

Weekly economic update

23 – 29 August 2010

Data from the labour market and about production in industry and construction proved to be worse than forecast, which weakened market expectations for rate hikes. The publications did not harm the zloty, but helped in strengthening the bond market. Only a series of disappointing US data on Thursday and a comment of ECB executive board member on Friday caused an adjustment on the currency market and EURPLN increased to ca. 3.98. Despite higher risk aversion, foreign demand for Polish bonds persisted amid the very low yields of Bunds and Treasuries.

This week investors' attention in the domestic market will be focused on the MPC meeting. Therefore, the economic data to be released shortly before the MPC decision (including retail sales and unemployment rate) will not have significant impact on market rates. Decision on interest rates will be also taken by the Hungarian central bank. Numerous indicators of economic climate in the US and euro zone, as well as American data from the housing market and revised GDP for Q2, will determine a direction of changes in market sentiment. In case of more disappointing readings, risk aversion and fears about global economic growth may strengthen.

Economic calendar

| Time CET | COUNTRY | INDICATOR | PERIOD | | FORECAST | | LAST VALUE |
|------------------------------|---------|---|--------|------|-------------|-------------|-------------|
| | | | | | MARKET | BZWBK | |
| MONDAY (23 August) | | | | | | | |
| | PL | MPC meeting | | | | | |
| 9:58 | EZ | Flash PMI – services | Aug | pts | 55.5 | - | 55.8 |
| 9:58 | EZ | Flash PMI – industry | Aug | pts | 56.2 | - | 56.7 |
| 11:00 | PL | Tender of 52-week T-bills worth PLN0.5-0.8bn | | | | | |
| 16:00 | EZ | Consumer confidence | Aug | pts | -14.0 | - | -14.1 |
| TUESDAY (24 August) | | | | | | | |
| | PL | MPC decision | | % | 3.50 | 3.50 | 3.50 |
| 10:00 | PL | Unemployment rate | Jul | % | | 11.4 | 11.6 |
| 10:00 | PL | Retail sales | Jul | %YoY | 4.5 | 3.0 | 6.4 |
| 11:00 | EZ | Industrial orders | Jun | %MoM | 1.5 | - | 3.8 |
| 16:00 | US | Home sales | Jul | m | 4.8 | - | 5.37 |
| WEDNESDAY (25 August) | | | | | | | |
| 10:00 | DE | Ifo index | Aug | pts | 105.7 | - | 106.2 |
| 11:00 | PL | Bond switching auction | | | | | |
| 14:30 | US | Durable goods orders | Jul | %MoM | 3.0 | - | -1.2 |
| 16:00 | US | New home sales | Jul | k | 330.0 | - | 330.0 |
| 16:00 | US | Home prices | Jul | %MoM | - | - | 0.5 |
| THURSDAY (26 August) | | | | | | | |
| 8:00 | DE | GfK index | Sep | pts | 4.0 | - | 3.9 |
| 10:00 | EZ | Money supply | Jul | %YoY | 0.3 | - | 0.2 |
| 14:30 | US | Initial jobless claims | week | k | 488.0 | - | 500.0 |
| FRIDAY (27 August) | | | | | | | |
| 14:00 | PL | Consumer confidence | Aug | pts | - | - | - |
| 14:30 | US | Core PCE | Q2 | q/q | 1.1 | - | 1.1 |
| 14:30 | US | Preliminary GDP | Q2 | q/q | 1.5 | - | 2.4 |
| 15:55 | US | Final Michigan | Aug | pts | 69.6 | - | 69.6 |

Source: BZ WBK, Reuters, Parkiet

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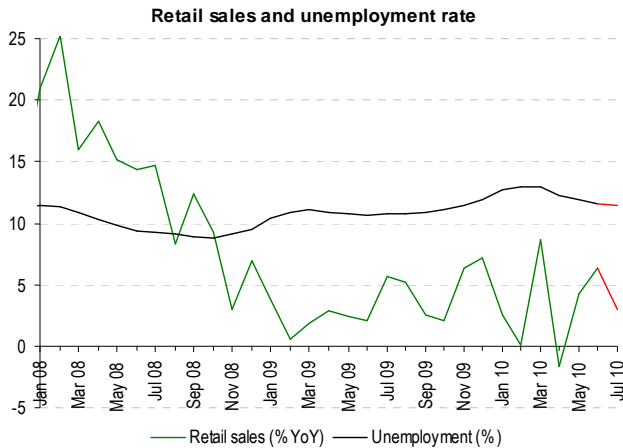
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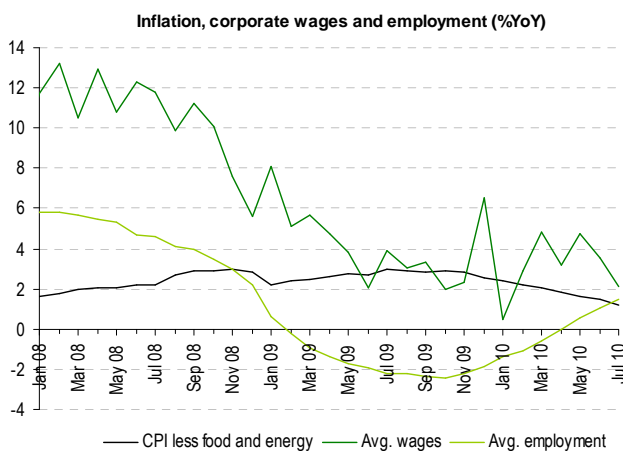
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What's hot this week – Eyes on the MPC

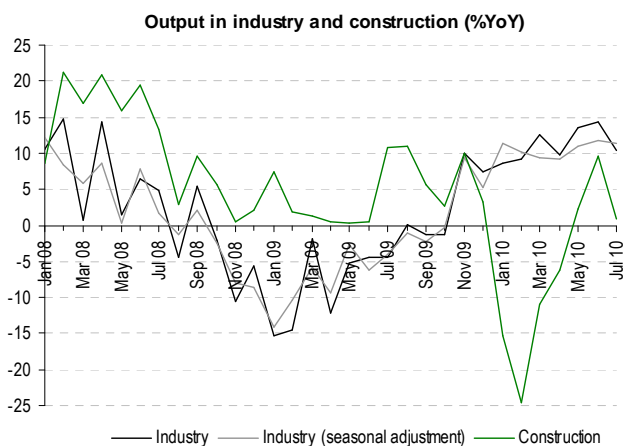


- This week, the next MPC meeting will be crucial for the domestic market. It will be interesting whether and how the tone of the Council statement will change after ambiguous last month's figures, the NBP President suggestion that he does not hurry with interest rate hikes and renewed fears about economic downturn abroad. We believe that the rhetoric of the Council would not be substantially changed leaving the open door for interest rate hike in the Q4.
- Just before the MPC decision figures on retail sales and unemployment for July will be announced. Sales growth will probably slow down due to the high base effect from last year, but market impact will be limited because of waiting for the MPC decision. The unemployment rate probably fell in July to 11.4%, in line with Ministry of Labour estimates.
- Indices of economic climate in the eurozone and the USA and revised US GDP data will be crucial abroad.

Economy last week – Lower production and wages, higher PPI



- Employment growth in corporate sector accelerated in July as expected to 1.4%, but wage growth was disappointing, dropping to 2.1% from 3.5% in June. Labour market data for July suggested that although employment growth continues, the market rebound is in its preliminary stage. It suggests that it does not create a wage pressure, which reduces concerns about the increase in inflation.
- In July all measures of core inflation have decreased, including CPI without food and energy prices, which was in line with our forecast at 1.2%, the lowest level for 33 months.
- Just the opposite signal stemmed from data on producer prices growth that accelerated to 3.8%YoY in July, despite a strengthening of the zloty in July, which contributed to lower export prices. In essence, the price increase occurred in the commodity sectors.



- Industrial production in July increased by 10.3%YoY, lower than market expected. However, after seasonal adjustment output growth was similar as in June and faster than in the first half of the year, which shows the continuation of the recovery in the manufacturing sector.
- Construction and assembly production strongly disappointed, as its growth slowed down in July to 0.8%YoY from 9.6%YoY in June. However, we must remember that production in this sector has been highly volatile recent months (under the influence of extreme weather conditions). August should see a clear upturn in this sector.
- The CSO survey showed a slight improvement of economic climate in industry and trade and the deterioration in construction. In all sectors the positive assessment of climate outnumbered the pessimistic responses.

Quote of the week – GDP growth in Q2 at 3.1%

Michał Boni, head of PM advisers, Dziennik GP, 18 Aug

Results of the Polish economy will be very good. After the Q2, Polish GDP growth on an annual basis will be about 3.1 percent. - Maybe a little more. That is slightly better than after the first three months of this year. A good result is primarily due to the export.

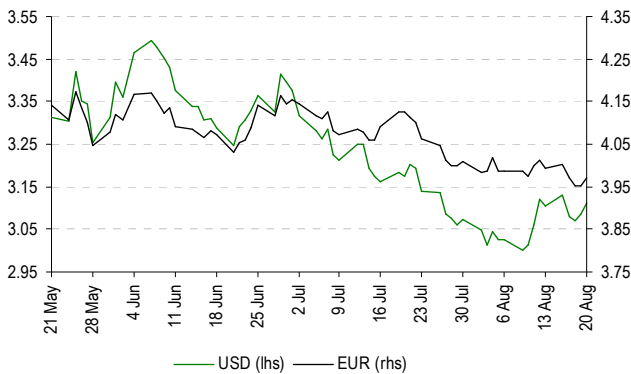
Ludwik Kotecki, deputy finance minister, TOK FM, 20 Aug

GDP growth in the second quarter will reach 3.1-3.2 percent.

Minister Boni's estimates concerning the economic growth in previous quarters were generally quite accurate, so the last statement should be regarded as a valuable hint ahead of the publication of the preliminary data on GDP next week. Our GDP forecast is also at 3.1%YoY in the Q2 and 3.2% in 2010, while the Ministry of Economy predicts an increase of 3.2% in the Q2 and 3% in the entire year.

Market monitor

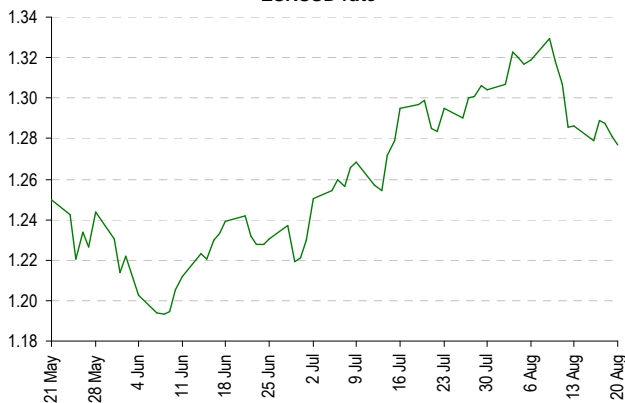
Zloty exchange rate



Stronger zloty due to demand for Polish bonds

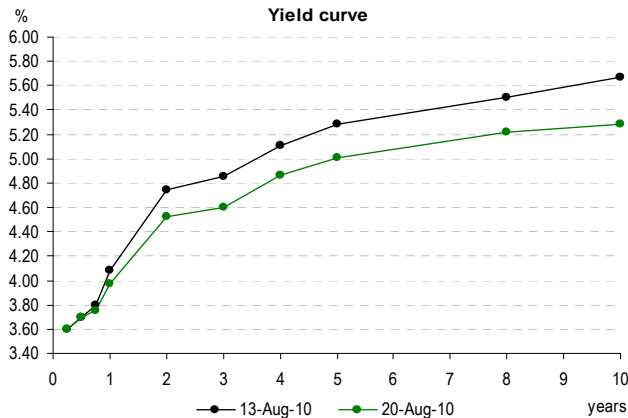
During the previous week the zloty gained slightly, mainly due to expectations that the expansive monetary policy conducted by the major central banks will be continued. As the yields of German and US bonds plunged, the investors were seeking prospect of higher return and started to buy securities of emerging countries, including Polish bonds. Lower than expected data published in the first part of the week did not influence the EURPLN. Only the Thursday's set of disappointing data from the US and Friday's comment by ECB Governing Council member Axel Weber triggered zloty's depreciation, and the EURPLN climbed ca. 3.98. During this week we expect that the further demand for Polish bonds and hedging connected with that operation will be supporting the zloty. Still, high risk aversion may be putting the negative pressure on the zloty. We forecast, that the EURPLN will stay in the range of 3.94-4.02 and the actual direction will be determined by the prevalence of one of the factors mentioned.

EURUSD rate



The EURUSD remained in the range of 1.25-1.30 pointed by us a week ago. The euro appreciated in the first part of the week due to investors' demand for high-yield bonds sold by Spain and Ireland. The turning point on the EURUSD market occurred as the lower-than-expected data from the US real estate market were published on Tuesday. Since then, the euro was depreciating, and high volatility was observed. The dollar gained considerably after the Friday's comment of Axel Weber, who claimed that the EBC should maintain its unlimited liquidity actions further past the 2010 and terminate them in early 2011. We expect that the downward trend of the EURUSD will be continued this week. The levels of support and resistance remain unchanged: 1.25-1.26 and 1.30 respectively.

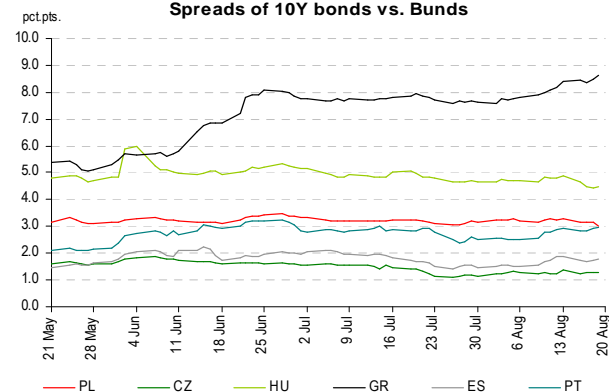
Yield curve



Strong demand on the domestic debt market

The yields on the domestic debt market dropped sharply last week. The reaction of the interest rate market appeared after lower-than-expected data on wage growth. Later in the week, the downward trend was continued, mainly driven by foreign demand. Global investors, amid very low yields of Treasuries and Bunds, were looking for more profitable investment opportunities, one of which is the purchase of Polish bonds. Further decreases in bond yields in the core debt markets and possible more "dovish" message after the MPC meeting can additionally support the demand for domestic securities.

Spreads of 10Y bonds vs. Bunds



10Y Bund yields set record lows four times last week. In addition, Germany sold a 30Y bonds at historically low yield of 2.37%. Demand for safe assets was triggered by concerns about the worsening global growth prospects after the publication of disappointing US data and belief that, given the weak global economy, expansionary monetary policy pursued by the ECB, Fed and BOJ will be conducted for a long time.

Peripheral European countries sold their bonds last week. Investors focused on the auction of the Irish debt, as the savings achieved by deep spending cuts may be consumed largely by help to local banks, in particular the Anglo Irish Bank.

Despite the increase in risk aversion the spreads narrowed because peripheral bond yields fell more than Bunds.

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