudes that MPC members may have in September after summer break in rate-setting meetings. Zloty's quotations may be sensitive to balance of payments data, which apart from exports' and imports' weaknesses in our opinion will show a clear widening of current account deficit, what may have negative impact on the exchange rate. There will be many key data releases abroad, which will be useful to assess economic outlook in global economy in H2. While EURPLN rate should consolidate in wide range 4.026-4.10, even bigger fluctuations may be observed in EURPLN due to changes in euro-dollar rate.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 August)					
14:00	**PL**	**Exports**	**Jun**	**€m**	**11702**	**11660**	**12088**
14:00	**PL**	**Imports**	**Jun**	**€m**	**12587**	**12400**	**13021**
14:00	**PL**	**Current account**	**Jun**	**€m**	**-1462**	**-1476**	**-815**
		TUESDAY (14 August)					
8:00	DE	Flash GDP	Q2	%QoQ	0.2	-	0.5
11:00	DE	ZEW index	Jul	pts	-19.6	-	-19.6
11:00	EZ	Flash GDP	Q2.	%QoQ	-0.2	-	0.0
11:00	EZ	Industrial output	Jun	%MoM	-0.7	-	0.6
14:00	**PL**	**CPI**	**Jul**	**%YoY**	**4.1**	**4.3**	**4.3**
14:00	**PL**	**Money supply**	**Jul**	**%YoY**	**10.9**	**10.6**	**11.1**
14:30	US	Retail sales excluding autos	Jul	%MoM	0.3	-	-0.4
		WEDNESDAY (15 August)					
	PL	**Market holiday**					
14:30	US	Core CPI	Jul	%MoM	0.2	-	0.2
14:30	US	NY Fed index	Aug	pts	6.0	-	7.39
15:15	US	Industrial output	Jul	%MoM	0.4	-	0.4
		THURSDAY (16 August)					
11:00	EZ	HICP	Jul	%YoY	2.4	-	2.4
14:30	US	Initial jobless claims	week	k	365	-	361
14:30	US	Home starts	Jul	k	756	-	760
14:30	US	Building permits	Jul	k	766	-	760
		FRIDAY (17 August)					
14:00	**PL**	**Wages in corporate sector**	**Jul**	**%YoY**	**4.0**	**3.8**	**4.3**
14:00	**PL**	**Employment in corporate sector**	**Jul**	**%YoY**	**0.0**	**0.1**	**0.1**
15:55	US	Flash Michigan index	Aug	pts	72.7	-	72.3

Source: BZ WBK, Reuters, Parkiet

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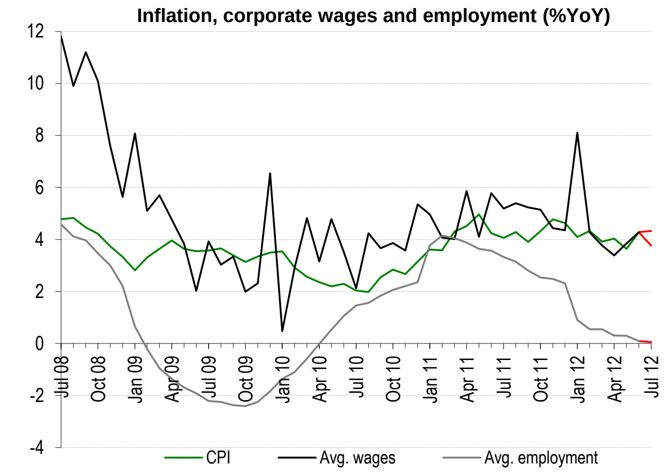
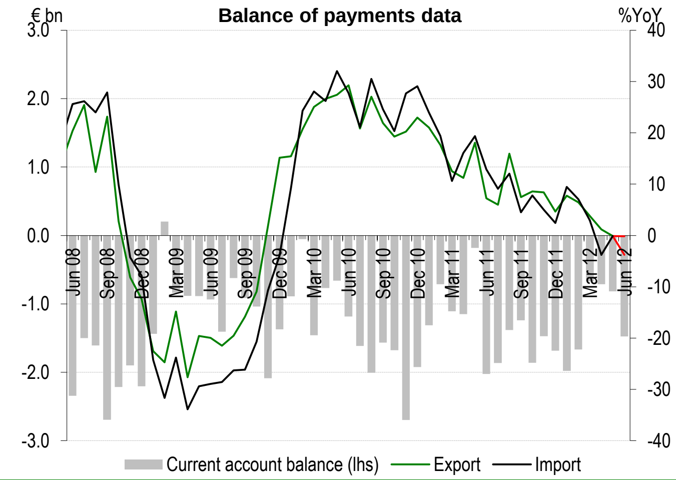
What's hot this week – Inflation still high, economic activity still weak



▪ This week the release of CPI data will be crucial for the market. While a clear decline of fuel prices had contributed to decrease of July's inflation rate, this was offset by lower than last year scale of seasonal drop in prices of food and clothing. Our forecast (4.3%) is again above market consensus, so if it materializes, it may push yields on debt market further up.

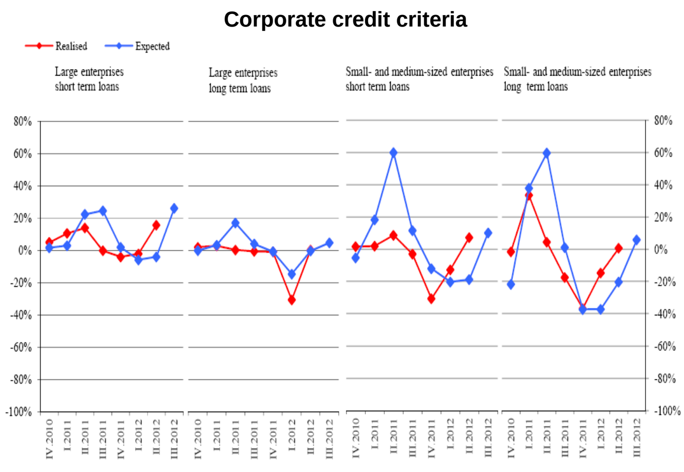
▪ In spite of still high inflation, in our opinion labour market data will not intensify fears about risk of materialization of second round effects. We expect that the annual pace of employment growth will be close to zero and that the wage growth will decelerate (slightly deeper than forecast by the market). That will confirm that stagnation on the labour market maintains and consequently deteriorates prospects of consumption demand.



▪ June's balance of payments data will be probably unsupportive for the zloty – weak data on industrial output and retail sales for that month, as well as CSO data on foreign trade released on Friday, indicate that pace of growth of exports and imports remained low. Current account deficit may increase considerably as a result of deterioration of current transfers' balance (which is indicated by Ministry of Finance's data on inflow of EU funds).

▪ Money supply data as usually will not have impact on the market. However, it is worth paying attention to tendencies on loan market – recent NBP report (see below) indicates increase of demand in all categories of loans for companies and households (including consumption loans), which may indicate a reversal of downward trends that have been seen for last few months.

Last week in the economy – Banks predict loan growth



▪ According to NBP survey among credit officers, share of banks declaring tightening of lending criteria declined in 2012Q2. Banks cut margins on corporate loans and eased lending criteria for short-term loans in this segment. At the same time, banks have seen rising demand for corporate loans, especially long-term ones. Banks are declaring that they will ease lending criteria in short-term loans in Q3 and that they expect further increase of enterprises' demand for loans.

▪ As regards housing loans, banks tightened criteria for this credit segment, but not as significantly as earlier. Banks expect a slight tightening of credit policy in Q3 and a rising demand for housing loans. Also, a strong revival in demand for consumption loans is expected.

Quote of the week – Economic slowdown deepens

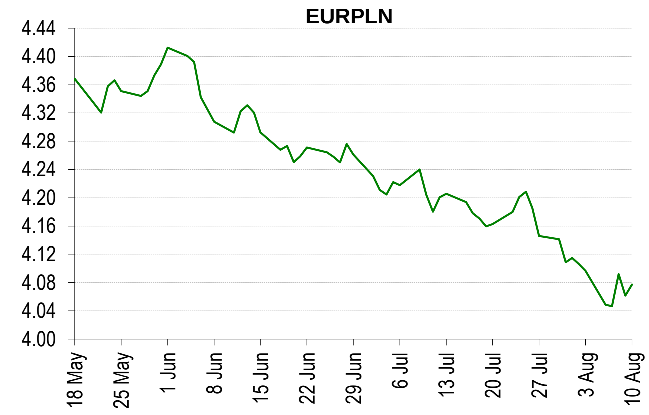
Elżbieta Chojna-Duch, MPC member, 03.08 TVN CNBC
Economic slowdown deepens and is visible. For sure we will consider possibility of interest rates' cut.

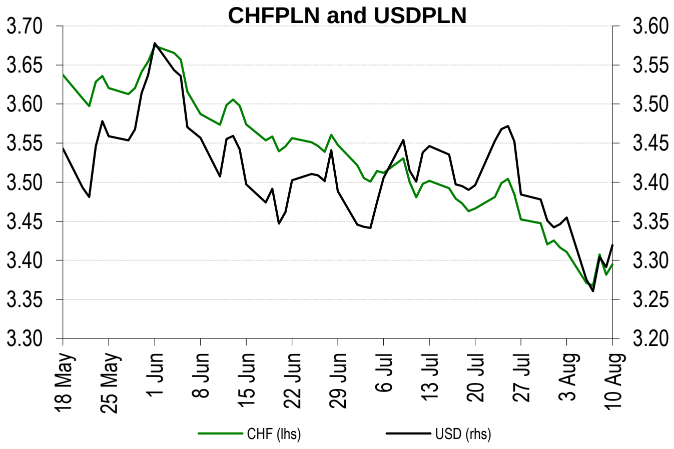
Ludwik Kotecki, MinFin chief economist, 08.08 TOKFM
In late August we will produce a forecast that will be final base for budget for 2013. Instead of acceleration, which was forecasted – i.e. from 2.5% in 2012 to 2.9% in 2013 – I would expect a stagnation at not higher than 2.5%, probably less. The data are worse and worse, but are coherent will macroeconomic scenario that is the base for budget for 2012. This 2.5% [in 2012] does not seem to be risky.

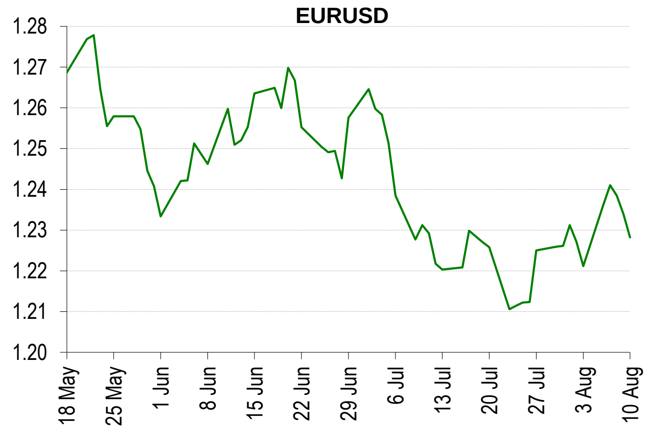
Jaime Reusche, Moody's Investors Service, 10.08 Reuters
Yes [for question if chances for Poland rating upgrade are low]. Currently holding stable prospect is crucial for Poland, taking external weaknesses and economic slowdown into consideration.

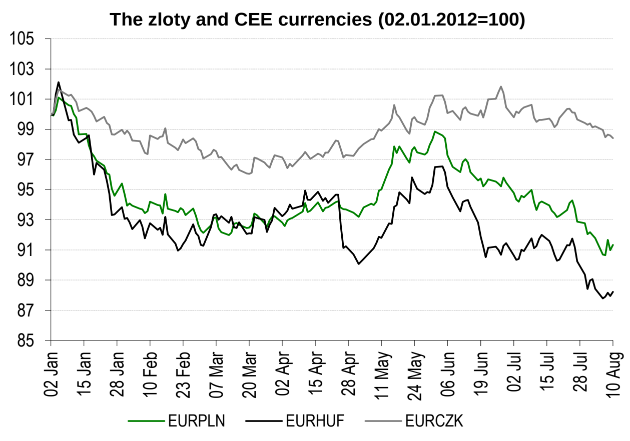
The case of slowdown of economic growth in Poland is more and more often appearing in statements of representatives of different institutions. Elżbieta Chojna-Duch repeated that the Council will take rates cut into consideration in Sep because of slowdown. In our opinion the motion for a rate cut will not win majority during next meeting. On the other hand Ludwik Kotecki suggested a revision of government forecast of economic growth for 2013. We think that the Ministry may not be able to hold planned fiscal path (decrease of general government deficit to 2.2% GDP in 2013). Sticking to consolidation plans during slowdown would be undesirable because of its procyclical nature. As regards statement of Moody's analyst, Poland should not count on rating upgrade, as long as its economy is slowing. However, it is worth emphasizing that Poland with its stable outlook still stands out against the European backdrop.

Foreign exchange market – Horizontal moves on the FX market, important macro data









Horizontal trend on the EURPLN after correction

- The beginning of the week was very promising. Positive mood after better than expected non-farm payrolls supported risky assets, including the Polish zloty. The EURPLN fell to 4.026, reaching a new this year minimum and the lowest level since July 2011. The zloty appreciation was broken by correction on the Polish debt market. The sell-off of bonds on the mid and long-end of the curve has initiated corrective move on the zloty. However, the EURPLN, after increasing towards 4.10 (this level effectively stopped upward move), has stabilized between 4.05 and 4.08, with the vital support level of 4.026.
- The USDPLN, after falling to ca 3.245 at the beginning of the week, increased again above 3.30 next days. It has remained above this level till week-end. One should notice that the CHFPLN, on the wave of optimism, declined below 3.40, reaching this year minimum at 3.365 (the lowest level since June 2011).
- This week the zloty will remain under influence the macroeconomic data both from Poland (investors focus on mainly balance of payment reading) and from Europe and the US (main attention focus on the preliminary Q2 GDP data from the euro zone). In our opinion, the EURPLN will consolidate in the wide range between 4.026-4.10. In the same time the USDPLN should be more volatile, following the EURUSD moves. The strong support level is at 3.30, while next is a last week minimum near 3.25. On the other hand the first resistance level is 3.35 and if the USDPLN breaks it, the way to further increase towards 3.40 and higher will be opened.

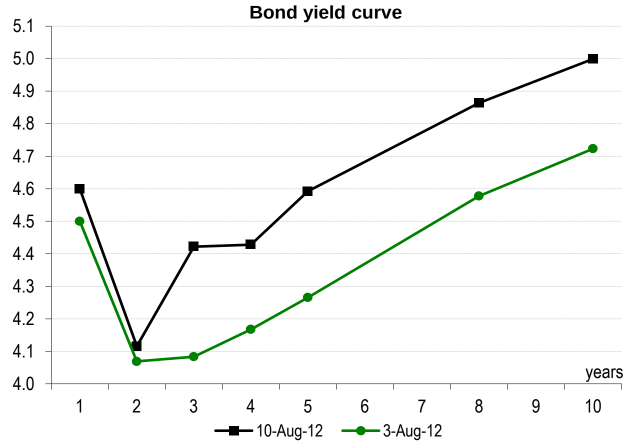
The EURUSD will stay under influence the macro data

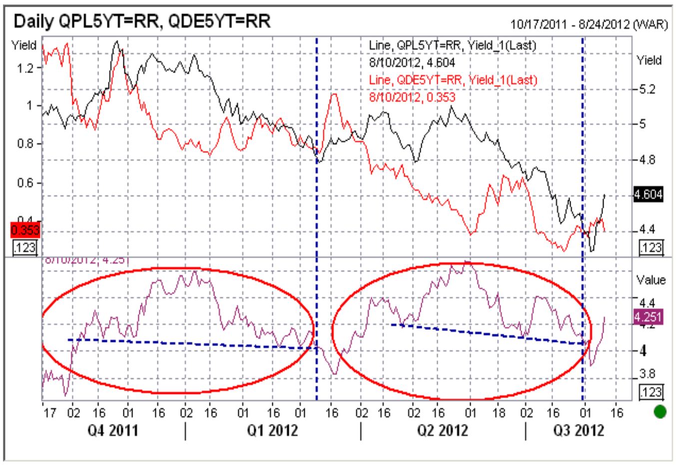
- The euro strengthening at the beginning of the week was short-lived only. The EURUSD did not break 1.245 and next days brought gradual decline of the exchange rate towards short term support at 1.225. The European currency weakened due to global mood deterioration due to the faded optimism about the ECB action and weak macro data from global economy.
- This week investors focus their attention on macro data, especially the preliminary Q2 GDP data in euro zone. If GDP data confirm the slow down of global economy, it will renew expectation about more quick action of the ECB (including further interest rate cut in September). As a consequence we do not exclude that the EURUSD might test again the resistance level at 1.245.

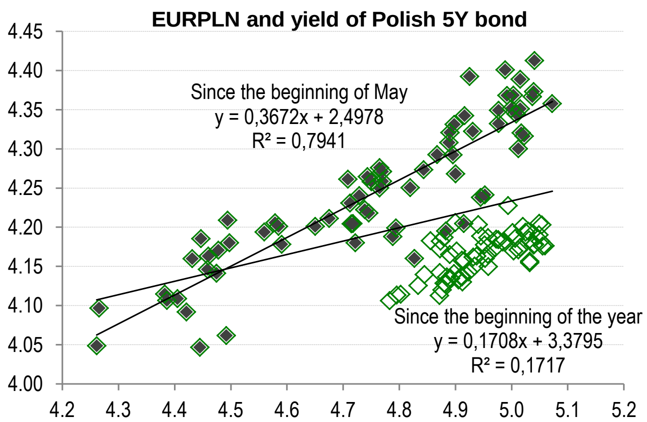
Corrective moves also on the HUF and the CZK

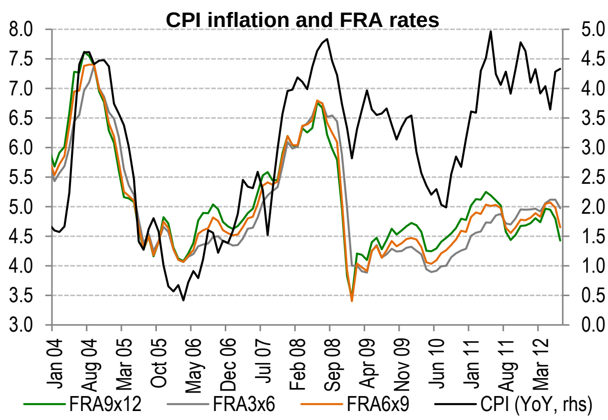
- The Hungarian forint and the Czech koruna both felt the pinch of the worsened external market sentiment in the second half of the week. Information that two members from the Hungarian Monetary Policy Board had voted favor the interest rate cut in July caused a bit deeper decline of the HUF at the end of the week. In our opinion, currently interest rate cuts in Hungary are rather less probable if talks between the Hungarian government and the IMF continue. We would like to point out that the EURHUF and EURCZK ended the week at the lower lever than week ago.
- One should notice that starting from the beginning of 2012 the forint has still performed better than other CEE3 currencies. In January – August, 10 period it strengthened by ca 12%, while the zloty gained nearly 9% and the Czech koruna increased only by 1.6%.

Interest rate market – CPI may push short end of the curve up









Strong weakening of domestic bonds

▪Soon after beginning of the past week a sudden correction of the last strengthening of Polish bonds occurred. Considerable surge of yields was not triggered by any data release, but was probably due to profit-taking. Yields of 5Y and 10Y bonds advanced compared to previous Friday by 33bps and 28bps, respectively. Short-term securities were much more stable and thus the yield curve steepened. 2-10 spread increased to 88bps (highest since early April) and 2-5 spread to 47bps (highest since mid-January).

▪IRS rates also advanced, but at a smaller scale. In case of 10Y tenor the asset swap spread rebounded from support at 40bps and reached 46bps at the end of the week.

Situation of 5Y bond in line with expectations

▪On the chart with domestic and German 5Y bonds and spread presented in a Report 2 weeks ago the situation changed in line with our expectations. We argued that yield of Polish 5Y bond may test local low at 4.45% and that proved correct assumption as during the past week yield plunged to lowest level in history (4.26%). Consequently, spread versus 5Y German bond broke support level. If the situation was to develop further in line with scenario from Q1 and Q2 2012, then in coming weeks yield of PS0417 should continue to increase. Such pattern is also supported by the fact that relationship of the Polish 5Y bond and the zloty clearly strengthened since the beginning of May. Deprecation of domestic currency – which is likely in our view in coming months – has negative impact on pricing of Polish bonds for foreign investors (that hold ca. 33% of domestic marketable debt and are major holders) and may trigger selling at least part of the portfolio.

FRA slightly up, market awaits CPI data

▪Weakening of bonds triggered also an upward move of FRA rates. The biggest move was recorded in case of FRA9x12 (by 16bps) and FRA6x9 (by 6bps). Both rates stabilized around levels last seen a year ago when worries over global economic outlook intensified and expectations for rate cuts – also in Poland – were very strong.

▪Our CPI forecast is again above market expectations (a month ago also was among the highest) while consensus is again at 4.1%. Still, this time data on higher than anticipated inflation may have bigger impact on the market than it had last month. In July it was broadly expected that CPI will increase and it actually did. This time, however, the majority of institutions surveyed by "Parkiet Daily" forecasts lower inflation. Tuesday's data may also have negative impact on 2Y bond.

▪ It is worth to notice that for 2 years FRA rates have not followed inflation strictly. That is because the market is more prone to react to data on economic activity. As investors are currently pricing-in 100bps rate cut in coming 9 months, we think the potential for further decline of FRA is limited (at least in coming weeks).