Bank Zachodni WBK

Weekly economic update

17 – 23 August 2009

Last week there was no clear direction of changes in risk appetite. In the first part of the week market participants became more cautious ahead of the FOMC meeting, which negatively affected the stock markets and the zloty. However, the official statement of the Fed was well-received by investors, bringing about an improvement in market sentiment and the zloty appreciation. An additional support for the local currency was clearly higher than expected surplus in Poland's current account of the balance of payments for June.

This week will be full of important data releases both locally and abroad. The key focus of attention for the zloty will be data abroad and related to that changes in risk appetite. As to the Polish interest rate market important factors include the zloty performance and the local macro figures, which will allow to assess domestic monetary policy prospects again following the higher than expected CPI numbers released last week.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 August)					
11:00	**PL**	**Auction PLN 0.8-1.0bn of 52-week Treasury Bills**					
11:00	EZ	Trade balance	Jun	€bn	3.0	-	1.9
14:30	US	NY Fed index	Aug	pts	3.0	-	-0.55
14:30	US	Capital flows	Jun	$bn	-	-	-19.8
		TUESDAY (18 August)					
11:00	DE	ZEW index	Aug	pts	45.0	-	39.5
14:00	**PL**	**Average wage in the enterprise sector**	**Jul**	**%YoY**	**2.1**	**2.2**	**2.0**
14:00	**PL**	**Average employment in the enterprise sector**	**Jul**	**%YoY**	**-2.3**	**-2.3**	**-1.9**
14:30	US	House starts	Jul	m	0.6	-	0.582
14:30	US	Building permits	Jul	m	0.58	-	0.57
14:30	US	PPI	Jul	%YoY	-5.9	-	-4.6
		WEDNESDAY (19 August)					
11:00	**PL**	**Buy-back auction of T-bills**					
14:00	**PL**	**Industrial output**	**Jul**	**%YoY**	**-3.8**	**-3.8**	**-4.3**
14:00	**PL**	**Construction output**	**Jul**	**%YoY**	**0.8**	**0.9**	**0.6**
14:00	**PL**	**PPI**	**Jul**	**%YoY**	**3.9**	**3.5**	**4.0**
		THURSDAY (20 August)					
14:00	**PL**	**Minutes of the MPC meeting**	**-**	**-**	**-**	**-**	**-**
14:00	**PL**	**Core inflation (CPI less food and energy prices)**	**Jul**	**%YoY**	**2.7**	**3.0***	**2.7**
14:30	US	Initial jobless claims	w/e	k	550.0	-	558.0
16:00	US	Philly Fed index	Aug	pts	-2.0	-	-7.5
16:00	US	Leading indicators	Jul	%	0.6	-	0.7
		FRIDAY (21 August)					
9:58	EZ	Flash PMI manufacturing	Aug	pts	47.5	-	46.3
9:58	EZ	Flash PMI services	Aug	pts	46.5	-	45.7
14:00	**PL**	**Business climate indicators**	**Aug**	**-**	**-**	**-**	-
16:00	US	Existing home sales	Jul	m	5.0	-	4.89

Source: BZ WBK, Parkiet, Reuters, * Our estimate changed from 2.8 after CPI data, while market consensus of 2.7 formulated before the CPI figures

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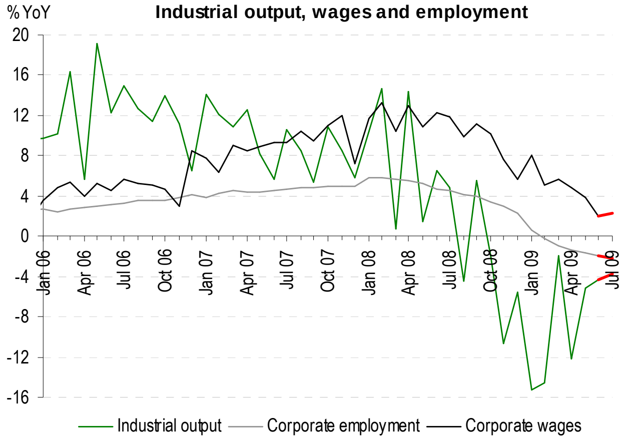
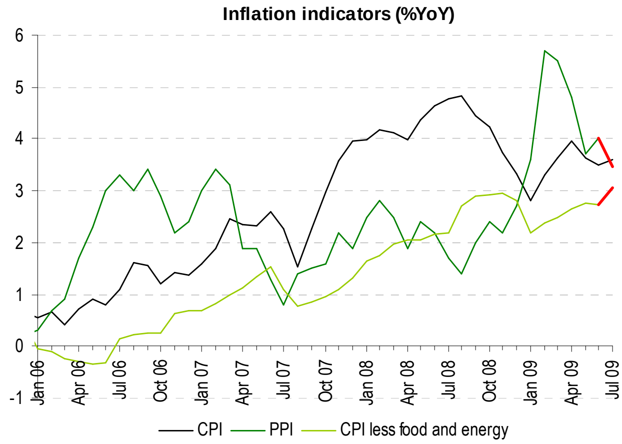
What's hot this week – Many important data locally and abroad

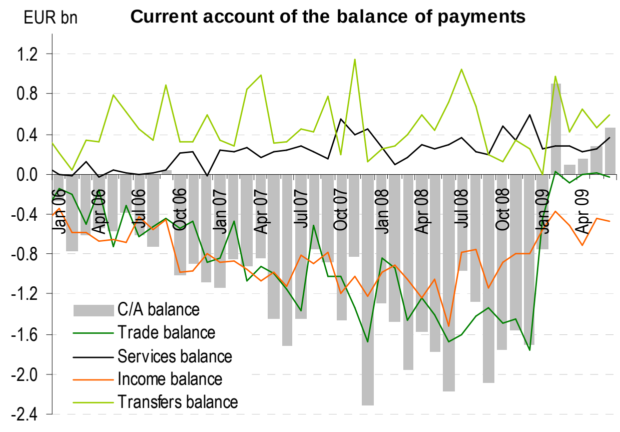


- We expect that domestic data from the labour market will show the continuation of employment reduction and only very moderate acceleration in wage growth rate. His Gould confirm that enterprises are still focused on lowering costs, which may negatively affect the financial situation of households, and therefore private consumption prospects in the following quarters.
- At the same time, production data will show gradual improvement of the situation in industry (lower scale of production reduction), which suggest the bottoming out process. Also, we expect another positive growth figure for the construction sector.
- Still, the data from abroad being indicator as regards recovery prospects will be the most important- in the euro zone preliminary PMI index for August and in the US some activity indicators and housing market.

Economy last week – CPI and C/A surplus higher than expected



- CPI inflation in July to 3.6%YoY from 3.5% in June, which was above market expectations and our forecast (3.4%) as well as the estimate of the Ministry of Finance (3.5%).
- Despite a clear drop in food prices, consistent with our forecasts, a high rise in tobacco prices resulting from a hike in excise tax and clear rise in fuel prices triggered a growth of CPI by 0.1% as compared to June.
- According to our estimates core inflation (CPI after excluding food and energy prices) rose again in July, perhaps even up to 3%YoY, mainly due to mentioned increase in prices of tobacco products.
- Although in August and September one may expect some drop in the headline inflation rate, it will remain near 3.5%, i.e. the upper limit of the tolerance band around the central bank's target of 2.5%.



- The balance of payments for June showed another C/A surplus and its size (€459m) significantly exceeded market expectations (€140m). The trade gap was smaller than we expected and reached €26m, with export import growth rates in euro terms also better than expected at –20.8%YoY and –31.5%YoY (positive surprise stronger in exports). Services, income and transfers' accounts also surprised on the upside.
- At the same time there was a continuation of negative tendencies in the capital and financial account, i.e. weaker inflow of EU funds and second in a row outflow of FDIs, but this is not a worrying situation given the C/A surplus in the past five months and a drop of cumulative 12M deficit to 2.5% of GDP from 3.2% after May. All in all, balance of payments for June confirmed the significant adjustment in Poland's external relations this year was not short-lived and this is a positive factor for the zloty in the medium-term.

Quote of the week – No chance for rate cuts?

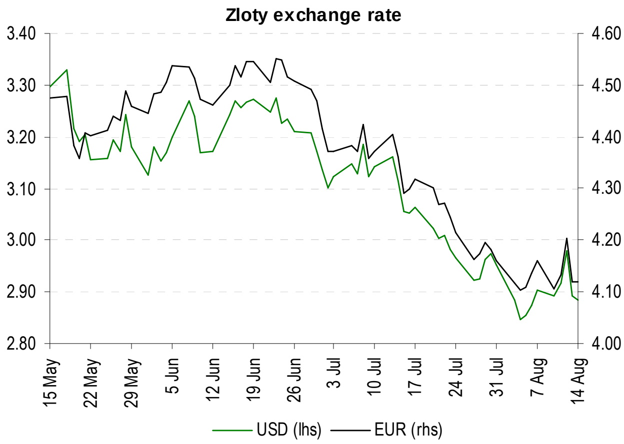
Dariusz Filar, MPC member, TVN CNBC, 13 August
As inflation does not fall and the economy has a chance of an improvement, the small gate is closing. The is no chance for rate cuts. I do not rule out that we, as the Council, will say in our next statement that the easing cycle is over.

Marian Noga, MPC member, PAP, 13 August
This year we will not see lower inflation than 3.5%YoY in June. Thus, I do not see a room for a rate cut. CPI data for July confirm my earlier view.

Andrzej Sławiński, MPC member, Reuters, 13 August
The inflation maintaining around the upper end of the tolerance band lowers probability of further monetary easing. Possible further monetary easing will depend on performance of the domestic demand.

CPI figures provided ammunition for haws in the MPC. However, moderately hawkish Andrzej Sławiński did not exclude further monetary easing depending on performance of domestic demand. In our view, the CPI for July changed inflation path for subsequent months, and thus may reduce the MPC's willingness to cut rates. It looks like we would have to wait for a possible rate cut until October and the decision will depend, among others, on the results of the new NBP projection. If there is further clear improvement in economic activity indicators until that time, one cannot exclude that interest rates will remain on hold until the year-end. Further changes in monetary policy would then depend on the new MPC, but taking into account a possibility of a monetary tightening by the ECB in 2010, the next move of the MPC could be a rate hike.

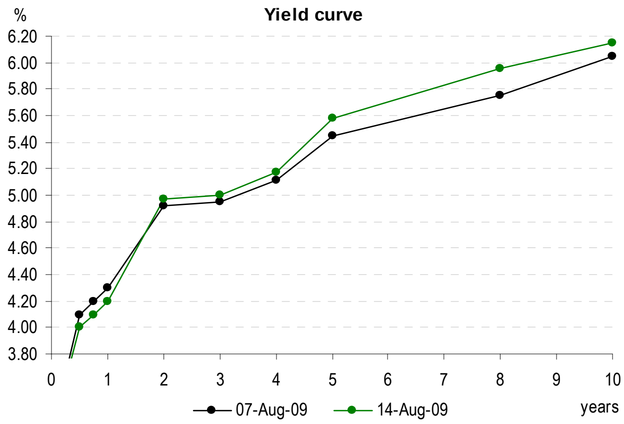
Market monitor



The zloty correction stopped. For how long?

▪ On Monday at the opening the EURPLN broke the level we indicated in the previous weekly as a strong support (4.08), but it was very temporarily and confirmed the importance of this level. Later during the week, in line with our expectations the EURPLN rate has been gradually rising, exceeding 4.21 on Wednesday. This was reinforced by some profit taking ahead of Fed meeting. However, the Fed's statement together with C/A surplus and better GDP in the euro zone brought EURPLN down again to the levels observed a week ago.

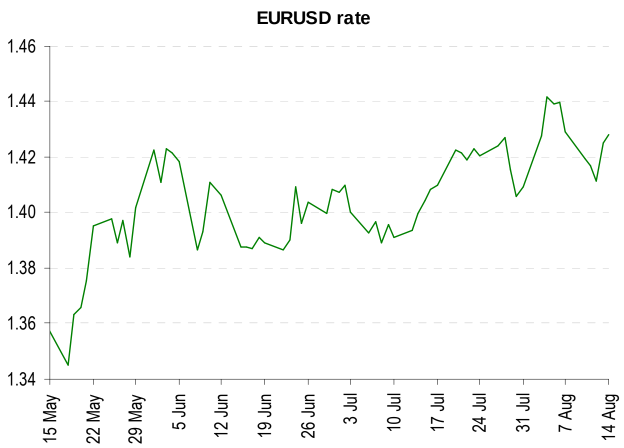
▪ This week, changes in global risk appetite, which may be connected with next data, will be the key for the zloty again. In our opinion, the recent zloty appreciation may cause another profit-taking and the local currency may be vulnerable to any possible disappointing economic news. Therefore, we still think that a return of EURPLN to above 4.20 is more likely than breaking the support level of 4.08.



Yield curve sharply up

▪ Local interest rates market weakened last week under influence of unexpected inflation rise in July. Yield curve moved up by 5-13 bp, with the strongest move in longer dated bonds. Rise in Polish yields was visible already before CPI data release due to rising risk aversion before Fed meeting. IRS rate went up in similar scale, so the asset swap spread did not change significantly, which shows no change in assessment of Poland's credit risk. Increase in FRA rates also had a similar scale.

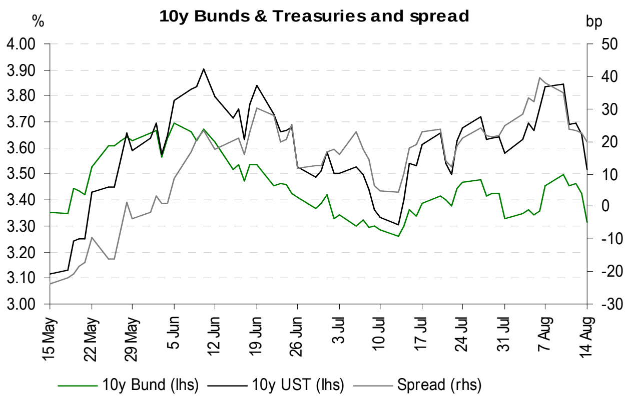
▪ Domestic data to be released this week will remind about still difficult situation in the economy, which will support Polish debt market, however a correction of the zloty expected by us will act towards further weakening, although in smaller scale than last week.



No major changes in EURUSD

▪ After a significant drop in EURUSD in reaction to better than expected data from the US labour market a week ago, the market has been trying to assess to what extent the negative relationship between risk aversion and dollar strength will hold. In the previous weeks the strong economic data, which led to increase risk appetite were negative for the dollar. Until the Fed meeting the dollar was rather stable. After the Fed statement release and disappointing US economic data and positive information from the euro zone, the EURUSD rose. At the end of the week higher risk aversion limited this increase and finally it ended at ca1.42, similarly as a week ago.

▪ This week we expect the EURUSD to fall, which would be caused by higher risk aversion on global markets. At the same time, we assume that data form the US and the euro zone will not change the assessment as regards relative strength of the two economies.



Strengthening in the core detb markets

▪ At the start of the past week yields of 10Y Treasuries and Bunds continued to rise after the data the US labour market data. However, an increase in risk aversion before the Fed meeting, good results at bond auctions in the US and lower than forecasted US CPI were positive for the core debt markets. Although the Fed's statement increased risk appetite, at the same time it curbed expectations for fast implementation of exit strategies from monetary policy easing instruments, thus was favourable for the core debt markets. At the end of the week yields of 10Y Treasuries and Bunds were at 3.56% and 3.37%, respectively, against 3.84% and 3.46% a week before.

▪ This week amid expected increase in risk aversion the core debt markets may experience further gains.

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