Bank Zachodni WBK

Weekly economic update

3 – 9 September 2012

Last week passed in moderately weak sentiment on the global market. The released macro data mostly proved to be weaker than expected, thus escalating market's concerns about economic growth outlook. However, rise of risk aversion was limited mainly thanks to hopes that central banks will take actions aiming at supporting the economic growth. These expectations rose mostly due to upcoming Jackson Hole conference (where Ben Bernanke can announce launch of QE3) and ECB meeting (where Mario Draghi may talk about purchases of euro zone peripheries' bonds). Investors' attention was also drawn by Italy and Spain. Italy managed to sell 5- and 10Y bonds, but Spanish regions (Valencia and Catalonia) are having financial difficulties. Still, bond yields of these two countries did not record considerable increases due to expectations about the ECB. The zloty posted a marked weakening, with EURPLN rising to 4.20 and USDPLN to 3.36. This development was due to comment of Marek Belka, who suggested that MPC bias changed to more dovish, unexpected cut of interest rates by the Hungarian central bank, rising global risk aversion and to weak data on Polish GDP in Q2. As regards domestic bond market, short end of the curve gained significantly thanks to rising expectations for interest rate cuts, while gain at the long end was limited by the zloty depreciation.

This week the investors will focus on central banks' meetings. We expect that the MPC will not change interest rates, but will ease its tone considerably and may suggest a cut of interest rates at the next meeting. Recently Marek Belka said that the Council will not surprise with its decision, so the MPC may want to signal a cut in its statement (as it happened prior to May's hike). In our view, the ECB will not present its full version of new programme of euro zone peripheries' yields stabilization, but may show further details to buy more time. Also a row of important macro data is due for release, including PMI indices, payrolls and unemployment in the USA, German exports.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (3 September)					
	US	Market holiday					
4:30	CN	PMI – manufacturing	Aug	pts	-	-	49.3
9:00	**PL**	**PMI – manufacturing**	**Aug**	**pts**	**49.0**	**49.0**	**49.7**
9:53	DE	PMI – manufacturing	Aug	pts	45.1	-	43.0
9:58	EZ	PMI – manufacturing	Aug	pts	45.3	-	44.0
		TUESDAY (4 September)					
16:00	US	ISM – manufacturing	Aug	pts	50.0	-	49.8
		WEDNESDAY (5 September)					
	PL	**MPC decision**		**%**	**4.75**	**4.75**	**4.75**
9:53	DE	PMI – services	Aug	pts	48.3	-	50.3
9:58	EZ	PMI – services	Aug	pts	47.5	-	47.9
11:00	EZ	Retail sales	Jul	%MoM	-0.2	-	0.1
		THURSDAY (6 September)					
11:00	**PL**	**Bond switch auction**					
11:00	EZ	GDP revision	Q2	%YoY	-0.4	-	0.0
13:00	GB	BoE decision		%	0.50	-	0.50
13:45	EZ	EBC decision		%	0.75	-	0.75
14:15	US	ADP report	Aug	k	150	-	163
14:30	US	Initial jobless claims	week	k	370		374
		FRIDAY (7 September)					
8:00	DE	Exports	Jul	%MoM	-0.5	-	-1.5
12:00	DE	Industrial output	Jul	%MoM	0.0	-	-0.9
14:30	US	Non-farm payrolls	Aug	k	135	-	163
14:30	US	Unemployment rate	Aug	%	8.2	-	8.3

Source: BZ WBK, Reuters, Dow Jones

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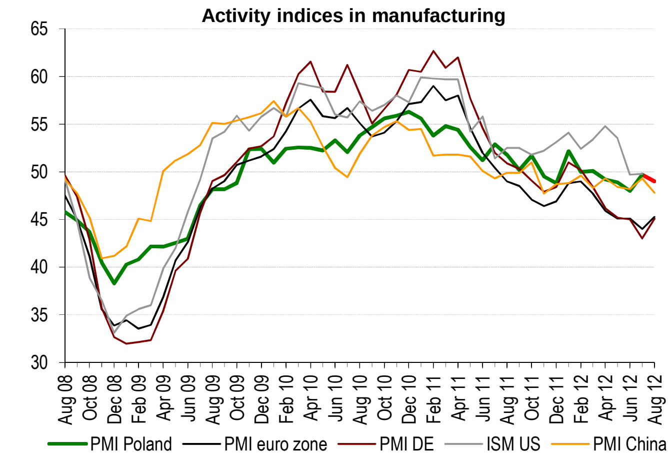
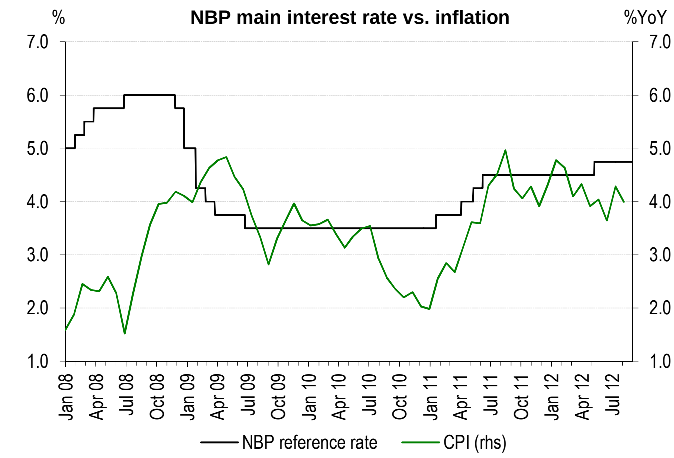
What's hot this week – Final PMI, first MPC meeting after holidays



▪ Although flash PMI indices in the euro zone saw a slight improvement, in case of Poland a correctional rebound took place one month earlier, and in August we expect to see a slight decrease of the index, confirming that situation in Polish industry continues deteriorating – probably the survey will show a further fall in new orders and production. In recent months the PMI report showed less pessimistic assessment of situation in the labour market, however thus far those signals have found no confirmation in the CSO data on corporate employment.

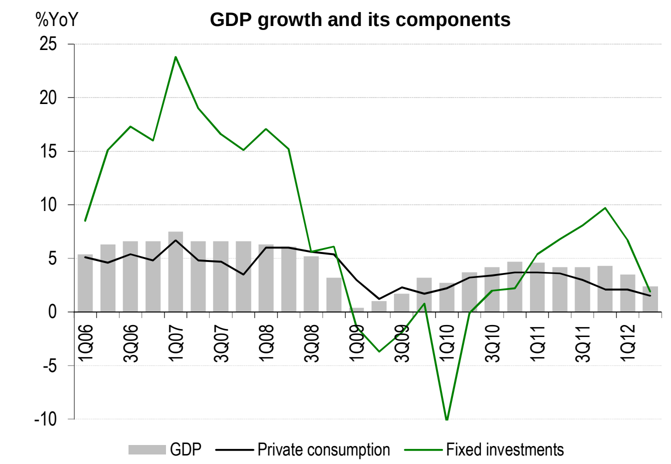
▪ The key event for the domestic financial market will be the first MPC's meeting after the summer break. Recent weak data, which worsened economic outlook for next quarters, convinced us to change interest rate forecasts – we now expect two rate cuts this year, 25bps each, however the first one will probably wait until October.



▪ It seems to us that in September the majority of Council members will not be ready yet to relax monetary policy (although they ought to be), but they will suggest possible rate cut in October in the statement.

▪ Please recall that the MPC did hike interest rates in May, i.e. exactly in the middle of quarter, which saw a drop in domestic demand. The Council justified it back then by saying that outlook for Polish economy is definitely far better than expected by most of analysts. Recent data have shown that this assessment was wrong. While some MPC members have already realised it (which is confirmed by rate-cut motions submitted in July, and recent M.Belka's comments), for some of them (Kaźmierczak) the current CPI reading is still the key decisive factor.

Last week in the economy – Considerable slowdown of GDP growth, falling domestic demand



▪ GDP growth decelerated in 2012Q2 to 2.4%YoY, below our forecast (which was actually the most pessimistic on the market). Domestic demand slowed markedly (-0.2%YoY). This was due to a strong slowdown of fixed investments (1.9%YoY) and considerably lower increase of stocks than one year ago (change of stocks subtracted almost 1.5pp from the GDP growth). Individual consumption is also decelerating. On the other hand, net exports had significant positive contribution to pace of GDP growth in Q2 (2.6pp), as the trade balance improved despite slowing exports (thanks to weaker imports).

▪ We expect a further deceleration of GDP growth in H2, probably below 2% in Q3. It means the necessity to revise earlier forecast of GDP for 2012 and 2013. Revised predictions will be published in upcoming monthly report.

Quote of the week – We now rather talk about rate cut prospects

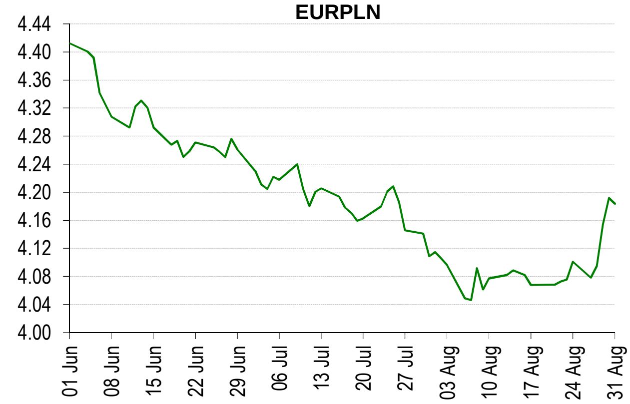
Marek Belka, NBP president, 28.08, PiN radio
Monetary policy bias surely changed as compared to the one from the previous months. We now rather talk about rate cut prospects and not about some pressing need of hikes. I do not expect the September's meeting to be turbulent. I do not expect the Council to surprise.

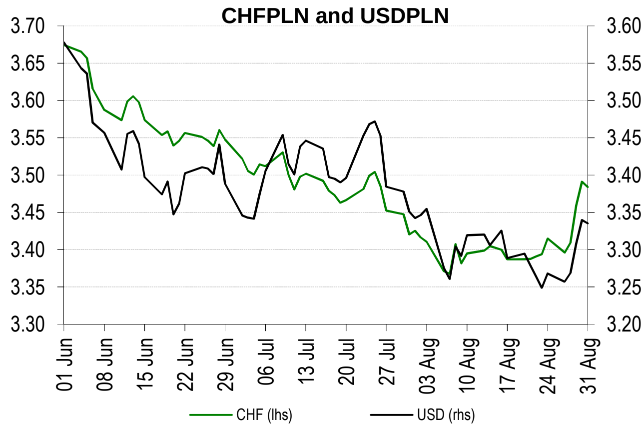
Elżbieta Chojna-Duch, MPC member, 27.08, Reuters
We should consider a verification of MPC target in September. For example, we can aim at a range, or raise the target itself. We live in an inflationary world, our current target makes our policy too restrictive.

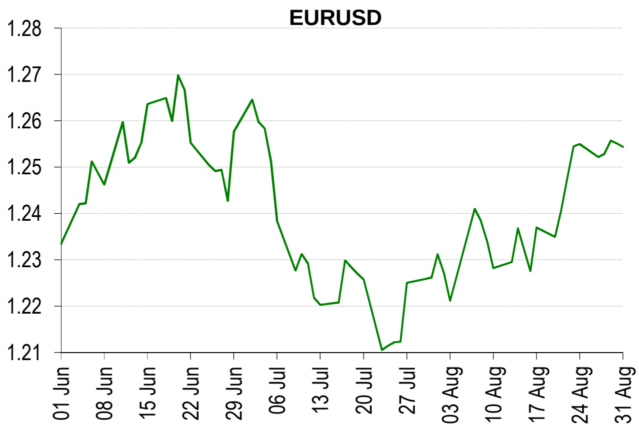
Andrzej Kaźmierczak, MPC member, 27.08, Reuters
Discussion about interest rate cut would be premature. First we need to be sure that inflation's decline is persistent and inflationary factors will not be considerable.

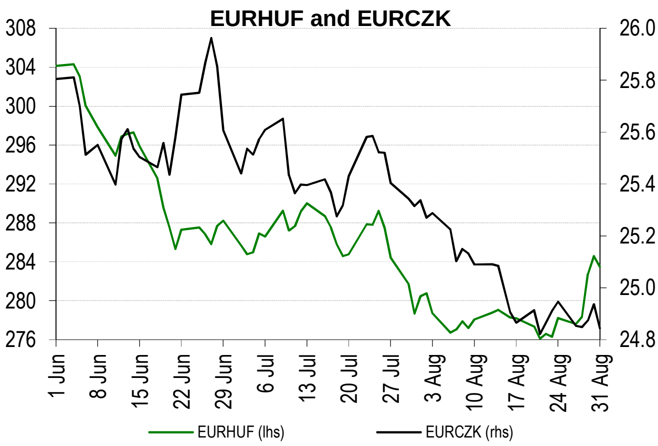
Marek Belka clearly suggested that the bias of the MPC has changed towards more dovish. And that was even before the release of GDP data that probably proved disappointing for the Council (July's projection prepared by the NBP suggested growth above 3% and recent forecasts of NBP economists pointed to 2.9%). We will probably see the effect of this publication in the tone of the statement. Most likely, there will be also a discussion on changing the inflation target though the outcome of these talks may not be known until the release of "Monetary policy guidelines for 2013" (end of September). A higher target would make it easier for the MPC to cut rates. However, we do not think the MPC will decide for such a move, as it surely would not improve credibility of its monetary policy.

Foreign exchange market – Zloty weaker, central banks will decide about FX market trends









Zloty sharply depreciated after weak Q2 GDP data

- Last week zloty significantly depreciated in relation to main currencies due to several reasons, including: (1) more dovish statement by the NBP's governor, who said that now rates cuts are more probable than hikes; (2) the Hungarian forint depreciation after unexpected central bank rate cut by 25bps; (3) weaker than expected Q2 2012 GDP growth data, which supported expectations for interest rates cuts later this year. The EURPLN, after breaking the first resistance level at 4.10, increased above 4.15 and tested 4.20 on Thursday (reaching weekly maximum at 4.206). The zloty trimmed part of losses on Friday.
- The Polish currency depreciated also in relation to the US dollar. The USDPLN, after trading in horizontal trend between 3.25-3.30, broke the upper limit of the range and increased to 3.33 after GDP data release. Sharp decline of the EURUSD (below 1.25 due to politicians' statement) caused the USDPLN increase towards 3.36. In case of the CHFPLN, the exchange rate moved up towards 3.50, ending the week near 3.48.
- This week will be very important for investors mainly due to central banks meetings (MPC, BoE, ECB). Materialization of our scenario (rates on hold, softer rhetoric of the Council) might stabilize the zloty. On the other hand any suggestion by the ECB about purchasing debt of the euro zone peripheries or decision of cut official rates could translate into risk-on mood. As a consequence the EURPLN should fall towards 4.14. However, the resistance zone between 4.20-4.22 is still valid and we think that its break will open the room for further increase towards 4.30.

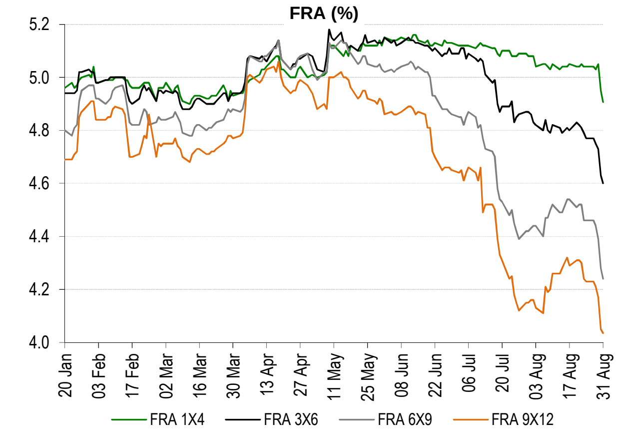
The EURUSD still under the Jackson Hole meeting

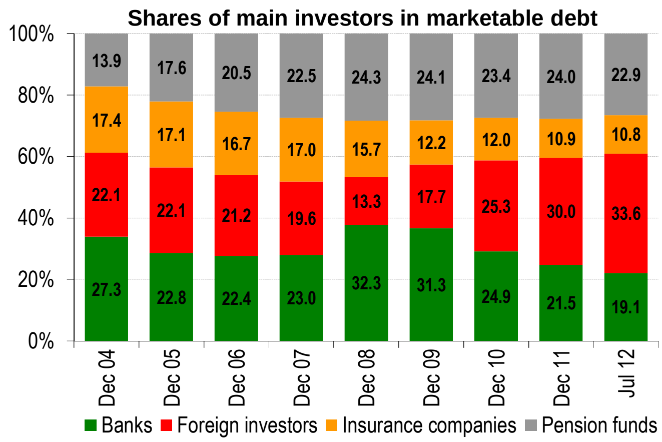
- The EURUSD has remained under expectations of Ben Bernanke's speech in Jackson Hole on Friday. Fears about global economy mix with hopes that central banks will act to stabilise situation on peripheries' debt or support economy (strong expectations on QE3 by Fed). As a result the EURUSD has consolidated between 1.2475-1.2575, mostly staying above 1.25, while downward move resulted from politicians' statements.
- Waiting for the Jackson Hole's news, the EURUSD has tested the upper limit of consolidation channel. Some suggestion that the QE3 this year is still probable, despite that such scenario is partly priced-in by market could result in the US dollar weakening and cause the EURUSD increase towards 1.27. This impulse could be strengthened by the ECB's decision about supporting the peripheral debt. Otherwise we foresee the EURUSD to decline towards 1.24-1.23.

EURHUF getting higher after NBH decision

- The Hungarian forint was under pressure after August's central bank decision. Unexpectedly, it decided to cut rates by 25bps to 6.75%, which caused strong sell-of of HUF. The EURHUF increased above 280, ending the week near 284. In weekly terms the Hungarian forint lost 2% against the euro.
- Comparing to zloty and forint, Czech currency was relatively stable last week. The EURCZK was fluctuating in range 24.845-24.94.

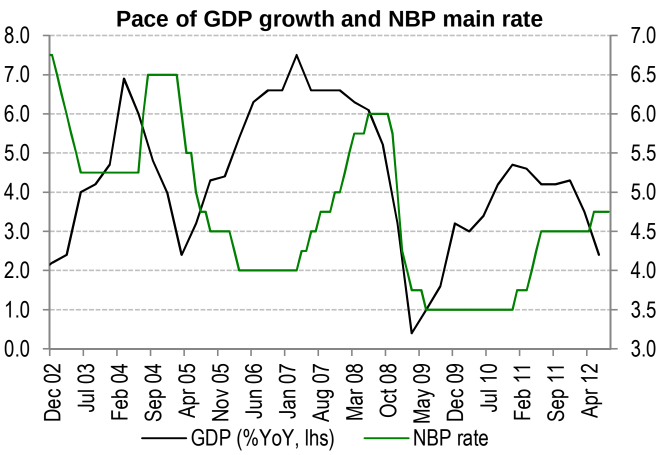
Interest rate market – MPC communique in the focus of attention





Bond auctions scheduled in September				
	Planned supply (bnPLN)	Change of yields since 1.08.2012	1.01.2012	Yield at last auction
6.09.12*				
WZ/PS	-	-/-2bps	-	-/4.36
19.09.12				
IZ0823	2.0-4.0	-	-	-
WZ0121		-	-	-
DS1021		-4bps	-101bps	5.56

*Switch auction



Short end of the curve down after GDP data

▪ The release of Polish Q2 GDP data (below even our most pessimistic forecast on the market) initiated sudden plunge of yields at the short end of the curve. More aggressive pricing in rate cuts was also triggered by the comment of NBP governor saying the bias of the MPC has changed and the unexpected rate cut in Hungary.

▪ FRA rates plunged by 9bps for 1x4 and nearly 20bps for 9x12 on weekly basis. Consequently, the market prices currently in that during next 3 months rates will be reduced with 80% of probability by 50bps. Furthermore, for the first time WIBOR rates reacted to switch of market expectations for rate cuts – after release of weaker than anticipated GDP rates plunged by 5-7bps, which was biggest daily decline since June 2009. On weekly basis 3M and 6M WIBOR declined by 12bps.

▪ Medium-term bonds gained ca. 10bps, slightly less than short-term bonds (13bps). Yields and the longer end fell at the end of the week by mere 3bps after an earlier increase due to the zloty depreciation. Over the whole week, trade volumes were very low, with small and temporary increase after data on GDP.

▪ Bond and IRS curves steepened over the last week. 2-10 spread rose in both cases by ca. 10bps.

▪ The finance ministry will sell WZ0117 and PS0417 bonds and purchase OK1012 and OK1013 at switch auction in September. The ministry will offer 10Y benchmark at a regular auction.

▪ Foreign investors' engagement in domestic PLN-denominated bonds rose by PLN3.9bn at the end of July to an all-time at PLN178.2bn. This makes 33.6% of marketable Polish debt securities. It is worth noting that domestic banks' holdings fell to PLN101.3bn (by PLN7.2bn, the highest decline since September 2011).

MPC's decision and statement in focus

▪ Even though we expect the first of two cuts forecast for this year in October, we do actually think that the MPC should not wait with monetary easing. What is interesting, if a cut was implemented in September, then it would be the seventh quarter after local peak of GDP growth (4.7%YoY in 2010Q4). A similar situation occurred in November 2008, when the previous MPC cut rates by 25bps (from 6.0%), initiating a rapid easing cycle, which brought the rates down to 3.5% in reaction to global financial crisis.

▪ In our view, statement from the September's MPC meeting will show a change in the Council's bias, suggested by the NBP president last week. We think that some correction of last decline of FRAs and strengthening of 2Y bonds may take place in first reaction after the decision. However, a more dovish tone of the communiqué may revive expectations for interest rate cut at the October's meeting.

▪ Bonds from the middle and longer end will stay under influence of global events and results of domestic switch auction. It is worth noting that spread between 5Y domestic papers and German bonds is close to local minimum (400bps) while 10Y spread rebounded from a resistance at 360bps.