Bank Zachodni WBK

Weekly economic update

19 – 25 November 2012

During the past week market attention focused again, after few months of break, on Greece. Initially, the market mood was improving due to suggestions of participants of the Eurogroup meeting that Greece will have two more years to reduce its debt. Still, during the negotiations the IMF opposed such solution and thus the decision on disbursement of the next tranche to Greece was postponed to November 20th. Investors started to worry whether this country will be able to buy back its maturing debt (finally it issued T-bills and there was no complications). Negative pressure on the market sentiment was put during the week (and will continue to do so in the nearest future) also by uncertainty regarding US fiscal situation. Minutes of November's Fed meeting strengthened expectations that QE3 may be extended or its scale increased.

Flash data on euro zone's Q3 GDP proved slightly better than expected (GDP declined by 0.1%QoQ). That was second consecutive quarter of GDP contraction and this means the euro zone entered technical recession for the second time since 2009. Data for Germany, France and Italy surprised to the upside, but it is worth to notice that survey activity indicators suggest more pronounced slowdown than macro data from real economy do. So far it is hard to prejudge whether this is an omen of deeper recession or too much pessimism from surveyed entrepreneurs.

This week the market will focus again on the Eurogroup meeting (Greek bailout), US macro data and flash PMIs. Regarding domestic data, the CSO will release numbers for labour market and output in industry and construction. In our opinion this data will confirm that the economic slowdown continues and together with data from the previous week (return of inflation into the tolerance band) shall strengthen expectations for NBP rate cuts. It is worth to remember, that data on industrial output will likely show a rebound due to statistical effects (number of working days) and may be misinterpreted by the market and fuel the correction on the bond market. The zloty will remain under influence of global factors. The EURPLN was only for a moment above the resistance at 4.18, so this level remains valid. It seems, that the market is already pricing-in further monetary policy easing by the MPC and therefore for further depreciation of the zloty another dovish signals from the Council and/or weak macro data may be needed.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (19 November)					
14:00	**PL**	**Wages in corporate sector**	**Oct**	**%YoY**	**2.5**	**1.7**	**1.6**
14:00	**PL**	**Employment in corporate sector**	**Oct**	**%YoY**	**-0.1**	**-0.1**	**0.0**
16:00	US	Home sales	Oct	m	4.75	-	4.75
		TUESDAY (20 November)					
14:00	**PL**	**Industrial output**	**Oct**	**%YoY**	**3.0**	**4.9**	**-5.2**
14:00	**PL**	**Construction and assembly output**	**Oct**	**%YoY**	**-7.0**	**-5.6**	**-17.8**
14:00	**PL**	**PPI**	**Oct**	**%YoY**	**1.7**	**1.7**	**1.8**
14:30	US	House starts	Oct	k	850	-	872
14:30	US	Building permits	Oct	k	865	-	890
		WEDNESDAY (21 November)					
11:00	**PL**	**Bond switch auction**					
14:00	**PL**	**Core inflation**	**Oct**	**%YoY**	**1.9**	**1.9**	**1.9**
14:30	US	Initial jobless claims	Week	k	400	-	439
15:55	US	Michigan index	Nov	pts	84.5	-	82.6
16:00	US	Leading indicators	Oct	%MoM	0.2	-	0.6
		THURSDAY (22 November)					
4:30	CN	Flash PMI-mfg	Nov	pts	-	-	49.5
9:28	DE	Flash PMI-mfg	Nov	pts	46.0	-	46.0
9:58	EZ	Flash PMI-mfg	Nov	pts	45.5	-	45.4
14:00	**PL**	**MPC minutes**					
16:00	EZ	Consumer confidence index	Nov	pts	-25.7	-	-25.6
		FRIDAY (23 November)					
10:00	DE	Ifo index	Nov	pts	99.5	-	100.0

Source: BZ WBK, Reuters, Parkiet, Dow Jones

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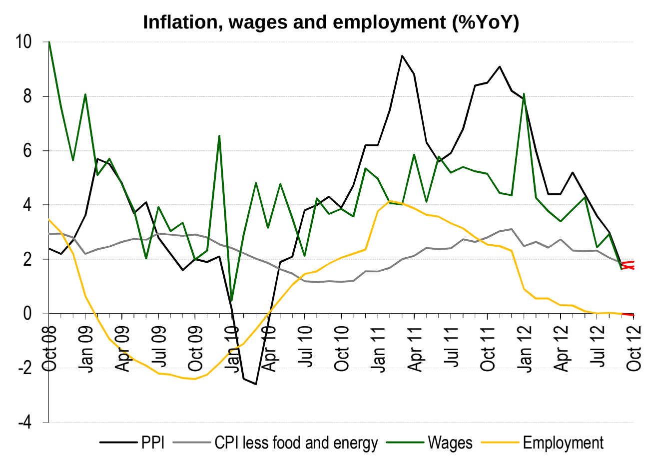
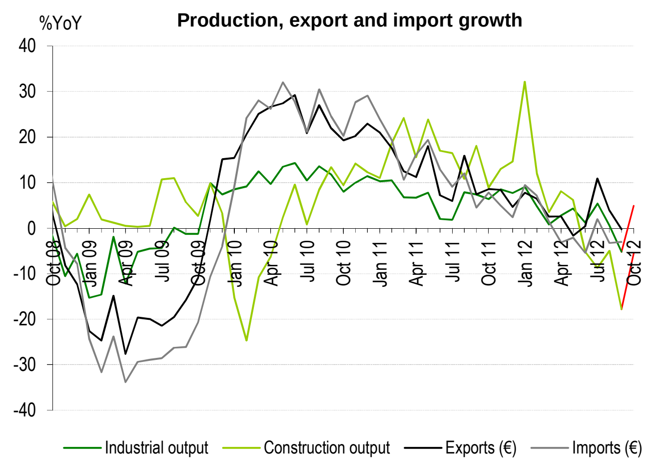
What's hot this week – New set of October's data

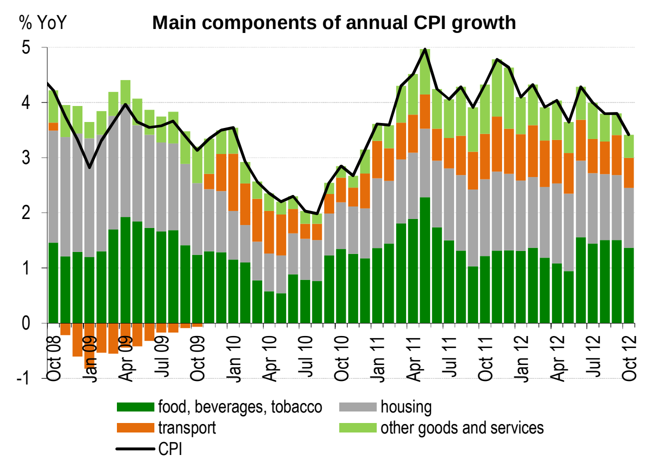


- We expect to see rather weak October's data from the labour market. Employment in corporate sector most likely fell by 0.1%YoY and was below last year's level for the second straight month. Meanwhile, wage growth probably accelerated slightly (to 1.7%YoY), supported by higher number of working days. Still, real wage bill in corporate sector has continued falling, having adverse effect on private consumption in the fourth quarter.
- PP growth probably slowed down to 1.7%YoY, among others thanks to appreciation of the zloty and slight decline of world commodity prices. In turn, core inflation excluding prices of food and energy is estimated to remain at 1.9%YoY. The data will confirm weakness of inflationary pressure, supporting our forecast of imminent drop of headline inflation rate.



- October saw some rebound in production, both in industry (4.9%YoY after -5.2% in September) and in construction (-5.6% after -17.8%YoY).
- While last month we had pointed out that production data was biased down by lower number of working days, in October the effect was opposite – there were two more working days than in 2011, which had positive impact on the volume of output. Therefore, attention should be focused on adjusted series, which in our view will show persistence of downward trend in production (close to zero growth in industry and -7%YoY in construction).
- October's industrial output data was negatively affected by temporary suspension of production in some areas, for example in car factories.

Last week in the economy – Inflation returned to tolerance band



- Export fell in September by 0.3%YoY and import by 3.0%YoY. Trade balance appeared to be slightly positive (€84bn, for the first time since 2005). Nevertheless, the current account deficit has increased due to lower balances of services and income. We predict that foreign trade turnover will continue slowing down in nearest months.
- In October the CPI inflation fell to 3.4%YoY from 3.8% in September. Thus, inflation returned to the tolerance band around the inflation target for the first time in 21 months. In our view, inflation will stay in this band in nearest quarters, and in few months' time it will be very close (or even below) the target.
- M3 money growth accelerated in October to 8.0%YoY from 7.6%. Loan growth after eliminating FX fluctuations slowed down to 6.8%YoY from 7.5% in September.

Quote of the week – Real interest rates should be positive, yet moderate

Adam Glapiński, MPC member, 10.11, Reuters
Two rate cuts by 25 bps are most likely.

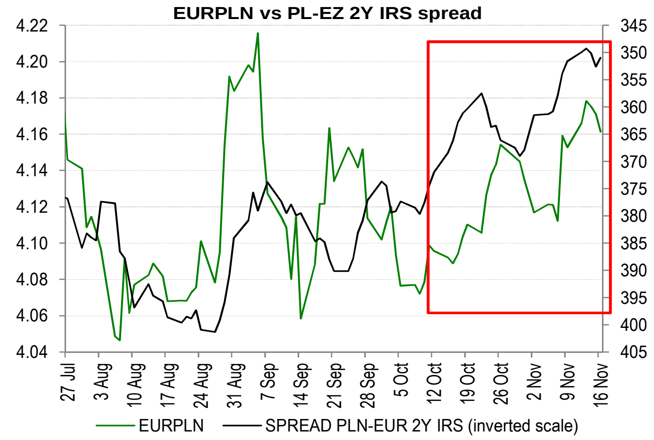
Jan Winiecki, MPC member, 12.11, TVN CNBC
I would be willing to accept even another reduction of 25 bps.

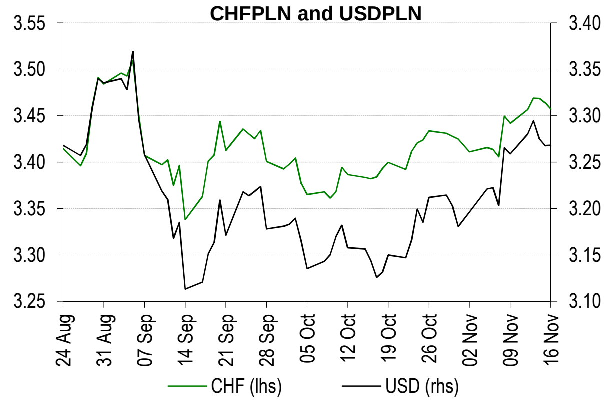
Anna Zielińska-Głębocka, MPC member, 14.11, Reuters
I think that scenario 25 and 50 is very realistic. 50 and 25 is also realistic. (...) In this cycle, I would have assumed [for a total cut of] 100 bps, and for the moment I cannot speak what's next.

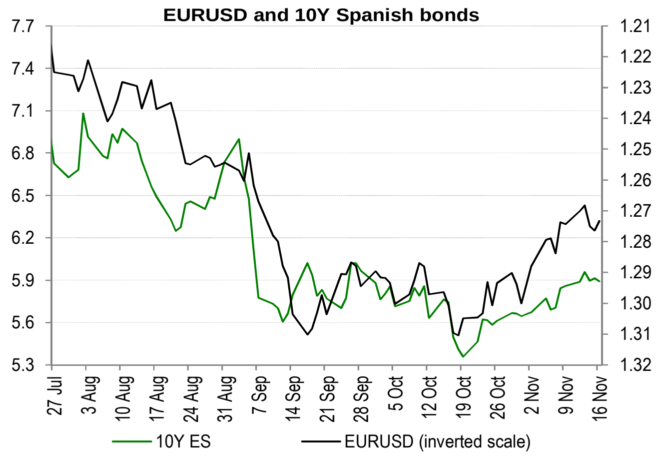
Jerzy Hausner, MPC member, 15.11, Dow Jones
The projection justifies easing of the monetary policy, but not a drastic one. (...) The real interest rates should be positive, although moderate.

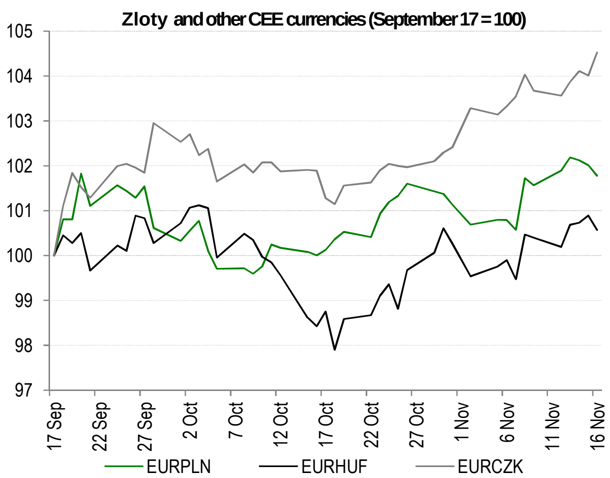
In October, the motion to cut rates by 25bps was supported not only by A. Bratkowski and E. Chojna-Duch, but also by M. Belka and A. Zielińska-Głębocka. One month later, rate reduction was backed by majority of Council members. Nevertheless, opinions regarding total required scale of monetary easing are still diversified. Comments of different MPC members suggest scale of total cuts between 50bp (Winiecki), through 75bp (Glapiński), 100bp (Zielińska-Głębocka), up to 125bp (Bratkowski). J. Hausner would like to keep real interest rates at moderate positive level, but he did not specify what level he sees as moderate. Interestingly, Zielińska-Głębocka seems to support a rate cut of 50pb in one shot, which she used to oppose in previous months. We think the Council will move in small steps (25bp) and the total scale of cuts will rather not exceed 100bp.

Foreign exchange market – US fiscal cliff and euro zone's debt crisis in the spotlight









Zloty recovers, CPI without impact on currency

- Last week the EURPLN increased temporarily above the local peak from the end of September (4.18) on the wave of concerns about the fate of Greece and the fiscal situation in the US. Publication of data on the Polish CPI did not affect the zloty. Consequently, at the end of the week a recovery after last depreciation occurred (the exchange rate declined to 4.15).
- The zloty was also under pressure against the dollar. USDPLN has tested resistance at 3.30-3.31 (the highest level since the beginning of September). At the end of the week there was a correction to 3.25.
- Just like a week ago, in the coming days investors will pay special attention to the Eurogroup meeting concerning disbursement of another bailout tranche for Greece. The week will be also full of data that will give a hint on the condition of the global economy. Recent releases, especially from Germany and the US, were disappointing and therefore in the short run the market may be sensitive to this data.
- The EURPLN was only for a moment above the resistance at 4.18, so this level remains valid. It seems, that the market is already pricing-in further easing of monetary policy by the MPC and therefore for further depreciation of the zloty another dovish signals from the Council and/or weak macro data may be needed.

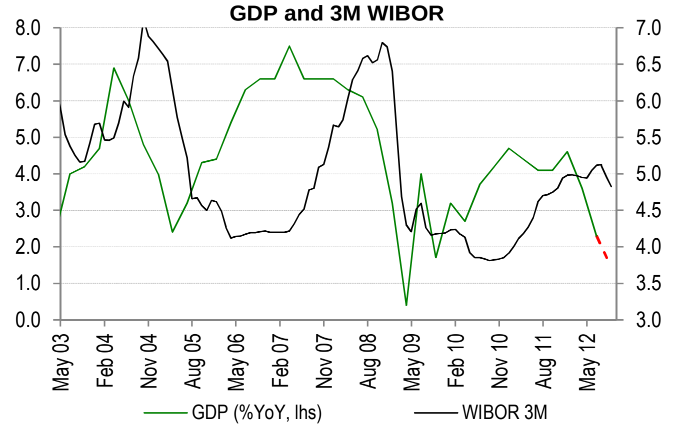
Dynamic fluctuations of the EURUSD

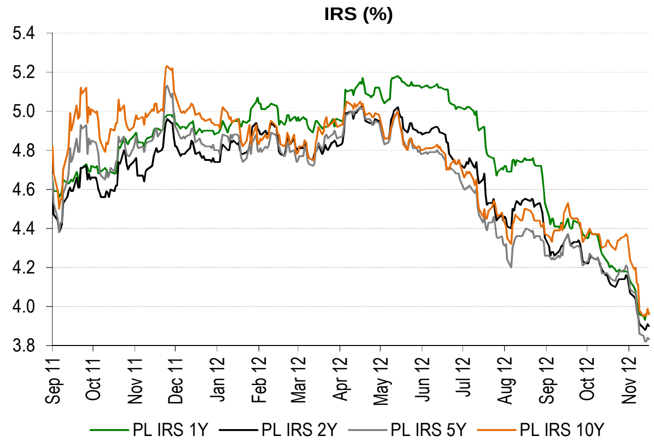
- Postponing the decision on disbursement of another bailout tranche for Greece by the Eurogroup clearly weighed the euro in the first days of the week. After breaking the support at 1.272, the EURUSD dropped to 1.266, the lowest since the first week of September. Rumours that Germany wants to pay three tranches of aid to Greece in a single payment was one of the factors that caused that the euro pared losses quickly. At the end of the week the EURUSD was near 1.275, slightly above the closing level of the previous week.
- The issue of debt crisis (in Europe and the US) will play a major role at the beginning of this week. The conclusions of the Eurogroup meeting scheduled for Tuesday could determine the direction of the EURUSD for the upcoming weeks. The chart shows that in recent weeks the situation in the peripheries of the euro zone's debt market had a major impact on the exchange rate. Macro data from the world may also be important. Weak US releases from last week pushed up the EURUSD, but hopes that the Fed will maintain (increase) scale of QE3 appeared only for a moment.
- The EURUSD stayed only temporarily below support at 1.272. Still, the scale of a rebound was so far too little, to announce the reversal of downward trend lasting since mid-October.

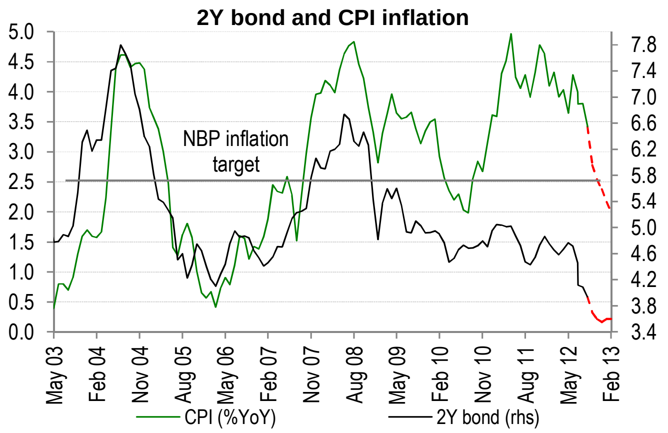
EURCZK at highest level since late July

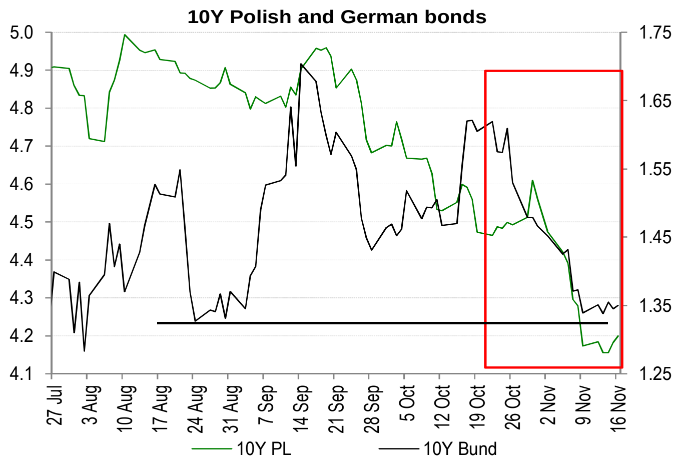
- Weaker than expected data on GDP growth in 3Q in Czech Republic and in Hungary put negative pressure on currencies of these countries during the past week. Consequently, the EURCZK reached highest level since late July (25.58). Czech koruna is also under pressure from cutting rates to record low level (0.05%). The EURHUF advanced temporarily above local peak from late October (286.2).
- Both exchange rates ended the week close to peaks from last 5 session and upcoming days may determine direction for next weeks.

Interest rate market – Data on output and Bunds to determine direction for bonds









WIBOR slowly down

▪ Just like we suggested last week, WIBOR rates moved down slightly. The scale of decline reached 1bps in case of 1M and 3M rates, 2bps for 6M and 9M ones and 3bps for 1Y rate.

▪ No major changes occurred in case of FRA. It seems that during the past weeks the market has been so aggressive in pricing in rate cuts, that there was no reaction to CPI data. The market still expects 3M WIBOR to be 100bps lower from current level in 9-months' time.

▪ In our view upcoming weeks and months will bring further gradual decline of money market rates. We assume, there is limited potential for increase of FRA and further declines may take place after GDP data (due at the end of November).

New records and then the correction

▪ At the beginning of the week the downward trend of the bonds' yields was continued and fresh record lows were reached (3.66% for 2Y, 3.70% for 5Y and 4.16% for 10Y).

▪ At the end of the week some correction occurred. It was triggered by data on CPI (that initiated profit taking form last strengthening) and end of appreciation trend of Bunds. IRS rates also increased quite visibly.

Data on output may push yields further up

▪ It seems that just like in case of money market rates, also in case of bonds new impulse may be required so that the downward trend will be continued. In our opinion such signals may emerge quite soon. One of it will be fast decline of inflation that in November may be below 3% and in January already slightly below the target (2.5%). Still, this week the upward correction of yields may be continued due to data on industrial output. Our forecast is clearly above market consensus and the release of data may put negative pressure on bonds.

▪ In recent weeks we pointed strong relationship of how Polish bonds performed and situation on the core fixed income market. Worries over fiscal crisis in Europe and in the US dragged yields of 10Y Bunds to the lowest level since late August. At the end of this week yields were above this support and as Eurogroup meeting is due this week as well as many macro data we assume that in coming days direction for the nearest future may be determined. Talks on fiscal cliff in the US may also prove important.

▪ On Wednesday's auction the Ministry of Finance will buy back soon-maturing OK0113 and PS0413 and will offer again new 10Y benchmark DS1023 and/or WZ0117/WZ0121. This will be next step in prefinancing of 2013 borrowing needs (according to our estimates the Ministry has already covered 10% of them, this year it expects to reach 20%). In late September the DS1023 was issued at yield of ca. 4.50% and currently on the market the yield is at ca. 4.20%. In September domestic banks purchased large amounts of floating bonds (WZ series) and this time the demand on the auction may be quite solid.