

Weekly economic update

5 – 11 November 2012

Due to shutdown of the US market related to approaching hurricane Sandy, the situation on the global market was differing a lot from developments taking place on the East Coast of the US. Limited liquidity constrained trading range and during the past week no breaking changes occurred. Some negative pressure on the single currency was put by information from Greece and Spain. First, comments from the ECB tamed expectations for next restructuring of Greek debt (the part in hands of public institutions) and at the end of the week the Court of Auditors suggested the labour market reform (which implementation is one of crucial conditions in obtaining next tranche of international aid) may be unconstitutional. Furthermore, market might have been somewhat disappointed by media citing unofficial comments of Spanish PM Mariano Rajoy who said reportedly that he does not see urgent necessity to ask for external help (while the market is looking forward to it for few weeks). Still, these rumours did not trigger weakening of Spanish debt and this shows that investors are not eager to trade 'against' the ECB. The zloty pared some part of losses suffered previous week largely due to better than expected data from the US.

Possible narrowing of interest rate differential between Poland and core markets, priced-in by the market, was one of important factors behind zloty depreciation in recent weeks. No surprise from the MPC regarding decision on interest rates this week (rate cut by 25bps) may put negative pressure on the zloty as it will dispel any uncertainty that the easing cycle has begun. The decision of the Council and the statement shall support (at least) short end of the bond curve. Regarding global events, investors' attention will likely focus on US elections. Next to results of presidential elections, results of voting for House of Representatives and Senate may be crucial, as it may determine the timing when the agreement on savings will be reached and whether the US will avoid fiscal cliff. On Thursday Spain will issue its bonds and this will be some kind of measure of investors' faith that debt crisis will be dealt with. Also the outcome of the ECB meeting is likely to be analysed by investors in this respect.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (5 November)							
10:30	EZ	Sentix index	Nov	pts	-20.0	-	-22.2
16:00	US	ISM – services	Oct	pts	54.5	-	55.1
TUESDAY (6 November)							
	US	Elections					
9:53	DE	PMI – services	Oct	pts	49.3	-	49.7
9:58	EZ	PMI – services	Oct	pts	46.2	-	46.1
12:00	DE	Industrial orders	Sep	%MoM	-0.5	-	-1.3
WEDNESDAY (7 November)							
	PL	MPC decision		%	4.50	4.50	4.50
11:00	EZ	Retail sales	Sep	%MoM	-0.1	-	0.1
12:00	DE	Industrial output	Sep	%MoM	-0.5	-	-0.5
THURSDAY (8 November)							
8:00	DE	Exports	Sep	%MoM	-1.5	-	2.4
11:00	PL	Bond auction (PS0418), planned supply PLN2-4bn					
13:00	GB	BoE decision		%	0.50	-	0.50
13:45	EZ	ECB decision		%	0.75	-	0.75
14:30	US	Initial jobless claims	Week	k	370	-	
14:30	US	Trade balance	Sep	\$bn	-45.3	-	-44.2
FRIDAY (9 November)							
4:30	CN	CPI	Oct	%YoY	1.9	-	1.9
4:30	CN	Industrial output	Oct	%YoY	9.4	-	9.2
15:55	US	Flash Michigan	Nov	pts	82.8	-	82.6

Source: BZ WBK, Reuters

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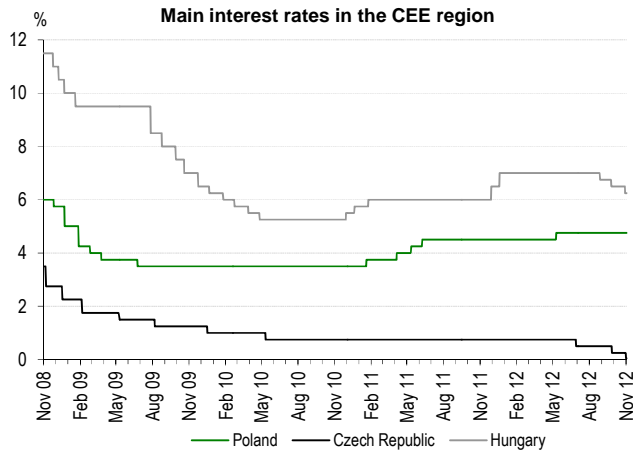
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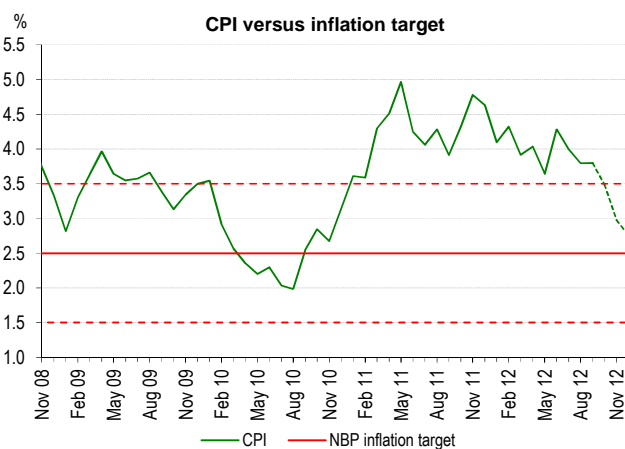
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What's hot this week – Rate cut... and what next?

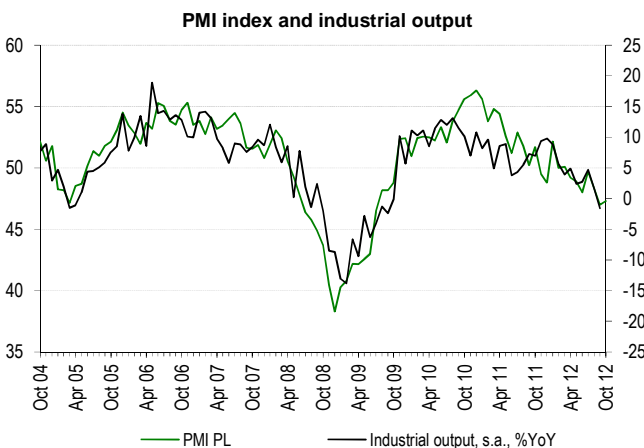


- The key event of the week in the domestic market will be MPC decision, to be announced on Wednesday.
- Interest rate cut seems to be almost a deal done – the conditions set by the Council last month have been met, and latest data delivered even more evidence that monetary policy easing is needed and justified.
- We do not know the results of the NBP's new projections, but they are likely to show deeper and faster drop in GDP growth and inflation.
- None of polled analysts predicts keeping interest rates stable, and rate cut is also priced-in by the financial market. At the same time, there are almost no opinions that cut may be deeper than 25bp (although such move would be justified in the light of recent data!), due to the MPC members' declarations that they do not want any sudden changes in monetary policy.



- Nevertheless, after surprising MPC decisions taken in previous months, there is still some degree of uncertainty regarding the nearest meeting's outcome, so even the announcement of the rate cut may strengthen expectations for further cuts.
- The key will be the official post-meeting statement though, and whether the MPC will herald a cycle of cuts.
- The tone of the Council's statement is likely to remain quite soft, however we do not expect a radical change, as long as the MPC members do not see a marked drop in observed inflation (not only in NBP forecasts). But this may take place quite soon, as our forecasts show that CPI will be falling quickly in nearest months, declining clearly below 3% in December and to (or below) the 2.5% target in Q1-13. At the same time, GDP growth will slow down to ca. 1%.

Last week in the economy – Polish PMI slightly up, unlike in Germany and euro area



- Polish manufacturing PMI increased in October to 47.3, beating expectations. However, the index remains well below neutral level of 50, signalling that activity in Polish industry is contracting, although at smaller pace. Slightly smaller decrease than in August was recorded in production size and in new orders (except export orders!). At the same time, sub-index of employment dropped sharply, showing fastest job reduction in companies in three years.
- Interestingly, once again Polish PMI contrasted with analogous indices for Germany and euro zone, where declines were recorded after two months of improvement.
- Households' inflation expectations decreased in October to 3.8%, not only thanks to drop in CPI, being a basis for calculation, but also due to improvement of structure of answers.

Quote of the week – Investors still very interested in Polish debt market

Wojciech Kowalczyk, deputy finance minister, 2 Nov, PAP

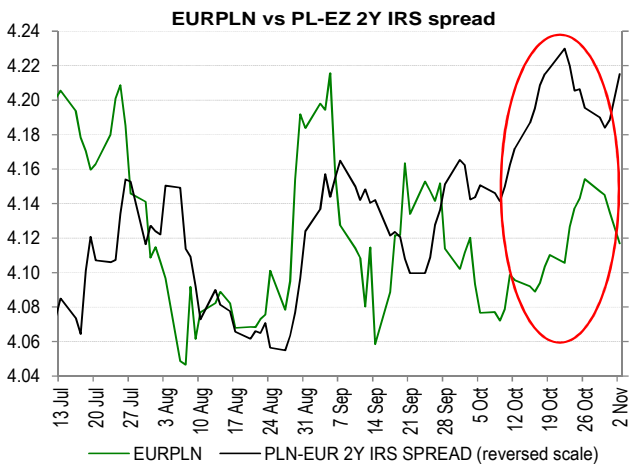
There is very high interest of Asian investors with Polish market, this includes the biggest and more respected institutions. Issue of bonds in Japanese markets and participation of stable investors is a good recommendation to buy our bonds also by other investors from other Asian countries.

Piotr Marczak, head of FinMin's debt department, 31 Oct, PAP

After completion of financing this year's borrowing requirements we are steadily fulfilling plan of financing at least 20% of next year's borrowing needs. This means we are holding substantial reserve of zloty and foreign-currency funds, which will amount to ca. PLN51bn at the end of October.

The successful issue of Polish bonds at the Japanese market was another confirmation that domestic bonds are still enjoying large interest from foreign investors. According to information released by the Ministry of Finance, at the end of September foreign investors possessed domestic treasuries worth a record-high PLN184.2bn (monthly increase by PLN4bn, strongest since May 2012). Therefore, their share in Polish marketable debt topped 35%. Demand of foreign players, still favourable supply situation, and expectations for interest rate cuts by the MPC, will keep supporting Polish bond yields. On the other hand, mid- and long end of the curve may be under pressure of zloty depreciation and higher global risk aversion.

Foreign exchange market – Outcome of MPC meeting may put negative pressure on the zloty



Domestic currency pares some losses

- After strong depreciation of the zloty recorded previous week, next five days brought recovery. Despite the inflow of negative information on Greece, the EURPLN plunged at the end of the week to ca. 4.10. The move down was to large extent driven by set of better than expected US data and was most visible on Thursday when the liquidity was very limited due to market holiday in Poland and persisting optimism worldwide.

- Though many vital events are due next week, we think the MPC decision may have visible impact on the zloty. On the chart we see that pricing-in of some narrowing of interest rate differential between Poland and the euro zone was a one of important factors fuelling depreciation of the zloty in recent weeks. We and the market expect a rate cut by 25bps but until it takes place, some uncertainty remains. Thus the decision in line with expectations may have an impact on the market. Furthermore, we think that new projection will show there is room for more easing and this will be reflected in the statement from the meeting. We assume its dovish tone will strengthen expectations for more rate cuts. Additionally, next interest rate cuts made recently by other central banks in CEE region (Hungary, Czech Republic) may also support expectations for relaxation of domestic monetary policy. Important levels for this week for the EURPLN are 4.10 and 4.16.

EURUSD stable due to hurricane

- Closure of US market during first two days of the week caused that there were no breakthrough changes in EURUSD rate. Over the week, the euro lost versus dollar due to new concerns about Greece (strengthening of worries whether the country will get next tranche of help) and Spain (still no formal application for help).

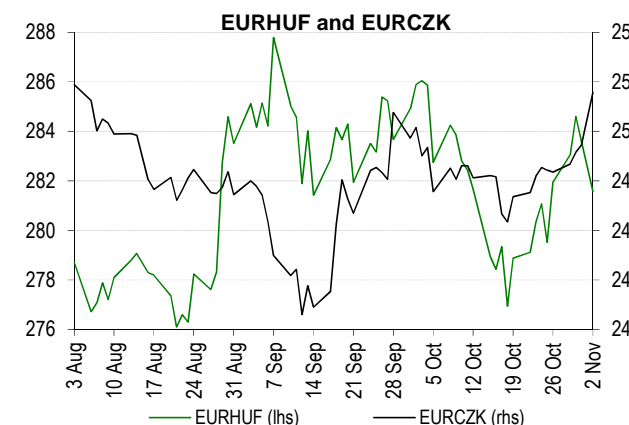
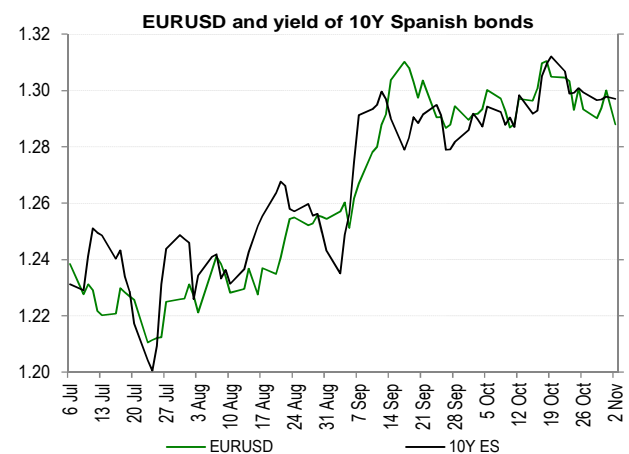
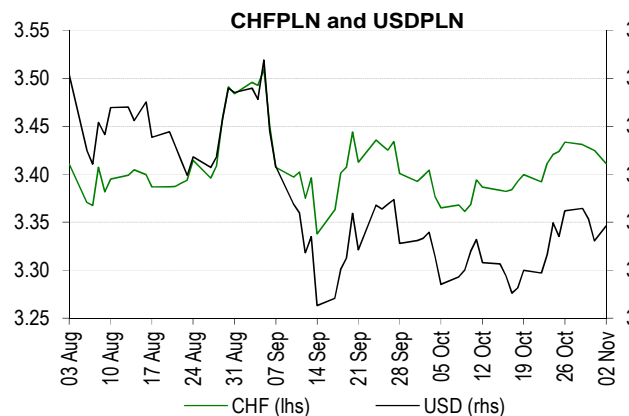
- This week, important events for global market will be elections of the US president and to the US Congress. The results of the latter will be also important as they may determine the pace at which agreement on budget savings will be made, and may decide whether the US will avoid a fiscal cliff at the start of 2013.

- Auction of Spanish bonds will be a gauge of investors' sentiment in Europe, as the issue of euro area's debt crisis is in the spotlight again. At the end of the week the EURUSD was near the important support, slightly above 1.28 (another support is at 1.274).

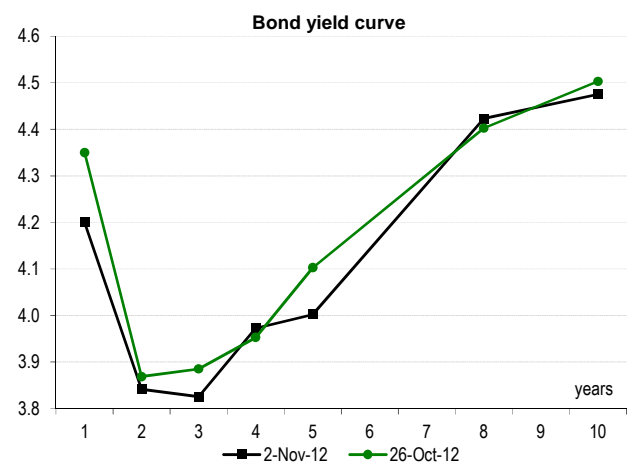
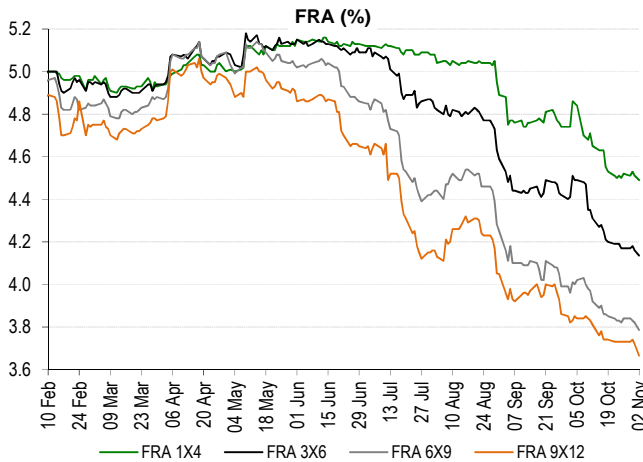
Crown falling after rate cut

- Czech crown depreciated against euro last week, hurt by unexpected interest rate cut by the central bank, to the lowest level in history (to 0.05% from 0.25%). The EURCZK rate rise during the week from 24.93 to 25.27, the highest level since the start of August 2012.

- Forint maintained the sell-off from last week, due to interest rate cut and uncertainty regarding timing of Hungarian government's agreement with the IMF concerning the loan. EURHUF rate soared at the start of the week from ca. 281 to 285.5, and in the next days forint was benefiting from improvement of global moods and trimmed almost all losses from the start of the week.



Interest rate market – The MPC’s decision and auction results are crucial for market mood



Money market rates lower ahead of rate cuts

- Last week brought further gradual decline in rates on the money market. At the end of October WIBOR 3M was quoted below the reference rate level, first time since the beginning of 2006. In weekly terms WIBOR rates declined by 3bps.
- As we expected FRA market has remained relatively stable. However, the end of the week brought significant decline (by 3-6bps in daily basis) in rates amid low activity of investors. The level of FRA rates suggest that investors expect WIBOR3M to fall by another 100bps in 9 months horizon.
- This week the main event is the MPC rate sitting. It is widely expected that the Council will cut rates by 25bps. We think that such decision together with keeping soft tone of statement might generate some impulse to further decline in FRA rates.

Bond market strengthened at the end of month

- At the beginning of last week investors have continued sale of medium and long-terms bonds. Yield of 10Y bonds (DS1021) tested resistance level at 4.55%, which effectively stopped upward move. Global investors’ mood improvement, which caused the zloty appreciation, also helped bonds to strength, trimming earlier losses in 5Y and 10Y sectors. In case of 2Y benchmark, yield declined to a new historical low (3.84%).
- The scope of changes on the IRS market was subdued. Rate of IRS 2Y has stabilized near 4.15%, while IRS 10Y has increased slightly above crucial support level at 4.35%. Currently IRS rates are oscillating slightly above historical minimum. In our opinion investors need an additional impulse to test or much more for breaking this level. We think that it could be interest rate cut decision and announcement of further monetary easing at November’s meeting.

Auction schedule for November

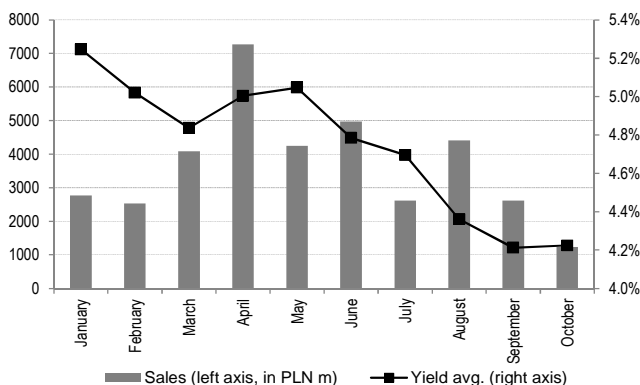
Regular auction			
Date of tender	Settlement date	Series	Expected offer (in PLN m)
8 Nov 2012	12 Nov 2012	PS0418	2,000–4,000
Switch auction			
Date of tender	Settlement date	T-bonds to be offered	T-bonds to be repurchased
21 Nov 2012	23 Nov 2012	DS1023 / WZ0117 / WZ0121	OK0113 / PS0413

- Auction calendar for November was in line with the quarterly issuance plan. However, the structure of offer a bit surprised as the MF decides to offer a new 5Y bond of PS series (PS0418). Detailed information about auction in November is presented in the table beside.

MPC decision and bond auction key for market

- This week the key events in the debt market will be Wednesday’s MPC decision and auction of new 5Y bonds. MPC decision to cut rates will be consistent with market expectations, so the key issue will be the post-meeting statement and press conference, which may include some suggestions concerning future policy actions. Announcement of more rate cuts may generate impulse for further strengthening at the short end of the curve.

Auction results of 5Y T-bonds in 2012



- On Thursday, after the MPC decision, the auction of new 5Y bond will be held; the supply is planned at PLN2-4bn. Auction may meet with large investors’ demand, especially that this may be the last regular auction this year. One should remember that Treasuries’ offer for December is conditional and will depend on market situation. Higher than initially planned sale of yen-denominated bonds (5Y and 15Y bonds were sold, worth in total JPY66bn) may support scenario of lack of debt supply in the last month of the year.

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