Eyeopener – Inflation below expectations

15 September 2010

- **Large fluctuations in EURPLN and EURUSD, following sudden swings in market sentiment**
- **Yields in the domestic and core markets fell under impact of economic data releases**
- **CPI inflation stable in August**
- **Today, auction of 10Y bonds, HICP in the euro zone and several indicators from the US**

The beginning of the European session was carried in a neutral sentiment, but the publication of the data in the euro zone significantly deteriorated the investors' mood. The industrial output advanced in July by 7.1%YoY and remained flat on monthly basis. The annual growth was the lowest since February 2010, when the output expanded by 4.3%. July was also the second consecutive month when the annual growth was diminishing. The ZEW index for the German economy also disappointed. In September the index plunged to -4.3pts, which was the first reading below zero since March 2009 and also the lowest value since that moment. Greece sold yesterday 26-week T-bills worth €1.17bn versus demand at €4.08bn and the average yield at 4.82% (4.65% previously on 13th July). Slovakia revised up its forecasts for the GDP growth in the 2010 from 3.2% to 4.0% but lowered its expectations for the 2011 growth from 3.8% to 3.3%. According to the Slovakia's ministry of finance, the threat for the coming year's economic growth would be the implementation of the fiscal savings plan in Slovakia and in other European countries. We think that the restrictive fiscal policy conducted by many European countries in 2011 may indeed put some negative pressure on the pace of the recovery in the euro zone. The news from Slovakia may be actually the first of many, that will be announced. At the end of the day the market sentiment improved after the data from the US. The retail sales in the US advanced in August by 0.4%MoM, which was slightly above the market expectations and second in a row month of positive monthly change.

EURPLN varied dynamically during yesterday's session. At the beginning, zloty clearly weakened, even temporarily exceeding the level of 3.95. After stabilizing slightly below this value, zloty started appreciating. As a result, at the end of the session in Europe EURPLN went back to ca. 3.92 where it remained until today's opening. It can be noticed that 3.92 is an important support level, which needs strong external stimulus to be broken. Until it occurs, we expect EURPLN rate to fluctuate within the range of 3.92-3.96.

The dynamic swings of the situations occurred on the EURUSD market as well. Just as we expected, at the beginning of the European session the euro was clearly depreciating, the EURUSD declined to 1.284. In the afternoon the exchange rate stabilized and than the euro started do recover. After the data on the US retail sales the upward trend of the EURUSD was strengthened. Overnight the dollar managed to pare some looses, the EURUSD declined from the slightly over 1.30 to ca. 1.275. The data on the US economy scheduled for today may limit the volatility in the first part of the session. We expect that till the data's publication the EURUSD will hover in the range of ca. 1.288-1.30.

The domestic fixed income market reacted to the lower than expected data on the CPI. Just after the publication the short-term IRS and FRA rates declined. Later in the day the bond yields joined the downward trend, initially those at the short end, later at the whole yield curve. Additionally, the yields of the 10Y bonds were under the pressure from the declining yields on the core fixed income markets.

On the core fixed income markets the downward trend continued after worse-than-expected macro data form euro zone. At the end of the day, yields of 10-year Bunds and treasuries were respectively 2.36% and 2.68%.

The CPI in August was below forecasts and flat versus the 2.0%YoY reached in July, that was mainly due to considerable seasonal drop in prices of vegetables and fruits. However, the food prices will rise in the coming months driven by the high food prices abroad and negative impact of the floods and adverse weather conditions this year. The moment of the CPI's recovery from the bottom has been postponed, but the scale of the expected increase of the inflation in general remains unchanged. We do not change our expectations regarding the actions of the MPC, assuming the first interest rate hike in October. Broader discussion of the data was presented in yesterday's *Instant comment*.

In response to yesterday's data, the Ministry of Finance lowered its inflation forecast for the end of the year to 2.5%. The Ministry of Economy predicts that the CPI will remain below the inflation target until the end of the year.

Inflation data led to mixed reactions of the MPC members. Anna Zielińska-Głębocka and Elżbieta Chojna-Duch suggested that there is no inflationary pressure visible, and thus there is no reason yet to raise interest rates. On the other hand, Adam Glapiński confirmed his earlier opinion that the Council should act pre-emptively and now it is time for decisive steps in the form of a rate hike of more than 25 bp.

Finance minister Jacek Rostowski said yesterday that exceeding the debt threshold of 55% of GDP in 2011 and 2012 is unlikely, assuming that there is no huge depreciation of the zloty. Meanwhile, according to today's *Rzeczpospolita* daily, public finance deficit in 2010 would not be lower than in 2009 and may reach even 7.5% of GDP, among others due to the high deficit in local governments. Rostowski confirmed yesterday that work over the ministry is working on the bank tax aimed at securing the stability of the financial system against crises that may occur in the future. He added that the tax may come into force in January 2011. He also suggested possible changes in the functioning of pro-family tax relief.

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F/X rates (today's opening)

EURUSD	1.2975	CADPLN	2.9345
USDPLN	3.0256	DKKPLN	0.5272
EURPLN	3.9263	NOKPLN	0.4995
CHFPLN	3.0191	SEKPLN	0.4270
JPYPLN*	3.5675	CZKPLN	0.1599
GBPPLN	4.6879	HUFPLN*	1.3968

*for 100JPY/100HUF

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.9209	3.9539	3.9375	3.9267	3.9493
USDPLN	3.0211	3.0803	3.0618	3.0261	3.0637
EURUSD	1.2827	1.2986	1.2863	1.2977	-

T-bonds

TERM	Yield (%)	Change (bp)	Last auction	Average yield
2L	4.66	-2	1.09	4.672
5L	5.14	-4	4.08	5.43
10L	5.45	-1	16.06	5.79

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1L	4.20	-5	0.45	5	1.28	-4
2L	4.58	-4	0.71	1	1.40	-5
3L	4.77	-4	1.04	5	1.63	-6
4L	4.87	-5	1.37	0	1.77	-7
5L	4.93	-5	1.71	0	1.96	-7
8L	4.98	-4	2.43	1	2.45	-5
10L	4.94	-5	2.71	1	2.68	-5

WIBOR rates

TERM	%	Daily change (bp)
O/N	2.86	3
T/N	2.94	2
SW	3.41	0
2W	3.46	0
1M	3.60	0
3M	3.82	1
6M	4.02	1
9M	4.20	0
1Y	4.25	0

FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	3.70	-5
3X6	4.11	-2
6X9	4.32	-2
9X12	4.51	-3
3X9	4.29	-1
6X12	4.49	-5

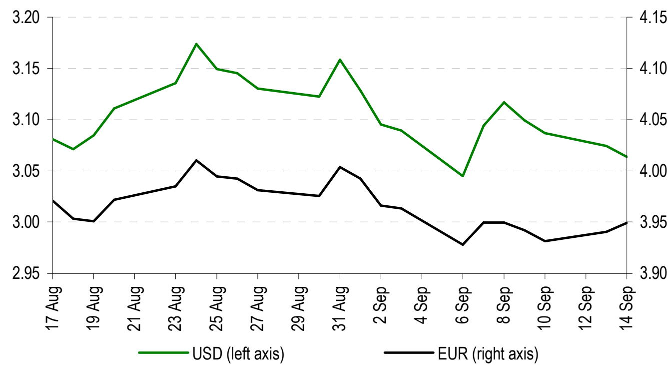
Measures of fiscal risk

Country	CDS 5Y		Spread 10Y*	
	Value	Change (bp)	Value	Change (bp)
Poland	136.9	-2	3.09	6
Czech Republic	93.9	0	1.05	3
Hungary	355.9	-7	4.79	4
Greece	910.2	-21	9.16	11
Spain	215.0	-13	1.79	6
Italy	190.5	-12	1.48	6
Portugal	320.1	-15	3.39	4
Germany	36.9	-1	--	--

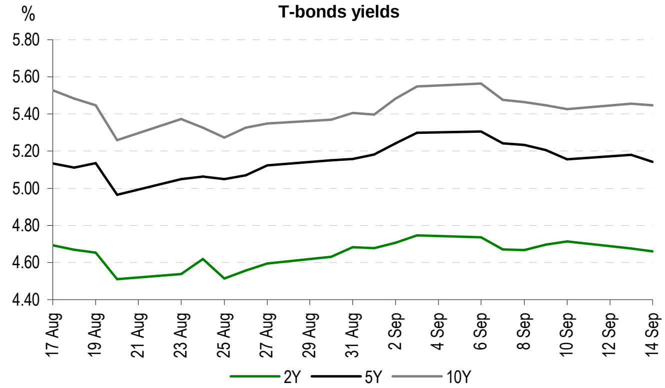
* 10Y treasury bonds over 10Y Bunds

Source: Reuters

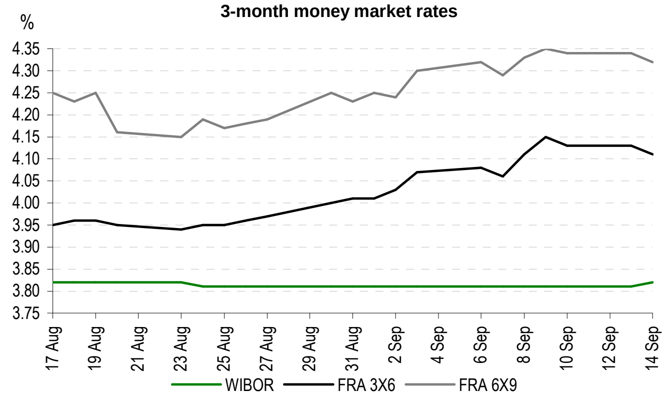
Zloty exchange rate (fixing)



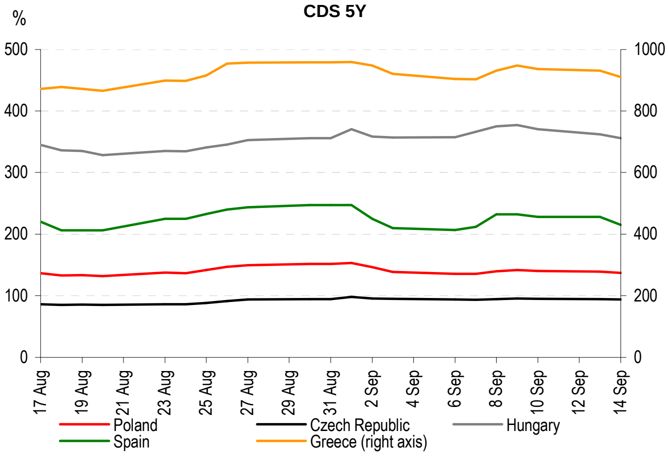
T-bonds yields



3-month money market rates



CDS 5Y



Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	ACTUAL VALUE	LAST VALUE *
		MONDAY (13 September)						
-	-	-	-	-	-	-	-	-
		TUESDAY (14 September)						
11:00	EZ	Industrial output	Jul	%YoY	8.0	-	7,1	8.2
11:00	DE	ZEW Index	Sep	pts.	10.0	-	-4,3	14.0
14:00	**PL**	**CPI**	**Aug**	**%YoY**	**2.2**	**2.2**	**2,0**	**2.0**
14:00	**PL**	**Monney supply**	**Aug**	**%YoY**	**8.6**	**8.6**	**9,3**	**7.8**
14:30	US	Retail sales	Aug	%MoM	0.3	-	0,4	0.3
		WEDNESDAY (15 September)						
11:00	**PL**	**Auction of 10Y bonds worth PLN1.5-3.0bn**						
11:00	EZ	HICP	Aug	%YoY	1.6	-	-	1.7
14:30	US	Import prices	Aug	%MoM	0.2	-	-	0.2
14:30	US	NY Fed Index	Sep	pts.	8.6	-	-	7.1
15:15	US	Capacity utilization rate	Aug	%	74.9	-	-	74.8
15:15	US	Industrial output	Aug	%MoM	0.2	-	-	1.0
		THURSDAY (16 September)						
14:00	**PL**	**Wages**	**Aug**	**%YoY**	**4.0**	**4,5**	-	**2.1**
14:00	**PL**	**Employment**	**Aug**	**%YoY**	**1.7**	**1.8**	-	**1.4**
14:30	US	Initial jobless claims	week	k	459.0	-	-	451.0
14:30	US	PPI	Aug	%MoM	0.2	--	-	0.2
16:00	US	Philly Fed Index	Sep	pts.	2.5	-	-	-7.7
		FRIDAY (17 September)						
10:00	EZ	Current account	Jul	€bn	**-**	-	-	-4.6
14:00	**PL**	**PPI**	**Aug**	**%YoY**	**4.2**	**3,6**	**-**	**3.9**
14:00	**PL**	**Industrial output**	**Aug**	**%YoY**	13.1	**15.8**	**-**	**10.3**
14:30	US	CPI	Aug	%MoM	0.3	-	-	0.3
15:55	US	Michigan Index	Sep	pts.	69.5	-	-	68.9

Source: BZ WBK, Parkiet, Reuters

* in case of the revision, the data is updated

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