Bank Zachodni WBK

Weekly economic update

5 – 11 October 2009

Past week brought significant deterioration in moods on the global markets along with a series of weaker than expected data from the US economy, including the closely watched non-farm payrolls report. This translated into fall in EURUSD and increased interest in safe assets and at the same time negatively affected the emerging markets currencies, including the zloty (EURPLN nearly 4.30 for a while). The domestic debt weakened moderately. Apart from global factors, the negative impact on the domestic currency was related to disappointing macro data – lower than expected PMI manufacturing for September, fall in consumer confidence indices reported by the stats office and Ipsos as well as unfavourable revision in balance of payments statistics. The FinMin's estimate of CPI inflation in September proved in line with expectations and had no impact on the market.

Outcome of the MPC meeting did not surprise. Interest rates were kept on hold and informal easing policy bias was maintained. However, there was a clear indication in the statement that one should expect change in policy bias to neutral in the near time – we expect it will take place in October when the new NBP projection for inflation and GDP will be revealed. *Monetary Policy Guidelines for 2010* adopted by the MPC did not bring changes in construction of the inflation target and ways of its realisation as well as in overall framework of monetary policy (direct inflation targeting). As to new instrument of monetary policy proposed by the NBP governor, the MPC only approved and included in the *Guidelines* the discount credit while purchase of commercial banks' bonds by the NBP did not win support from the Council.

This week there are no major event locally apart from 2Y bond auction, so the domestic market will be driven mainly by changes in moods on the global markets. Sentiment abroad will depend on new macro data, outcome of the ECB meeting and the first of the US Q3 earnings reports, which come towards the end of the week.

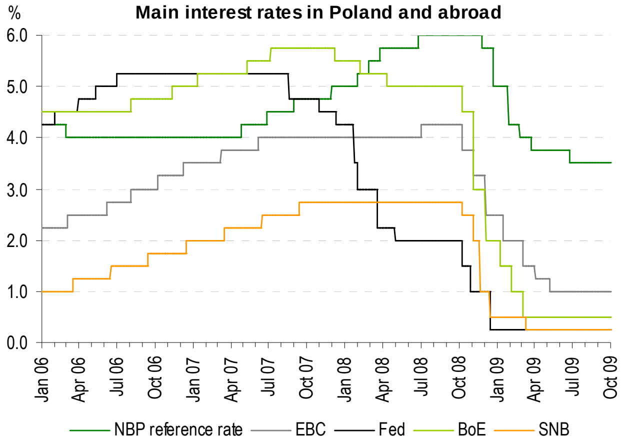
Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (5 October)					
11:00	**PL**	**Buy-back tender of Treasury Bills maturing from October 14 to December 16**					
9:58	EZ	PMI services	Sep	pts	50.6	-	49.9
9:58	EZ	PMI composite	Sep	pts	50.8	-	50.4
11:00	EZ	Retail sales	Aug	%YoY	-2.6	-	-1.8
16:00	US	ISM services	Sep	pts	49.9	-	48.4
		TUESDAY (6 October)					
10:30	GB	Industrial output	Aug	%YoY	-8.7	-	-9.3
		WEDNESDAY (7 October)					
	PL	**Auction of 2Y bonds OK0112 worth PLN2.5-4.5bn**					
11:00	EZ	Revised GDP	Q2	%YoY	-4.7	-	-4.7
		THURSDAY (8 October)					
13:00	GB	Bank of England decision	-	%	0.5	0.5	0.5
13:45	EZ	ECB decision	-	%	1.0	1.0	1.0
14:30	US	Initial jobless claims	w/e	k	545.0	-	551.0
16:00	US	Wholesale inventories	Aug	%	-1.0	-	-1.4
		FRIDAY (9 October)					
14:30	US	Trade balance	Aug	$bn	-32.0	-	-31.96

Source: BZ WBK, Reuters,

Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – Focus on events abroad



- There are no major domestic events scheduled for this week, apart from T-bills buy-back and 2Y bonds auction.
- Nevertheless, as usual in the week following the MPC meeting, one can expect interviews with members of the Council, but before the publication of a new set of monthly data, no groundbreaking declarations on monetary policy outlook should be expected.
- At the beginning of the week the global markets may be influenced by the weekend's G7 statement.
- Amid lack of major events locally, the key focus of attention this week will be new indicators of economic activity abroad and outcome of the ECB meeting. We expect the ECB to leave rates unchanged, make a careful assessment of the economic situation and indicate that monetary policy will remain very accommodative for sometime yet.

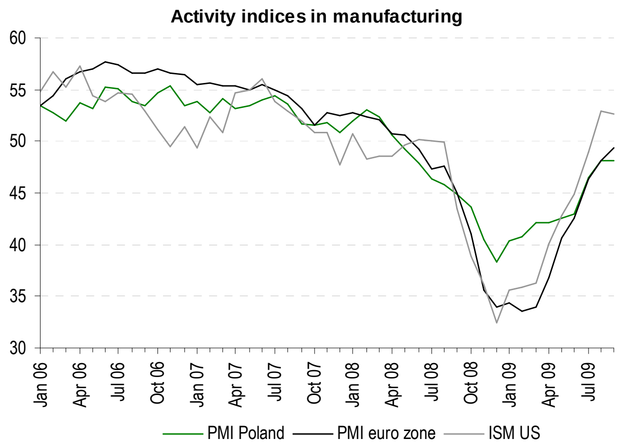
Economy last week – MPC did not surprise, new data disappointed

Excerpts from the September MPC statement (marked significant changes to the August statement)

In the Council's assessment, inflation is likely to remain at an elevated level in the coming months, mainly due to the relatively high annual growth of food prices and regulated prices, including, above all, energy prices. ~~The recently observed rise in crude oil prices, mitigated to a certain extent by the recent zloty appreciation, may also be conducive to inflation remaining at an increased level.~~ In the medium term, however, low demand pressure and a slower growth of labour costs should be conducive to inflation decrease.

In the Council's assessment, the probability of inflation running below the inflation target in the medium term is higher than the probability of its running above the target. **At the same time, in the Council's assessment, the probability of inflation running below the inflation target in the medium term has decreased in recent months.** In the Council's view, the expected improvement in the global economic activity and the implemented cuts in the NBP interest rates together with the lowering of the required reserve rate will support the return of the economy to the potential growth path. The Council's decisions in the coming months will take account of the incoming information on the outlook for economic growth and inflation, the situation in the financial markets in Poland and abroad, information on the public finance sector and the zloty exchange rate developments.

- At the September meeting, the MPC left interest rates unchanged, with the reference rate at 3.5%. In addition, the Council maintained the informal easing bias in monetary policy.
- However, in contrast to statements released in previous months, this time the Council wrote that "the probability of inflation running below the inflation target in the medium term has decreased in recent months", which should be regarded as a signal of a change in bias to neutral in October, if the assessment of outlook for inflation and growth do not change significantly under the influence of new data and the results of the new projection of the NBP.
- We still expect that after a change to the neutral stance in October, interest rate will remain unchanged until the end of the current MPC's term.



- The MinFin said that it expects CPI inflation to decline in September to 3.5%YoY from 3.7% (with price growth of 0.2%MoM), which is in line with our forecast and market consensus. The ministry assumes a rise in food prices by 0.4%MoM and a decline of fuel prices by 1.4%MoM, which is close to our assumptions.
- Poland's manufacturing PMI remained flat in September at 48.2, while market consensus and our forecast pointed to a rise to 48.8. Sub-index for output fell as compared to August, but remained above 50pts. The result for Poland is disappointing, especially that the euro zone's PMI rose in September to 49.3, stronger than the market expected.
- After a few months of improvement, consumer sentiment indicators of CSO and Ipsos deteriorated in September. All indices fell during the month and for most of them the annual declines have deepened.

Quote of the week – We will propose to publish a path of future interest rates

Sławomir Skrzypek, NBP president, MPC press conference, 30 Sep

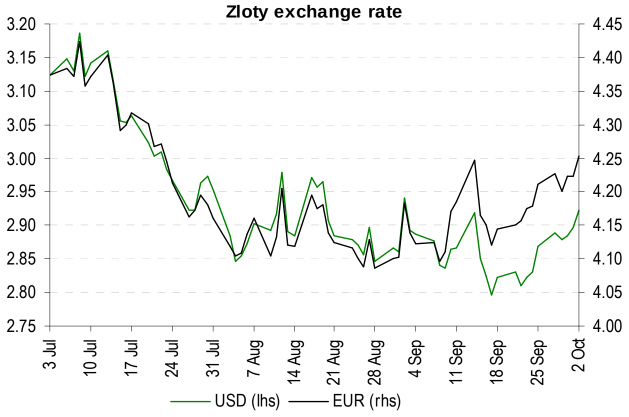
We will propose the Council to publish a path of future interest rates. But if there is no agreement on such a radical change in communication, then we can discuss a return to formal policy bias. Soon will present concrete proposals on this [introduction of discount credit], including the rate for such loans. And therefore, the NBP may be publishing information about additional rate, i.e. discount rate.

Marian Noga, MPC member, PAP, 30 Sep

In the Monetary Policy Guidelines for 2010 we have included discount credit, previously presented by the president Skrzypek. But nothing in that case had been done. Its launch will require presentation of details by the Management Board for discussion and approval of the Council.

A few weeks ago the NBP President announced the extension of repo maturity to 12M (which earned positive opinions of MPC members) and announced plans to introduce new monetary policy instruments: the discount credit and the purchase of bonds of banks by the NBP. Only discount credit has gained approval of the MPC, which is reflected in the *Monetary Policy Guidelines for 2010*. Now the head of the NBP announced he will propose to the new Council to change the way of communication - publishing the path of future interest rates, or at least a return to the formal bias of the monetary policy. Among these solutions, which according to us would have positive impact on the transparency of monetary policy, it is more likely the formal policy bias will be restored.

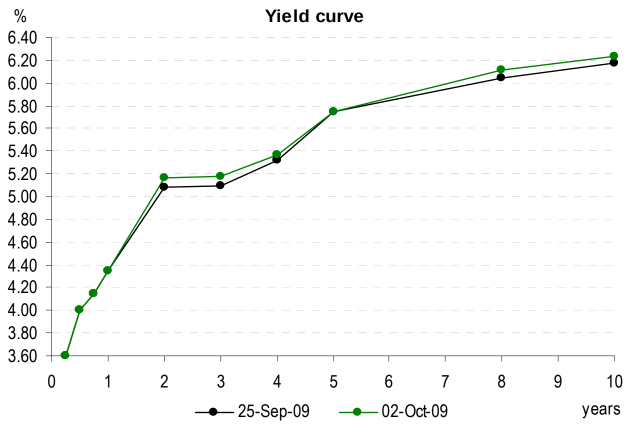
Market monitor



Further correction of the zloty

▪ Last week the weakening trend of the zloty was continued. The domestic currency was negatively affected by domestic factors (concerns connected with exchange from PLN to EUR of dividend payment to Eureko from PZU insurer), as well as clear deterioration in sentiment on the global markets. At the end of the week the upgrade of Hungary's rating outlook from negative to stable by S&P and the agreement on funds payment to Eureko helped the domestic currency and at the end of the Friday's session the zloty recovered part of its weekly losses.

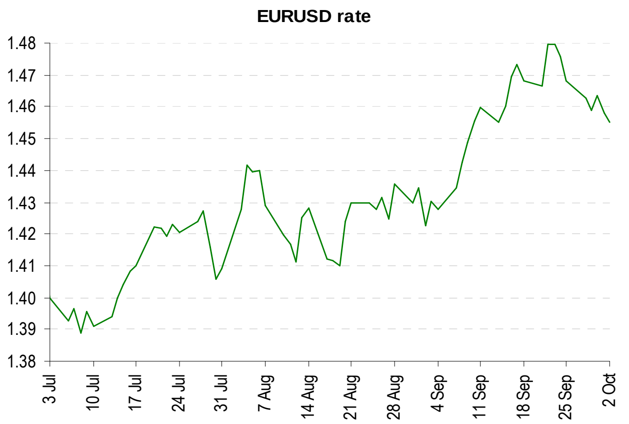
▪ This week, amid lack of important events in Poland, the zloty performance will depend mainly on changes in global moods. We think that EURPLN rise to 4.30 or even above is still possible.



Moderate weakening of domestic bonds

▪ The domestic debt market weakened, though the 5Y bond performed reasonably well and yields in this segment remained unchanged. Lowered interest in emerging markets' assets and zloty weakening had negative influence on the domestic debt market. During the week the expectations for bonds sale from PZU portfolio put pressure on the market, though the final agreement with the Eureko in connection with news the PZU will not sale much of its bonds portfolio limited the scale of local debt market weakening.

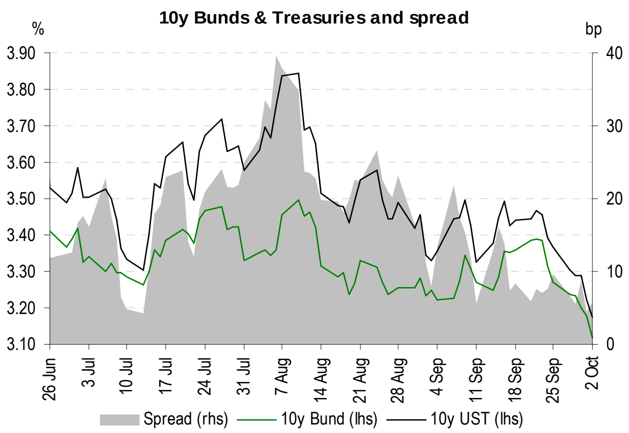
▪ This week the activity of the debt market may be limited similar to the past week and the market will remain under influence of changes in global moods and the zloty exchange rate. An important test for the market will be auction of 2Y bonds.



Fall in EURUSD

▪ The dollar quite significantly recovered against the euro last week. The US currency was supported by higher interest in purchases of US government bonds amid rising risk aversion in the global markets. The reason for weaker moods was a series of weaker than expected data from the US economy (consumer confidence index, manufacturing ISM, Chicago PMI, new jobless claims, factory orders and key data on non-farm payrolls). As a result, on Friday the EURUSD rate fell below 1.45. However, shortly later it rebounded quickly to above 1.46 as investors started to assess the condition of the US economy less optimistic as compared to the euro zone.

▪ Despite some rebound in EURUSD towards the end of the past week, this week the tendency of the dollar appreciation amid higher risk aversion may be continued.



Strengthening in the core debt markets

▪ Clear increase in risk aversion in the global markets supported the core debt markets. Growing concerns over the double bottom recession increased the interest in safe haven bonds of the US and German governments. In the euro zone the spread between the German bond yields and bonds of other countries increased. During the week yields of 10Y Treasuries and Bunds fell to 3.16% and 3.11% from 3.37% and 3.27%, respectively, a week earlier.

▪ This week the core debt markets may strengthen again amid further reaction of investors to series of unfavourable data released the past week. Whether the tendency will be limited or strengthened will depend on new macroeconomic data. The result of the ECB meeting may be also important.

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