

# Weekly economic update

9 – 15 August 2010

Last week's information brought ambiguous signals as regards the scale of recovery in the Polish economy as on the one hand we saw lower than expected PMI manufacturing index despite clear increase of this indicator in the euro zone, while on the other hand there was information showing that improvement in the labour market continues with further fall in the unemployment rate. Still, details of the government's Multi-Year Financial Plan approved by the Cabinet on Tuesday, are not known. The planned increase in VAT rates will lead to a moderate increase in inflation (it is hard to assess what scale of the increase will be passed to consumers, but even if all of it affects prices, the CPI may be higher by ca. 0.5 pct. point.). The influence on GDP growth should be rather limited as well. This does not change the fact that increasing taxes is not a proper way to deal with public finance sector problems and to reduce fiscal deficit permanently, some steps towards reforming spending side of the budget would be welcome.

The Polish foreign exchange market saw some stabilisation at the level close to 4.0 for EURPLN. We expect that the Polish currency may depreciate slightly this week, which may be influenced by high current account deficit in June, as well as low CPI inflation in July. The latter factor, together with recent dovish comments by the NBP President may support the Polish debt market, limiting expectations for monetary policy tightening.

The key events abroad this week include Fed meeting and data on GDP growth in the euro zone. Also, a few important indicators in the US will be released (e.g. CPI, retail sales).

## Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (9 August)</b>						
11:00	PL	Tender of 52-week T-bills worth PLN1.0-1.5bn				
<b>TUESDAY (10 August)</b>						
	JP	BoJ decision		%	0.1	- 0.1
16:00	US	Wholesale inventories	Jun	%MoM	0.4	- 0.5
20:15	US	Fed decision		%	0.0-0.25	- 0.0-0.25
<b>WEDNESDAY (11 August)</b>						
14:00	PL	Current account balance	Jun	€ bn	-752	-745 -268
14:30	US	Trade balance	Jun	\$ bn	-42.0	- -42.27
<b>THURSDAY (12 August)</b>						
11:00	EZ	Industrial production	Jun	%YoY	9.3	- 9.4
14:30	US	Jobless claims	week	k	465.0	- 479.0
14:30	US	Import prices	Jul	%MoM	0.3	- -1.3
<b>FRIDAY (13 August)</b>						
14:00	PL	CPI	Jul	%YoY	2.2	2.0 2.3
14:00	PL	Money supply	Jul	%YoY	7.8	7.6 7.1
8:00	DE	Preliminary GDP	Q2	%QoQ	1.3	- 0.2
11:00	EZ	Preliminary GDP	Q2	%QoQ	0.7	- 0.2
14:30	US	CPI	Jul	%MoM	0.2	- -0.1
14:30	US	Retail sales	Jul	%MoM	0.5	- -0.5
15:55	US	Preliminary Michigan	Aug	pts	68.9	- 67.8

Source: BZ WBK, Reuters, Parkiet

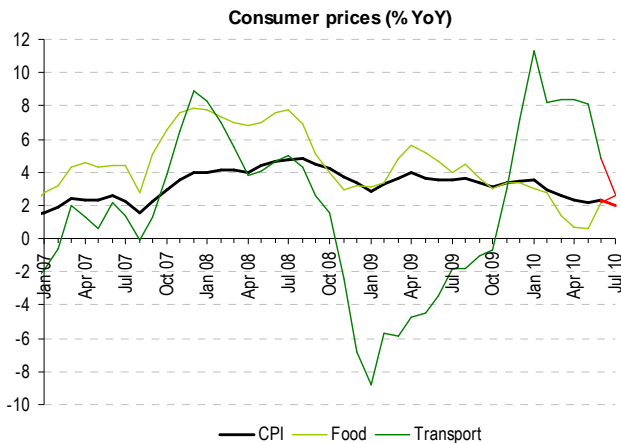
**Maciej Reluga** Chief economist (+48 22) 586 8363

**Piotr Bielski** (+48 22) 586 8333

**Piotr Bujak** (+48 22) 586 8341

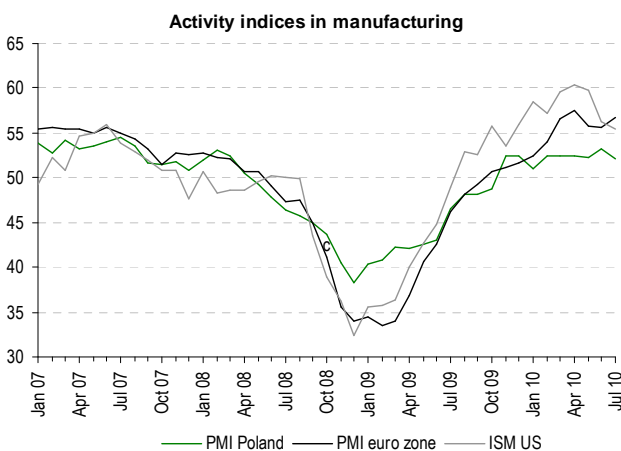
e-mail: ekonomia@bzbwbk.pl

## What's hot this week – Fed, inflation, current account

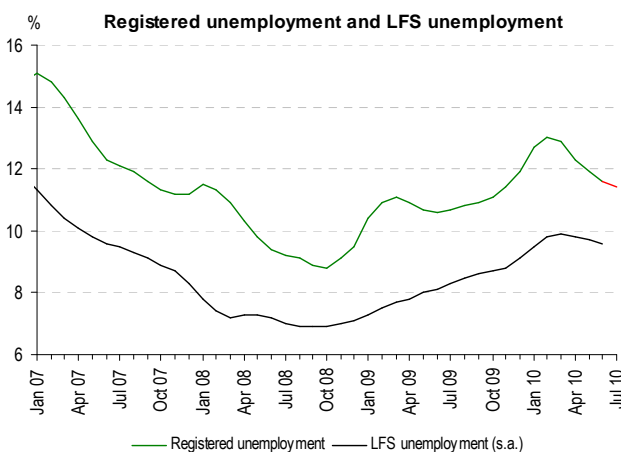


- Data releases and events this week are not numerous, yet important. At the start of the week the focus will be on Fed meeting and statement, in which investors will seek guidance on the prospects of economic recovery.
- Balance of payments data will show quite large current account deficit in June (low transfers from the EU) amid still very high growth rate of trade turnover.
- We expect a drop in inflation in July to 2.0%, the Ministry of Finance predicts 2.1%, while many market forecasts are even higher (2.2%), so the realization of our forecast would be a positive impulse for the debt market. The key will be the food prices, which according to our forecast decreased by ca. 1%MoM. Panic in world wheat markets may be negatively affecting food prices and inflation in the coming months.

## Economy last week – Slower activity growth in manufacturing



- The domestic PMI manufacturing index unexpectedly fell in July to 52.1 from 53.3 in June, despite continued growth in the euro zone PMI (to 56.7). However, the index remained above 50 points, and above long term trend, which indicates a continuation of growth in industrial activity. According to the report, industrial production growth was the slowest since January, employment fell slightly. Despite weakening of the total inflow of orders, strong growth of export orders was maintained.
- Despite the adoption of the Multi-Year Financial Plan by the government, the document has still not been published. Changes in VAT will be slightly different than media suggested last week. VAT on unprocessed food will go up from 3% to 5% and the rate of processed food will fall from 7% to 5%. Rates for other goods and services will increase by 1 pp (preferential rate to 8% and the base rate to 23%).



- NBP credit officer survey showed that in the second quarter of this year a gradual easing of credit policy was continued in the segment of loans for business and housing loans, which was accompanied by tightening of the criteria for consumer loans. Banks have seen a growth in demand for most types of credit (except for long-term loans for large companies).
- The Ministry of Labour estimates that the registered unemployment rate fell in July to 11.4% against 11.6% in June. This indicates that the improvement of the Polish labour market continues. The positive trend is also confirmed by the LFS unemployment data published by the Eurostat, according to which the seasonally adjusted jobless rate in Poland fell in June for the third time in a row, to 9.6%.

## Quote of the week – NBP governor's dovish heart

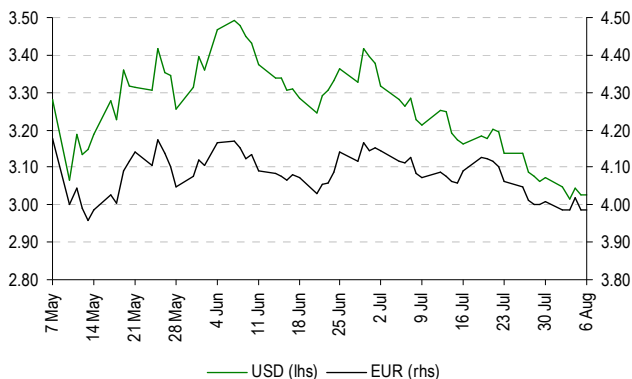
### Marek Belka, NBP governor, TVP3, 5 Aug

This (VAT) hike will have a very limited impact on inflation (...) of about 0.3 pp rise in prices at the start of the year. (...) Obviously it would be better to find savings and curb spending, but I know how hard it is. (...) One should not worry about inflation, it is a long term. It is safeguarded by the NBP. Interest rates are where they are, we will change them when needed, we will reduce them if possible, and if nothing else comes to our minds, they will remain unchanged. (...) Recently the factors like strengthening of the zloty and very stable situation in the labour market, i.e. lack of wage pressure, are increasing a dovish bias in my heart. However, whether the hawk will show its claws will depend on the final shape of budget draft for the next year.

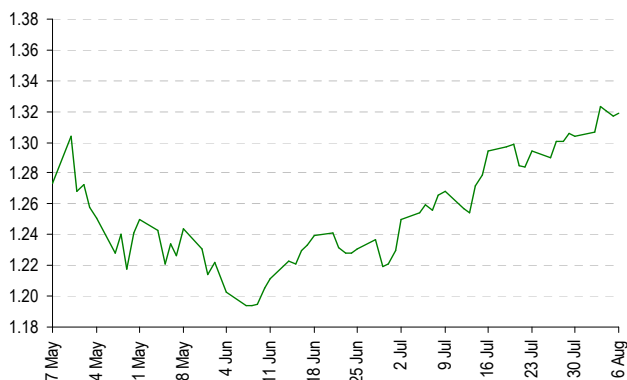
After a series of hawkish comments of MPC members (mainly those appointed by the president), suggesting a possibility of speeding up interest rate hike decisions due to inflationary consequences of higher VAT rates, the tone of the latest interview with NBP President is far more dovish. Marek Belka is not concerned about inflation outlook and in his comments there is even a mention about potential interest rate cut, which is in contrast to signals coming recently from other MPC members. On the other hand, one has to remember that just after Belka's nomination for the NBP President, the Council's statement became more hawkish. Moreover, Belka reminded that the decision on monetary tightening will depend on the final shape of next year's budget. We still think that the first rate hike will take place in Q4.

Market monitor

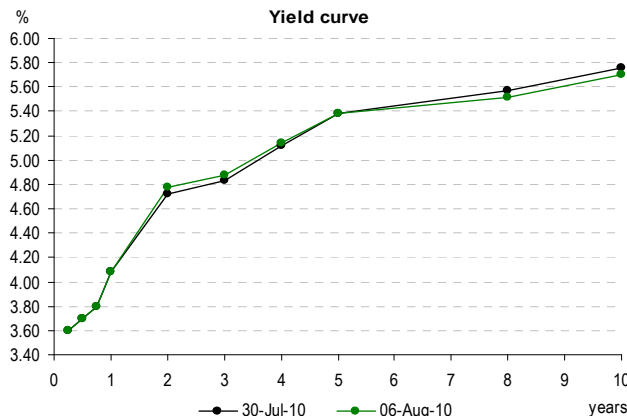
Zloty exchange rate



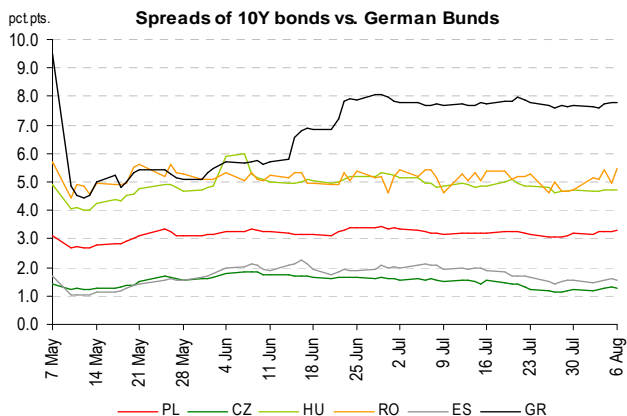
EURUSD rate



Yield curve



Spreads of 10Y bonds vs. German Bunds



The EURPLN stable, the EURUSD higher

▪ The zloty remains beyond interest of global investors and last week it was traded in the horizontal trend in the range 3.98-4.02. The range was narrower as compared to the one we had suggested a week ago. The exchange rate was not influenced much by weaker PMI reading, by positive information in the region (IMF accepted support package for Romania), nor by overall positive sentiment in the European market (quite good data, successful debt auctions). The only local factor influencing the foreign exchange market (EURPLN fell from 4.02 to 4.00) was the result of bond auction. During the last five session the zloty rate against the euro was close to the downward trend line. We expect that this week the EURPLN may rise, even to 4.04.

▪ The euro continued the upward trend against the dollar driven by better-than-expected PMI for the euro zone, positive results of Portuguese and Spanish bond auctions, confirmation of the second tranche for Greece from IMF and quite optimistic comment by the ECB. On the other side of the Atlantic the situation was worse amid some disappointing figures on US consumers, weak manufacturing ISM and lower than forecast results of companies. Overall, this was not the picture supporting the greenback and the EURUSD rate rose in line with our expectations to 1.32, breaking this level after publication of much weaker than forecast non-farm payrolls data. Currently, the situation is interesting as EURUSD is struggling with resistance zone 1.335-1.34. It is constrained from the bottom by a support 1.32 and the upward trend line.

The market under the influence of the domestic issues

▪ The hawkish comments of the MPC members triggered the yields surge at the beginning of the week, mainly in the 2-5 year tenor. The long end remained stable. In the second part of the week the yields declined on the prospect on Wednesday's bond auction (investors wanted to buy some bonds before the auction as the solid demand was expected). The yields of 2Y bonds were stable, the remaining part of the curve declined. Consequently, the yield curve flattened during the past week. The FinMin sold on Wednesday 2Y and 5Y bonds worth a record PLN6bn (after the main auction there was even a supplementary tender). The market expectations for interest rates hikes may be tamed in coming days due to NBP governor comments, although their impact on the fixed income market on Friday was limited.

▪ During the past week the yields of 10Y Bunds and Treasuries plunged, what has been particularly seen during US trading hours (in response to week US data). The yields of Bunds and Treasuries declined on the weekly basis by 14 and 7 bps respectively.

▪ Spain and Portugal sold their bonds last week on pretty good conditions. Spain sold bonds worth €3.5bn with yields lower than on the previous auction. Portugal gathered €1.156bn, which was more than initially planned.

▪ The rise of risk appetite was not clearly reflected in the 10Y bonds spreads of the PIIGS and Germany. At the beginning of the week the spreads did decline, but later in the week started to rise. However, the upward trend has been a result of declining Bunds yields, not by the surge of PIIGS bond yields (the latter actually declined too).

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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](mailto:ekonomia@bzwbk.pl), <http://www.bzwbk.pl>



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