Bank Zachodni WBK

Eyeopener – Global recession fears rising

21 November 2008

- **Zloty still under impact of risk aversion, bond market stabilised**
- **Industrial output slowing down, although not so much in construction; core inflation still high**
- **Today, flash PMI in euro zone and business climate indicators in Poland**

Strong gains in stock markets in US and Asia and clear deterioration in moods in international markets triggered zloty weakening versus main currencies on Thursday morning. During the day the zloty was relatively stable with little tendency to appreciate, however at the end of session, the rate returned to opening levels. At close, the EURPLN was at 3.85 and USDPLN at 3.076. Higher risk aversion was favouring dollar strengthening around the globe – EURUSD was below 1.25 at the end of Polish session, versus 1.265 at Wednesday's close.

Industrial production rose 0.2%YoY in October (0.5% after seasonal adjustment), which was slightly above our forecast, but well below market expectations. In construction sector, situation was still not that bad (over 10% growth), however it is unlikely that this will last in the following months. Deterioration in prospects of economic growth was also confirmed by financial results of companies for Q3 (more detailed discussion of the data was presented in yesterday's *Instant comment* note). Most of core inflation measures fell in October, with exception of net inflation (rise to 4.5% from 4.3%YoY) and CPI excluding food and energy prices (stable at 2.9%). Nevertheless, inflation will definitely fall next year due to weaker demand and lower prices of commodities. Minutes of the last MPC meeting showed that economic slowdown was one of the main topics of discussion within the Council. Although there was no motion to change rates submitted in October, some members signalled possibility of cuts in the following months. In our view, it will be reflected in the change from neutral to easing bias at the nearest meeting, although the first rate cut will rather take place at the beginning of the next year, and may be even higher than 25 bp, conditional on the upcoming economic data releases.

Domestic debt market saw stabilisation yesterday amid still limited liquidity. High risk aversion is still discouraging foreign investors from buying Polish bonds.

Meanwhile, core debt markets saw continuation of rapid strengthening, after release of next US data confirmed that recession may be deep, and investors started worrying that losses of US and European companies may be much bigger than expected. Number of new jobless claims increased by 27,000 last week, to 542,000, the highest level since 1992. Economists expected a drop to 505,000 from 516,000 in the previous week. US leading indicator fell in October by 0,8%MoM after 0.1% rise in September. Market expectations were at 0.6%. In turn, Philadelphia Fed index fell to –39.3 from –37.5 in October (expected –35). In effect, yields of 10Y Treasuries and Bunds fell to 3.19% and 3.40% at the end of Polish session, from 3.26% and 3.52% in the morning. Yield of 2Y US Treasuries fell below 1%, to the lowest level in history, as the market is increasingly taking into account a possibility that the Fed may cut main interest rate to zero to avoid deflation. Also, bonds strengthening resulted from flee of capital from risky to safe assets.

Swiss National Bank unexpectedly cut interest rates yesterday by 100 bp, reducing target for 3M LIBOR to 0.5%-1.5%.

Prime Minister Donald Tusk repeated yesterday in the Sejm that he is ready for talks with the opposition on the date of the euro zone entry and said that at the beginning of the next week he will meet heads of parliamentary caucuses to continue consultations on the issue. The earlier such meeting, which was held at the beginning of November did not bring change in the Law and Justice's stance. The main opposition party is still against the swift euro adoption. President of the Law and Justice repeated yesterday that it is impossible to change his opinion on the issue and he again called for a national referendum (let us recall that recent opinion poll by OBOP showed only 20% of Poles support euro adoption in 2012). PM Tusk said yesterday that he is not able to "jump over the very high crossbar of aversion" and announced that he "will search other ways", if the opposition does not decide for a change in the constitution. As for now we do not know what ways he has in mind, as so far everyone agrees that without changes in the constitution the zloty should not enter the ERM2. Doubts on this issue were not eliminated after yesterday's press conference of the PM with the MPC and NBP management board. Although PM Tusk said that the euro zone entry in 2012 is "in 100% real", he did not explain how he will reach a political consensus, which – as he admits – is necessary for successful realisation of the swift euro adoption plan. The positive element is that the government and the NBP have agreed that they will closely cooperate during preparations for euro adoption (although such cooperation seems to be quite obvious).

Today, CSO will publish data about business climate in Polish enterprises sector in November. In the euro zone, flash PMI indices will be released. Analysts predict fall in manufacturing index to 40.5 from 41.1 in October, and drop in services to 45.0 from 45.8.

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F/X rates (today's opening)

EURUSD	1.2507	CADPLN	2.3832
USDPLN	3.0557	DKKPLN	0.5130
EURPLN	3.8199	NOKPLN	0.4278
CHFPLN	2.4918	SEKPLN	0.3705
JPYPLN*	3.2189	CZKPLN	0.1492
GBPPLN	4.5348	HUFPLN	1.4162

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.8264	3.8633	3.8448	3.8630	3.8620
USDPLN	3.0560	3.0874	3.0697	3.0923	3.0845
EURUSD	1.2486	1.2578	1.2526	1.2495	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0710	**6.38**	**8**	6.08	6.471
5Y	PS0413	**6.39**	**2**	1.10	5.926
10Y	DS1017	**6.43**	**-1**	8.10	5.859

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	5.64	-2	1.87	-12	3.41	-10
2Y	**5.45**	**-3**	1.97	-16	3.10	-14
3Y	5.36	-3	2.28	-20	3.29	-19
4Y	5.34	-3	2.57	-27	3.33	-19
5Y	**5.34**	**-3**	2.79	-26	3.36	-28
8Y	5.31	-3	3.10	-37	3.80	-17
10Y	**5.27**	**-2**	3.34	-30	3.97	-20

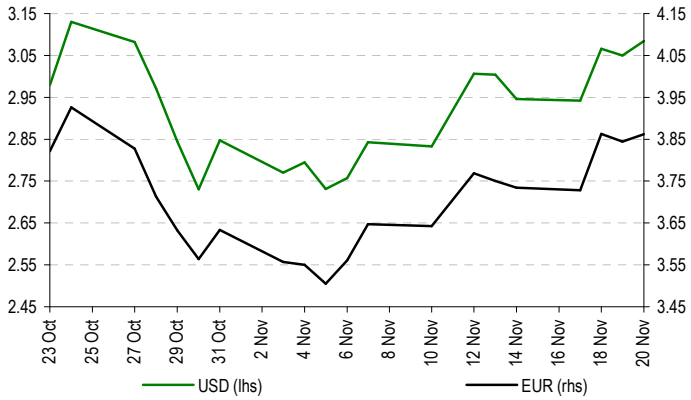
WIBOR rates

TERM	%	Daily change (bp)
O/N	5.11	-6
T/N	5.98	66
SW	6.20	5
2W	6.26	1
1M	6.45	0
3M	6.72	0
6M	6.80	0
9M	6.83	0
1Y	6.84	0

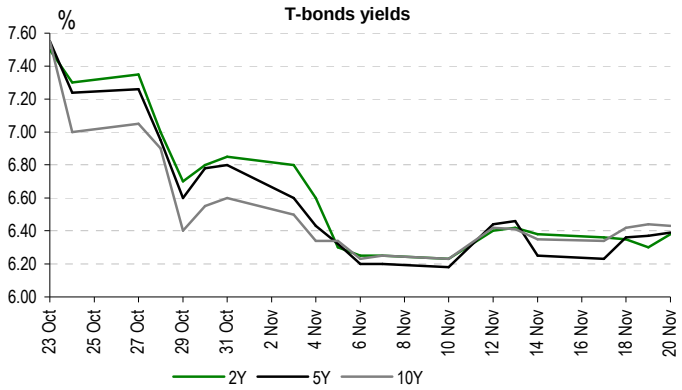
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	6.43	-5
3X6	5.85	-3
6X9	4.88	-2
9X12	4.75	-10
3X9	5.54	-1
6X12	5.06	6

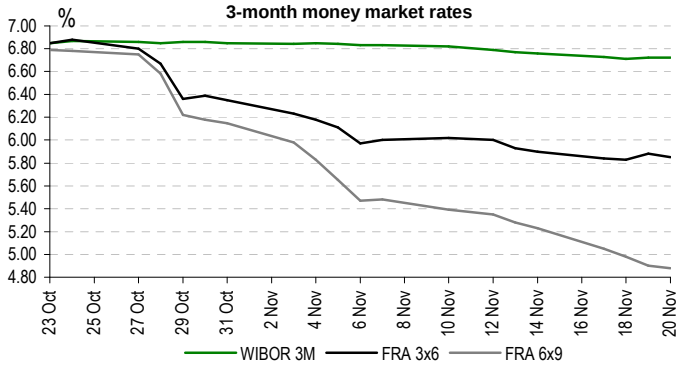
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



* for 100 JPY

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