Bank Zachodni WBK

Weekly economic update

26 November – 2 December 2012

In spite of disappointment due to postponement of the Eurogroup's decision on bailout instalment for Greece and downgrade of French credit rating from the triple-A grade, the global sentiment was rather stable over the week. It was supported, among others, by hopes that Greek issues will be resolved in the upcoming days, by lower worries about the US fiscal cliff and by better-than-expected economic activity indicators from Europe (PMI, Ifo). Domestic macroeconomic data also surprised slightly on the upside (wages, production), but not strongly enough to change the assessment of Poland's economic outlook for the upcoming quarters. In our view these figures were better as compared with September mainly due to statistical effects (working days). Meanwhile, a rapid decline of PPI inflation and low core inflation confirmed lack of significant risk of rising inflationary pressure. Quite numerous comments of MPC members in recent days have shown that another interest rate cut in December (probably by 25bps) is highly probable, even though MPC members' views on potential total scale of monetary easing still differ strongly.

This week will start and conclude with releases of domestic macroeconomic data. On Monday we will see data on retail sales and unemployment for October. They are likely to confirm the weakness of consumer demand and of labour market (however, this time the data on car sales is indicating an upward risk for our sales forecast, which is below consensus). From the market point of view, Friday will be more important, as it is a date of release of GDP data for Q3. A confirmation of strong deceleration of economic growth and a second straight decline of domestic demand may underpin expectations about interest rates cuts, which may terminate the correction on the Polish debt market and exert negative pressure on the zloty. The beginning of the week will be a third in a row marked by the Eurogroup's deadlock to make decision on help for Greece. News about this issue may be a gauge of global markets' moods in the upcoming days. As regards the latter part of the week, data from the USA may be important as they will affect the assessment of prospects for the world's biggest economy.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (26 November)					
10:00	**PL**	**Retail sales**	**Oct**	**%YoY**	**3.7**	**3.2**	**3.1**
10:00	**PL**	**Unemployment rate**	**Oct**	**%YoY**	**12.5**	**12.5**	**12.4**
		TUESDAY (27 November)					
14:30	US	Durable goods orders	Oct	%MoM	-0.3	-	9.8
15:00	US	S&P/Case-Shiller home price index	Sep	%MoM	0.4	-	0.5
16:00	US	Consumer confidence index	Nov	pts	73.0	-	72.2
20:00	US	Fed Beige Book					
		WEDNESDAY (28 November)					
16:00	US	New home sales	Oct	k	390	-	389
		THURSDAY (29 November)					
14:30	US	Preliminary GDP	Q3	%QoQ	2.8	-	1.3
14:30	US	Initial jobless claims	week	k	395	-	410
16:00	US	Pending home sales	Oct	%MoM	-0.5	-	0.3
		FRIDAY (30 November)					
11:00	EZ	Flash HICP	Nov	%YoY	2.4	-	2.5
14:00	**PL**	**GDP**	**Q3**	**%YoY**	**1.8**	**1.7**	**2.3**
14:00	**PL**	**Fixed investments**	**Q3**	**%YoY**	**-1.4**	**-3.0**	**1.3**
14:00	**PL**	**Private consumption**	**Q3**	**%YoY**	**1.0**	**1.0**	**1.2**
14:30	US	Personal income	Oct	%MoM	0.2	-	0.4
14:30	US	Consumer spending	Oct	%MoM	0.1	-	0.8
14:30	US	Core PCE	Oct	%MoM	0.1	-	0.1
15:45	US	Chicago PMI index	Nov	pts	51.0	-	49.9

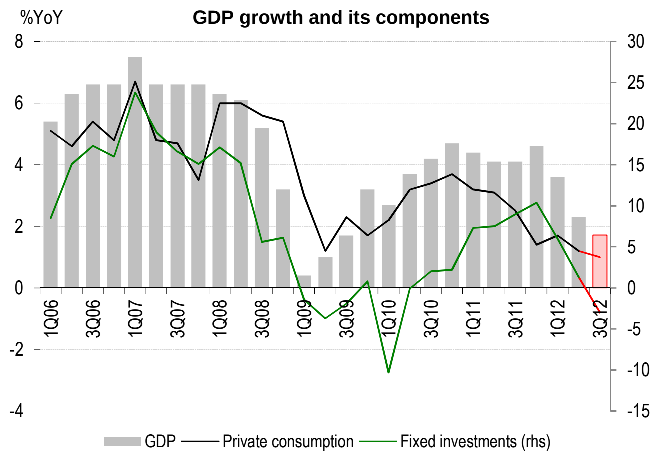
Source: BZ WBK, Reuters, Parkiet, Dow Jones

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

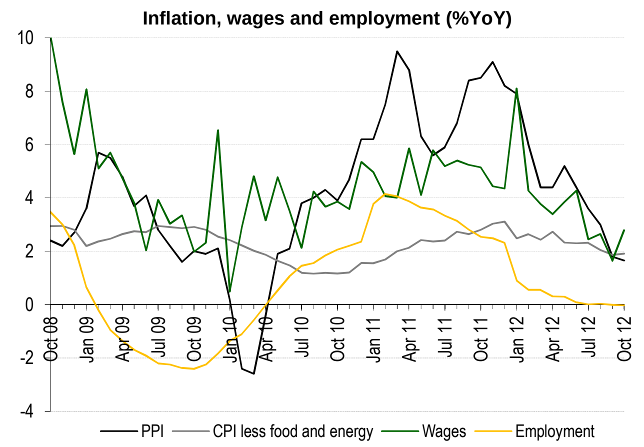
Agnieszka Decewicz +48 22 586 8341 **Marcin Luziński** +48 22 586 8362

What's hot this week – Slowdown of GDP growth

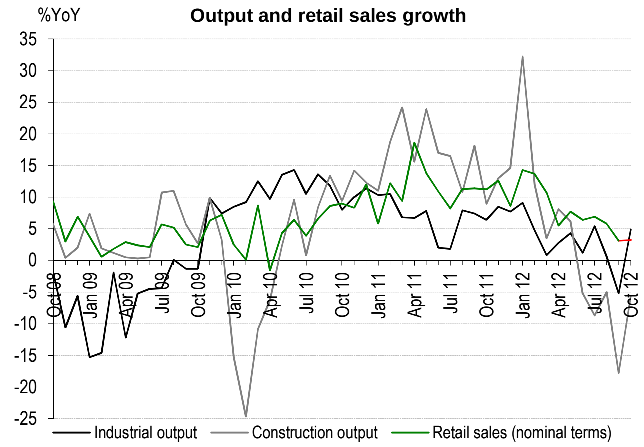


- Polish Q3 GDP data will be released on Friday. We estimate that economic growth slowed down to 1.7%YoY (from 2.3% in Q2). The GDP growth was undermined by a weak domestic demand, which recorded a second contraction in a row (-1.8%YoY) with slowing private consumption (1.0%YoY) and falling investments (-3.0%YoY). Growth was supported by net exports, which contributed 3.6pp (as compared to 2.6pp in Q2). Even though we estimate exports posted a contraction on an annual basis, the stronger deceleration of imports will translate into improving trade balance. We are expecting a further deceleration of GDP growth in the upcoming quarters, with possible bottoming-out in Q4-12 or Q1-13.
- We are expecting a rise in unemployment rate to 12.5% and a moderate expansion of retail sales by 3.2%YoY in October. These data will support our forecast of further slowdown of private consumption in Q4.

Last week in the economy – Output and wages higher thanks to working days effect



- Employment growth in corporate sector reached 0%YoY. But, to be precise, the number of employed was lower than a year ago (5510k versus 5512k in October 2011). On monthly terms 4k of people lost their jobs and since the start the fall was already 41k. These numbers clearly show that demand for labour is very weak.
- Average wage growth in corporate sector accelerated from 1.6%YoY to 2.8%YoY. We believe that the higher rate of growth was mainly due to statistical effect (higher number of working days had positive impact on salaries in some sectors). Wage growth remains moderate (and in of real terms still below zero), reflecting the absence of risk of second round effects.
- The wage bill has increased by 2.8%YoY but in real terms fell by 0.7%YoY. Decline in the real purchasing power of Polish consumers will negatively affect private consumption growth in Q4.



- Industrial production rose in October by 4.6%YoY. Clear rebound, as compared to more than 5% drop in September was associated with a greater number of working days. However the seasonally adjusted data also showed a slight rebound – in October an increase of 0.6%YoY compared with a fall of 1.6% the month before. In our opinion this is not a promise of recovery, and we still have to wait a couple of months for the bottom in economic cycle.
- October's data from the construction sector was also better than expected. The decline in annual terms was lower than in the last four months and amounted 3.6%YoY (-5.6% we expected, consensus -7%).
- PPI inflation declined in October to 1.0%YoY (from 1.8%YoY). As we expected in October core inflation excluding food and energy prices remained at 1.9%.

Quote of the week – Christmas gift

Andrzej Bratkowski, MPC member, 22.11, PAP
Given the confirmed negative trends in economy, I think rates are too high by 1.5pp and we should cut the main rate to 3.0% as quickly as possible.

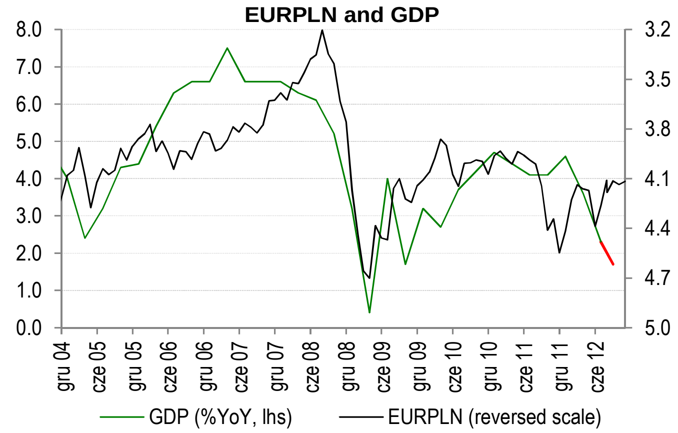
Anna Zielińska-Głębocka, MPC member, 22.11, Reuters
In my opinion rates should be cut by 75-100bps, including the already implemented one. I will vote for a cut in December.

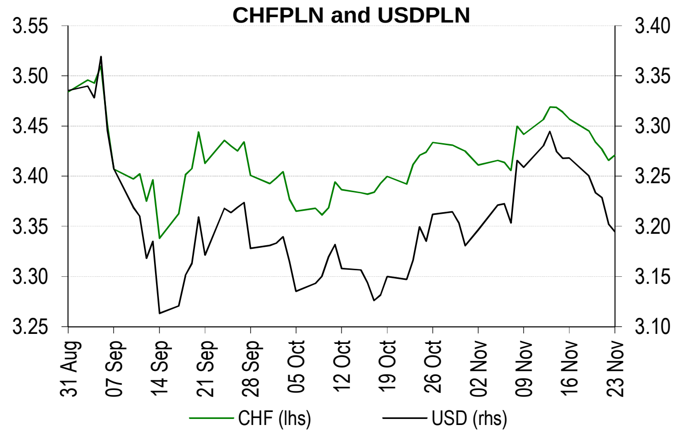
Jan Winiecki, MPC member, 21.11, Reuters
As I said before, I can see room for a cautions reduction of rates, twice by 25bps and I stick to this view.

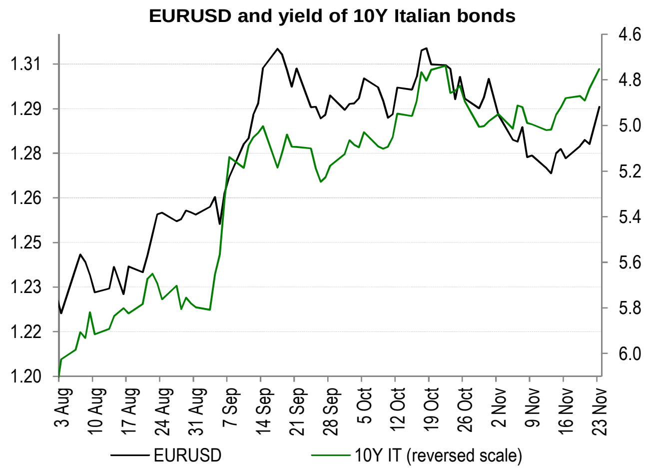
Andrzej Kaźmierczak, MPC member, 20.11, PAP
There is actually a chance that the MPC will deliver a Christmas gift for the Polish people and cuts rates.

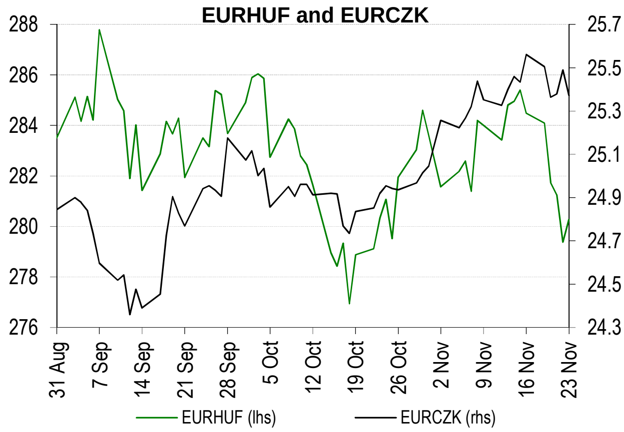
Minutes of the November's MPC meeting showed that still not all of the Council members are sure that interest rate cuts are necessary, but the majority's assessment of economic outlook has deteriorated due to recent weak macro data. Stance of the most dovish members has become even more radical, which is shown by comments of A. Bratkowski. Still, Bratkowski presents an extreme point of view and we do not expect that idea to cut rates by more than 25bps in one move will assemble majority. Cut is December seems to be almost a deal done, which is proved by comments of MPC members (even those recently opposing monetary easing). We are assuming that another cut may be delivered as soon as in January, and then the MPC will switch to "wait-and-see" mode, at least until the release of new GDP and CPI projections in March.

Foreign exchange market – Eurogroup decision and GDP data important for the zloty









The zloty may lose after the domestic GDP data

▪ Last week EURPLN approached the support at 4.10. Appreciation of the zloty was the result of increased hopes for avoidance of sharp fiscal tightening in the US in 2013. Disappointment with Eurogroup's decision was temporary, as the statements of the euro area leaders that appeared after the meeting suggested that an agreement is near. Moreover, better than expected European flash PMI and Poland's industrial production also had the positive impact on the domestic currency.

▪ The zloty significantly gained versus the dollar. USDPLN fell from 3.27 to 3.18.

▪ The market expects positive decisions regarding help for Greece at a meeting of the Eurogroup scheduled for Monday. Last week there were some comments that reinforced those hopes so any further delay could result in another wave of risk aversion.

▪ Our GDP forecast for the Q3 differs from the consensus to a much lesser extent than in the case of reading for Q2, which was released in late August. Back then, after the publication expectations for rate cuts sharply increased and led to weakening of the zloty. This time the response of the domestic currency to the reading may be smaller, as monetary policy easing in the coming months is largely discounted by the market.

▪ Important levels for EURPLN for this week are 4.10 and 4.18.

Eurogroup decision in focus

▪ Euro gained last week against the dollar. The euro has benefited from a decline in worries about spending cuts in the US, and lower concerns about the outlook for the global economy (after flash PMI and Ifo). As a result, at the end of the week EURUSD was testing resistance at 1.29 (highest level since the beginning of the month).

▪ The chart on the left shows that the issue of the crisis in the euro area is an important factor affecting the EURUSD exchange rate. Last week the euro has gained significantly in anticipation of a favourable decision concerning Greece and therefore the reaction of the exchange to this week's summit results can be asymmetrical (rise may be smaller than the potential decline if the decision is postponed again).

▪ In addition to the debt crisis, data published in the US may be also relevant, especially the second estimate of US GDP for Q3 and the index of consumer sentiment.

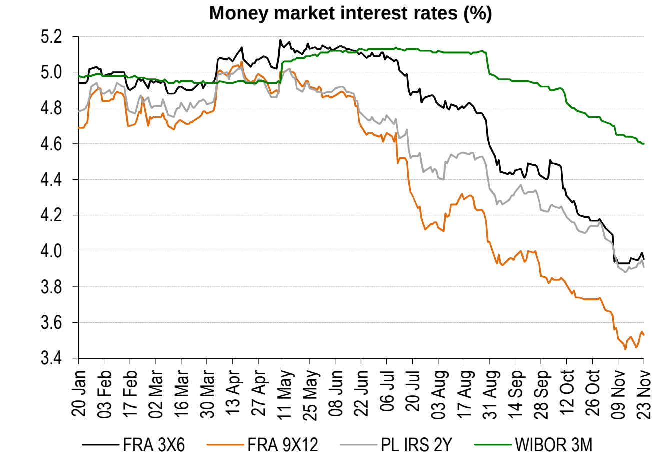
▪ Recently there is no clear directional trend in the EURUSD market. Maybe this week will show what is more likely, the increase in the direction of 1.30 (or higher) or testing of a local minimum at 1.266.

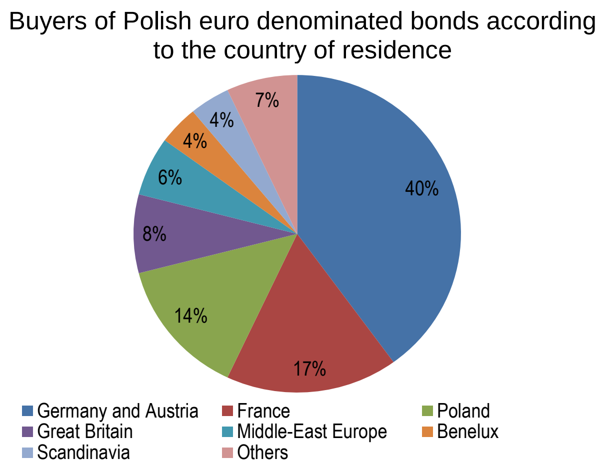
Forint waits for the decision of the central bank

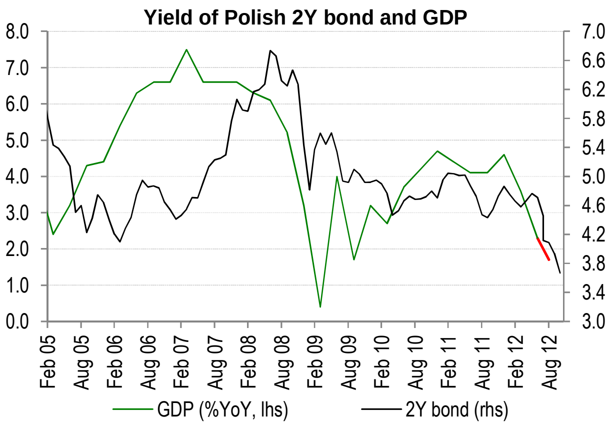
▪ Pretty good global sentiment that was dominant over the past week has caused that EURCZK and EURHUF diverted from the local peaks. At the end of the week EURCZK was close to 25.40, and EURHUF just below 280.

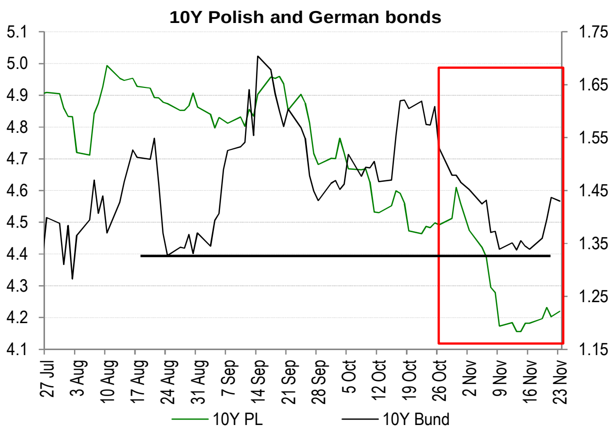
▪ On Tuesday the Hungarian central bank will decide whether to cut interest rates further. The market expects that there will be the fourth reduction in rates since the end of August. If the forint weakens in response to the decision, it may also affect the zloty to some extent.

Interest rate market – Data on Polish GDP may terminate correction on the bond market









Further steady decline of WIBOR

- WIBOR rates followed the scenario seen during last weeks of a gradual decline. On the FRA market some upward correction was recorded amid rising yields of Polish bonds. There was no reaction to comments of MPC members.
- This week the WIBOR rates are likely to continue the downward trend at pace seen recently.

Domestic bond curve slightly up…

- On the domestic debt market the upward correction of yields was continued. Still, Polish debt showed only marginal reaction to above-consensus data on domestic industrial output and further weakening of 10Y Bunds. IRS rates increased at somewhat bigger scale. These rates in 2-10Y segment have rebounded already by 7-8bps from all-time lows established in the previous week. Coming back to the bond market, the result of the last switch auction is the best example how limited is room for weakening of Polish bonds.
- The Finance Ministry sold bonds worth PLN10.24bn (record at switch auction). As we expected, a very high demand was declared for floating rate bonds. WZ0117 sale reached PLN4.36bn and WZ0121 reached PLN4.42. Additionally, the Ministry raised PLN1.46bn from issue of DS1023. What is interesting, yields reached by this paper was slightly above the market level. The fact that the investors did not quickly sell their bonds at market prices shows they are unwilling to get rid of domestic bonds. After this auction the Ministry has covered already ca. 22% of next year's gross borrowing needs (estimated at PLN145bn by the draft budget). The head of Ministry's Public Debt Department, Piotr Marczak, said that foreign investors were playing the main role during the auction. It seems that this group – holding ca. 62% of OK0113, according to data from end of September – has rolled-over a good part of means gathered on buybacks. Marczak added that December auctions are conditional and it will depend on market conditions whether they will be carried.
- Additionally, the Ministry reopened the issuance of euro-denominated bonds maturing in mid-2024 and sold debt worth €750m (from the sale of the same series in October €1.75bn was collected) at yield of 3.21%. The chart shows the structure of buyers at this auction regarding the country of residence. This auction is expected to be last of this kind this year and currently the ministry has covered 75% of FX financing needs for 2013.

… but data on GDP may halt this trend

- Domestic bonds remained resilient to factors that could have potentially triggered some more visible weakening and this week the correction may be terminated. The event that may play main role in this scenario is the release of Q3 GDP data. As the data will show the continuation of visible deceleration of economic growth, expectations for rate cuts may gain strength. It is also worth to notice that the trade volume on the Polish bond market remains subdued and this may magnify the scale of reaction to this data.

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