Bank Zachodni WBK

Weekly economic update

27 August – 2 September 2012

In the first half of the week media information on possible ECB's intention to establish a cap on yields for bonds from the euro zone's peripheries had positive impact on global market moods. Even a statement from the central bank that such reports are only misleading did not change the situation. Besides, minutes from last FOMC meeting proved dovish, though in the following days James Bullard from the Fed said that regarding recent decent macro data they are somewhat stale. Also, there was a rumour that Spanish government considers making a request for using EFSF in order to lower yields of bonds. Domestic bonds and the zloty did not really benefit much from persisting optimism, while the EURUSD reached nearly 1.26. At the end of the week global market mood deteriorated due to publication of poor data from Europe and Japan and that triggered zloty's depreciation. Just like we expected, Polish macroeconomic data were better than market consensus. Furthermore, market participants were surprised by the fact that in July there were two motions to cut the NBP reference rate (by 25 and by 50 bp).

Last week of holidays may be very interesting regarding domestic data as well as global events. According to our forecasts, the deceleration GDP growth rate in Q2 was bigger than the market anticipates. Consequently, if our expectations prove correct, release of that data may have some impact on the interest rate market and the currency. At the end of the past week the EURPLN was testing vital resistance on daily charts at 4.10. Disappointing data on Polish GDP may initiate another upward move towards 4.14. For domestic bonds, Thursday's data may be an impulse for further strengthening. Attention of foreign investors will focus first on German Ifo index, then on preliminary data of US GDP, Italian 5Y and 10Y bond auction and finally on Fed's governor speech at conference in Jackson Hole. Similarly as it was the case in the past, Ben Bernanke might present some details on further actions of the central bank in terms of supporting economic growth. Results of Italian debt auction may be important from the point of view of expectations for ECB's proposals of stabilising the market.

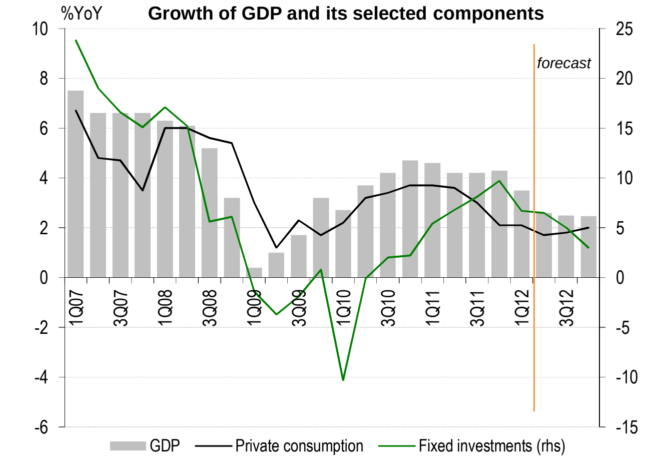
Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 August)					
10:00	DE	Ifo index	Aug	pts	102.6	-	103.3
		TUESDAY (28 August)					
8:00	DE	GfK index	Sep	pts	5.9	-	5.9
15:00	US	S&P/Case-Shiller home price index	Jun	%MoM	0.6	-	0.9
16:00	US	Consumer confidence index	Aug	pts	66.0	-	65.9
		WEDNESDAY (29 August)					
14:30	US	Preliminary GDP	Q2	%QoQ	1.7	-	2.6
16:00	US	Pending home sales	Jul	%MoM	1.1	-	-1.4
20:00	US	Fed Beige Book					
		THURSDAY (30 August)					
10:00	**PL**	**GDP**	**Q2**	**%YoY**	**2.9**	**2.6**	**3.5**
10:00	**PL**	**Private consumption**	**Q2**	**%YoY**	**1.9**	**1.7**	**2.1**
10:00	**PL**	**Fixed investments**	**Q2**	**%YoY**	**5.5**	**6.5**	**6.7**
14:30	US	Consumer spending	Jul	%MoM	0.4	-	0.0
14:30	US	Personal income	Jul	%MoM	0.3	-	0.5
14:30	US	Core PCE	Jul	%MoM	0.1	-	0.2
14:30	US	Initial jobless claims	week	k	370	-	
		FRIDAY (31 August)					
11:00	EZ	Flash HICP	Aug	%YoY	2.5	-	2.4
14:00	**PL**	**Inflation expectations**	**Aug**	**%YoY**	**-**	**-**	**3.5**
15:45	US	Chicago PMI index	Aug	pts	53.5	-	53.7
15:55	US	Michigan index	Aug	pts	73.6	-	73.6
16:00	US	Industrial orders	Jul	%MoM	1.2	-	-0.5

Source: BZ WBK, Reuters, Parkiet

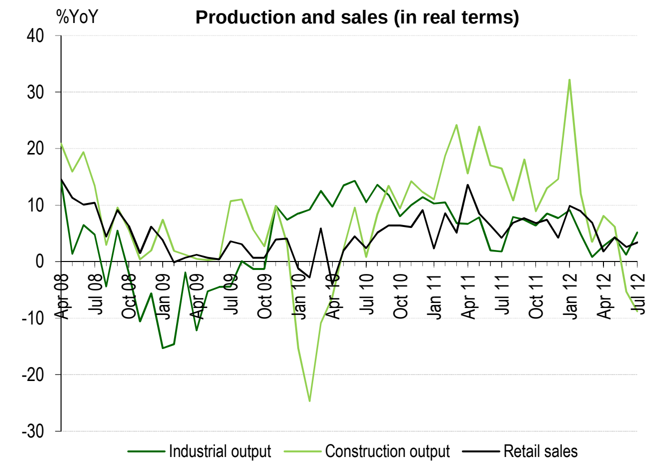
Maciej Reluga Chief economist +48 22 586 8363 e-mail: ekonomia@bzwbk.pl
Piotr Bielski +48 22 586 8333 **Marcin Sulewski** +48 22 586 8342
Agnieszka Decewicz +48 22 586 8341 **Marcin Luziński** +48 22 586 8362

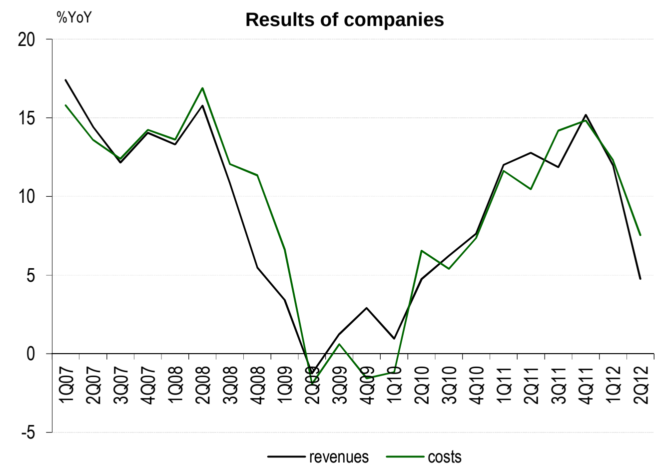
What's hot this week – Slowdown of economic growth



- This week we will see Polish GDP for 2012Q2. In our view the domestic economic growth decelerated markedly (to 2.6%YoY from 3.5%YoY in Q1), which was mainly due to a weakening private consumption, while fixed investments still showed a decent pace of growth and net exports' contribution was positive. As regards economic growth, we are most pessimistic among market analysts (market forecasts fall into 2.6-3.3% range, with median at 2.9%), but we see some upward risk for our prediction after better-than-expected data on trade deficit in June.
- We expect that the measure of households' inflation expectations may record a quite significant increase in August due to changed calculations base.

Last week in the economy – Mixed data from Polish economy





- Data released in the previous week were rather mixed. Even though industrial output and retail sales proved to be better than expected, disappointment was delivered by data on: construction output, unemployment, companies' results and households' income.
- Industrial output accelerated in July to 5.2%YoY (1.2%YoY in June). Seasonally adjusted growth was also solid and amounted almost to 5% (3.5% in Q2). Still, we do not expect the July's results to be repeated in the upcoming months and maintain our expectations for further deceleration of industry.
- Retail sales recorded a robust growth by 6.9%YoY in nominal terms and by 3.4%YoY in real terms. Car and food sales were rather weak, but fuels and durable goods saw good results.
- Construction output disappointed strongly with a decline by 8.8%YoY. A decline occurred also in seasonally adjusted data and in all branches of the sector.
- Non-financial companies posted very weak results in Q2. Annual drop of net profit amounted to almost 34% (the highest decrease since 2009Q1) as compared to growth by 7.3% in Q1. Pace of growth of revenues decelerated considerably (to 4.8%YoY from 12%YoY in Q1).
- Households' real gross disposable income fell in Q1 by 1.9%YoY and saving rate slid below zero. It means that households are consuming their savings, which is not a good signal for the future.
- Unemployment rate eased in July to 12.3%. Monthly drop of number of jobseekers was the weakest since 2002 (excluding the crisis year 2009), thus confirming the earlier information on weakness of Polish labour market.
- PPI inflation fell in July to 3.7%YoY from 4.4% in June, while core inflation excluding food and energy prices stayed at 2.3%YoY.

Quote of the week – Do not follow this path

Jan Winiecki, MPC member, 20.08, TVN CNBC

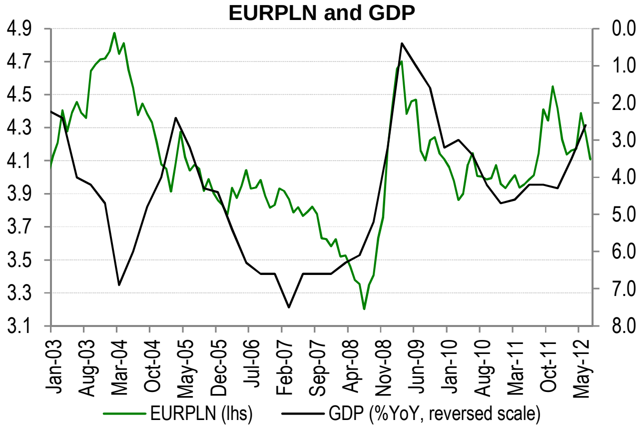
I do not think that there is such a need [of interest rate cut]. A cut of interest rates in our economy under current uncertainty is not able to affect the economy as regards its revival. [If we cut interest rate at once by 50 or 75bps] then we would follow the same path towards economic disaster, which is followed by the West. How is interest rate below 1% helping the euro zone countries? How is interest below 0.25% supporting the USA? It is not. (…) Shall we follow this path?

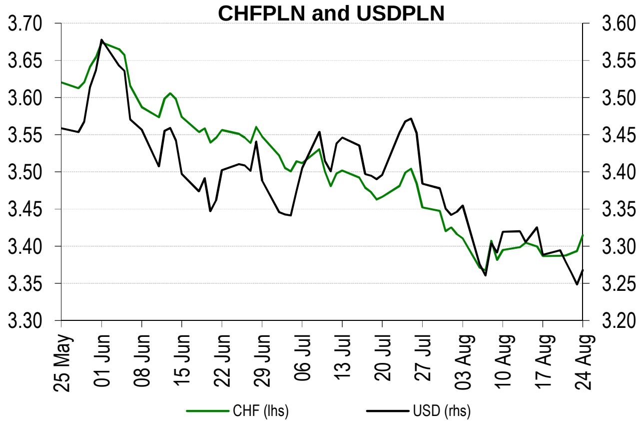
Minutes from the MPC meeting, 23.08, NBP

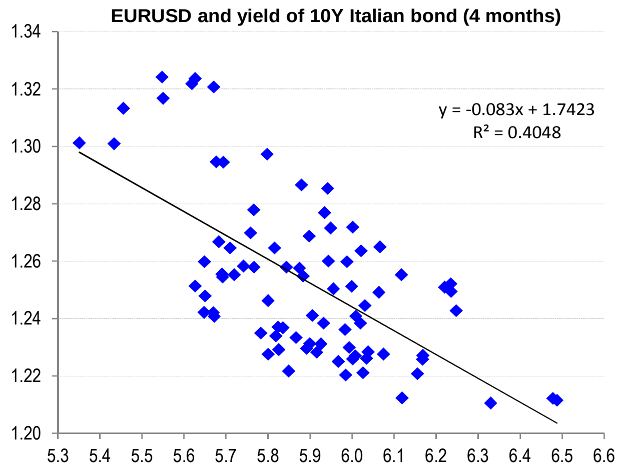
In the opinion of those Council members, data and forecasts which had been released since the previous meeting of the Council did not provide grounds for further NBP interest rate increases, though they did not completely rule out the possibility of raising the NBP interest rates. According to those Council members, current or forecast macroeconomic situation did not justify interest rate cuts.

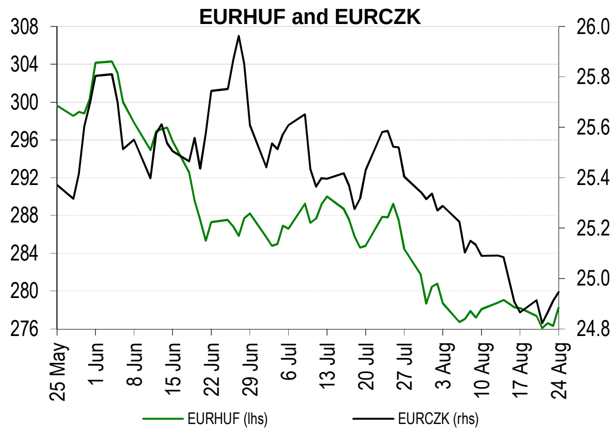
Minutes from the July's MPC meeting reveal huge differences between MPC's members' assessment of domestic economic conditions. Some members indicated that the data suggest only an insignificant slowdown of growth and a considerable risk of second-round effects. Other members were of opinion that the slowdown may be deeper than in the NBP projection, while current level of interest rate is too high and it may harm growth. Even though minutes read that cuts are unjustified and hikes cannot be ruled out, two motions for interest rate cuts were filed during the meeting: by 50bps and by 25bps. It is worth noting that a row of new weak data appeared since July's meeting. We think that further motions for cuts are probable, but there will be no majority to support such a decision in the nearest future, which was indicated also by Winiecki's comment. Still, we hope that the MPC will finally ease the tone of its statements and will rule out following a hiking path.

Foreign exchange market – EURPLN highest since the beginning of August









EURPN tested 4.10

- The zloty depreciated last week versus the euro amid worries over global economic growth, weaker hopes for QE3 and gloomy outlook for any less strict conditions for Greece from Germany and France. As a result, due to high risk aversion at the end of the week the EURPLN was testing vital resistance at 4.10.
- Domestic currency gained versus the dollar due to the visible increase of the EURUSD. The USDPLN tested support at 3.24 but ended the week close to 3.28.
- Chart showing the EURPLN exchange rate and pace of GDP growth clearly shows that particularly since the beginning of the financial crisis in 2008 the relationship between the currency and situation in economy is quite strong. Our forecast of GDP growth for Q2 is the lowest at the market and if it proves correct, the data release may disappoint investors and have a negative impact on the zloty. An anticipated – not only by us – further deceleration of pace of economic growth in 2013 supports our forecast of zloty's depreciation versus current market levels particularly in the first half of the coming year. If the EURPLN stays above 4.10, then the next resistance is at 4.14.

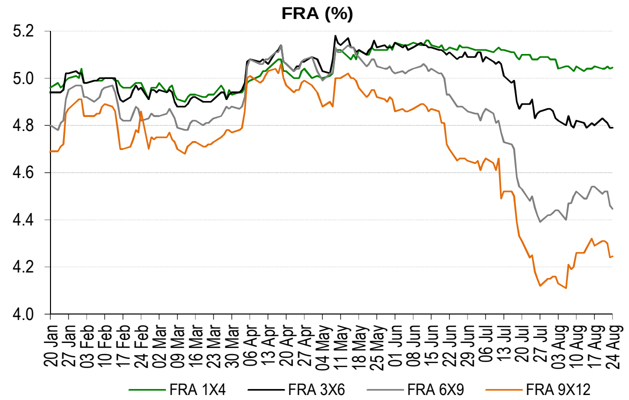
EURUSD temporarily highest since early July

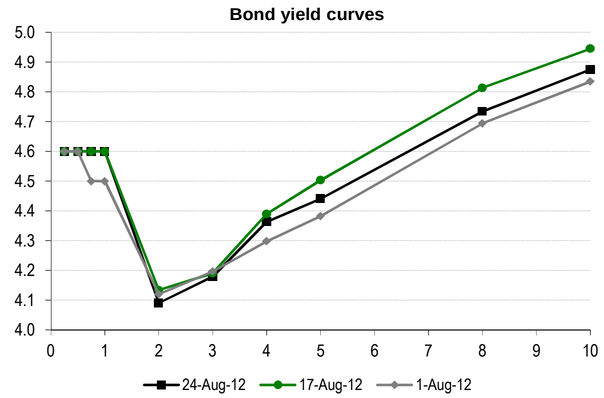
- Rumours saying that ECB intends to set a cap on yields for bonds from the euro zone's peripheries had a positive impact on the euro versus the dollar. Even a statement from the central bank that such reports are only misleading did not change the situation. Besides, minutes from last FOMC meeting proved surprisingly dovish and there was a rumour that Spanish government considers making a request for using EFSF in order to lower yields of bonds. This pushed the EURUSD for a while to nearly 1.26, highest level since the beginning of July. At the end of the week the exchange rate retreated back to 1.25.
- Even though no decisive actions were taken after the announcement made by Draghi that the ECB is ready to take stabilizing actions, Italian 10Y bonds recovered faster than the euro versus the dollar. 4-month correlation between EURUSD and yield of 10Y Italian bond weakened from nearly -0.8 just before the last ECB meeting to -0.65 currently, but that is still a high level. The perspective of Wednesday's auction and upcoming ECB meeting make results of debt sale an important factor for the situation on the market. Later in the week, investors' attention will focus on the speech to be delivered by Bernanke.
- From the technical analysis point of view, the exchange rate retreated at the end of the week from the upper band of the downward trend channel lasting since mid-2011. If that tendency was to be continued, then at the end of the year the EURUSD may reach 1.20, which is in line with our current forecast.

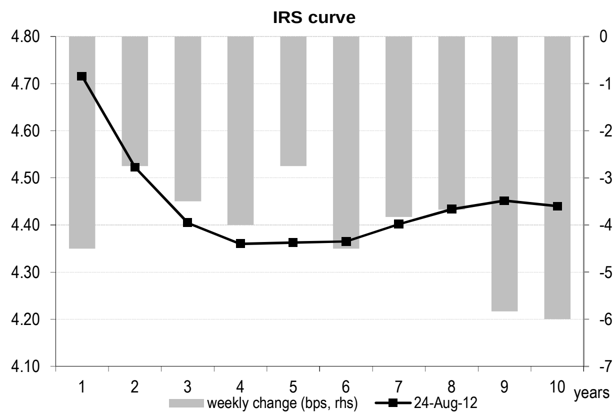
EURHUF and EURCZK close to local lows for a while

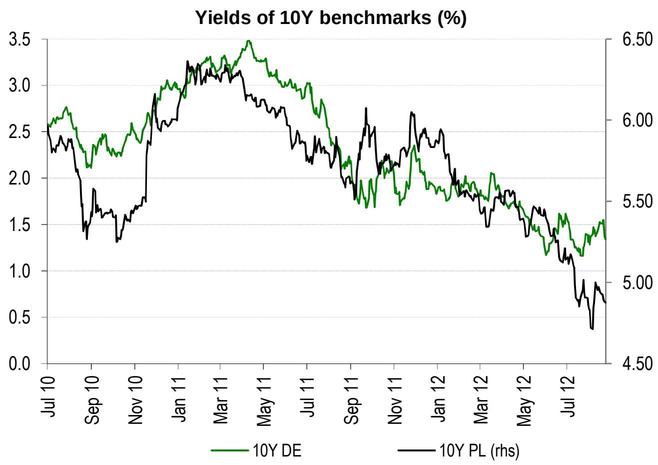
- The EURCZK approached at the beginning of the past week the lowest level since late April (24.68), but rebounded to 24.9 due to higher risk aversion in the following days.
- Also the EURHUF tested its local low (275 from first week of August) but just like in case of the koruna and the zloty, the forint gave away almost all gains at the end of the week (the exchange rate increased to nearly 279).

Interest rate market – Expectations for interest rate cuts strengthen









Minutes from July's meeting supported rate cuts

▪ Last week, the interest rate market was relatively calm due to holiday period. Released domestic macroeconomic data had limited impact on market's mood. FRA rates, after an earlier increase, remained relatively stable. Published minutes from the July's MPC meeting, showing that the Council voted two motions for rate cuts, caused a decline in FRA rates.

▪ Currently FRA quotations clearly suggest that market is pricing-in three full cuts (by 25bps each) in one year's horizon. However, one should notice that market players are divided about the question when will the MPC start its easing cycle. The first cut is expected mostly in October or November. In our opinion the beginning of 2013 is more probable, while in coming months we expect the Council to change its tone towards neutral.

▪ Last week the short end of the curve weakened significantly. Increase in yield of 2Y benchmark happened together with low turnovers. However, the move could have partly come from the lower expectations about interest rate cuts. Taking into account the relatively stable yields on mid and long end, we observed a yield curve flattening (the spread 2-10Y narrowed by 10bps in weekly terms).

▪ IRS rates were also relatively stable during the week. However, information about two motions for rate cuts at July's meeting helped the market to slide by 3-4bps along the curve. Weekly changes in IRS rates were higher than on bond yields and as a consequence asset swap spread narrowed, mainly in case of 2Y sector.

GDP data and supply for September are crucial

▪ The interest rate market has remained under interest rate cuts expectations. Therefore, investors will focus on Q2 GDP data (30.08), which will complete the picture of economic activity. Materialization of our scenario (GDP growth at 2.6%) could support the downward move on the front end of the curve (mainly FRA). It might strengthen expectations for interest rate cuts already this year, as they were already escalated by minutes of the July's MPC meeting.

▪ The long end of the curve will be vulnerable to global mood. We think that in short term Bund yields will decline further, which may also support the Polish 10Y bonds. An important support level is at 4.80%.

▪ From the supply side, this week's net inflows on the market will amount to ca. PLN2bn due to T-bills redemption (29.08). We believe that these means will flow into domestic banks, who are the main holders of T-bills. According to MF data at the end of June domestic commercial banks held T-bills worth ca. PLN7bn or 60% of total amount outstanding in this instruments.

▪ Poland's MF will also announce plan of Treasury Securities supply for September. We do not expect significant changes compared with Q3 issuance plan. It assumed two auctions next month: (1) switch (06.09) and (2) standard (12.09 or 19.09), at which the Ministry will offer bonds PS/DS/WS/WZ/IZ (depending on market situation) worth PLN2.0-4.0bn. In case of switch tender the Ministry could offer a buyback not only of bonds maturing in October 2012, but also papers maturing in January 2013. If we are right, then the MF will start to pre-finance the 2013 borrowing requirements.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl