Bank Zachodni WBK

Weekly economic update

20 – 26 September 2010

Market moods were quite volatile last week, which affected the behaviour of the Polish currency. However, in line with our expectations from the previous report, the zloty weakened against the euro over the week. In turn, the direction of change in the bond market was opposite to our prediction – yields decreased, among others under the influence of less hawkish than we expected data from the domestic economy, and thanks to a very good result of the 10Y bond auction and a signal from Moody's about increasing pressure on rating upgrade for Poland and Czech Republic. It seems that the correction in the domestic FX market is coming to an end and the next week the zloty should strengthen gradually towards 3.92. On the debt market we may see a slight increase in yields at the short end of the curve, while the long end should be stable with slight chances for further strengthening.

This week, there will be fewer domestic publications (focus on the CSO conference on Friday and the MPC minutes the day before), while agenda abroad is pretty tight. Particularly important for global sentiment may be new data from the US housing market and a statement after the Fed meeting (after dovish tone of the Beige Book, there was some talk of softer tone of FOMC communiqué or even an extension of quantitative easing)

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (20 September)					
11:00	**PL**	**Tender of 52-week T-bills worth PLN0.5-0.6bn**					
		TUESDAY (21 September)					
14:00	**PL**	**Core inflation**	**Aug**	**%YoY**	**1.2**	**1.2**	**1.2**
14:30	US	Building permits	Aug	k	560.0	-	559.0
14:30	US	House starts	Aug	k	550.0	-	546.0
20:15	US	Fed decision		%	0.0-0.25	-	0.0-0.25
		WEDNESDAY (22 September)					
11:00	**PL**	**Bonds switching auction**					
11:00	EZ	Industrial orders	Jul	%YoY	16.3	-	22.6
14:00	**PL**	**Business climate indicators**	**Sep**	**pts**	-	-	-
16:00	EZ	Consumer confidence	Sep	pts	-10.0	-	-11.7
16:00	US	Home price index	Jul	%MoM	-	-	-0.3
		THURSDAY (23 September)					
9:58	EZ	Flash PMI – industry	Sep	pts.	54.5	-	55.0
9:58	EZ	Flash PMI – services	Sep	pts.	55.5	-	55.6
14:00	**PL**	**MPC minutes**			**-**	**-**	**-**
14:30	US	Initial jobless claims	week	k	450.0	-	450.0
16:00	US	Home sales	Aug	m	4.1	-	3.83
16:00	US	Leading indicators	Aug	pts.	0.1	-	0.1
		FRIDAY (24 September)					
10:00	**PL**	**Retail sales**	**Aug**	**%YoY**	**5.9**	**5.7**	**3.9**
10:00	**PL**	**Unemployment rate**	**Aug**	**%**	**-**	**11.4**	**11.4**
10:00	DE	Ifo index	Sep	pts	106.2	-	106.7
14:30	US	Flash durable goods orders	Aug	%MoM	-1.0	-	0.4
16:00	US	New home sales	Aug	k	290.0	-	276.0

Source: BZ WBK, Parkiet. Reuters

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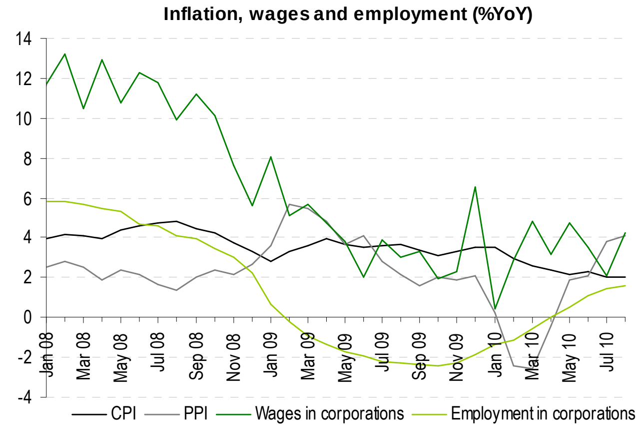
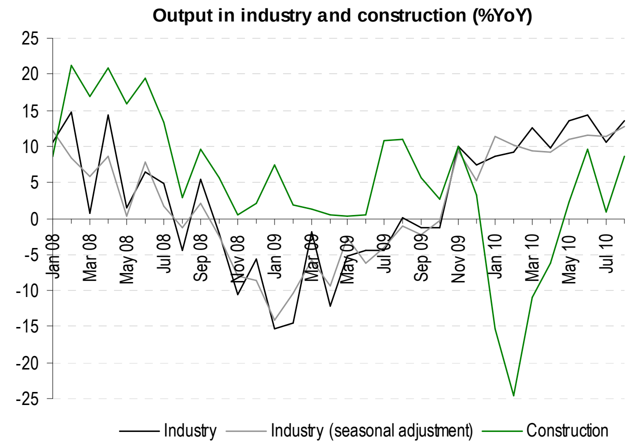
What's hot this week – Fed meeting and numerous data abroad

- This week, events and publications abroad will dominate, including FOMC meeting, set of business climate indicators in the US and euro zone, and data from the US housing market.
- On the domestic ground, the most important will be Friday's press conference of the CSO, at which data on retail sales and unemployment will be released. Also, interesting will be the minutes of the MPC meeting in August, at which a motion to hike rates was submitted. Data on core inflation and business climate should have limited impact on the market.
- Growth in retail sales according to our forecast accelerated to 5.7%YoY, among others thanks to improving growth in consumers' income and high propensity to consume. According to Polish association of retailers, sales growth in August amounted to 4-5%YoY.

Economy last week – Hawkish data, yet not as much as we expected



- Inflation in August reached 2.0%YoY and was below forecast, which was mainly due to strong seasonal drop in prices of vegetables and fruits. However, the food prices will go up in the coming months driven by high food prices abroad and negative impact of floods and adverse weather conditions this year. The moment of the CPI's rebound from the bottom has been delayed, but the scale of the expected inflation increase in general remains unchanged.
- Growth in employment and wages in corporate sector in August (respectively 1.6% and 4.2%YoY) was lower than we expected. However, labour income of households is growing at the fastest rate for over 1.5 years, and the following months should bring further improvement, which will support consumer demand and will raise dynamics of unit labour costs. In our view, this will be one of the arguments supporting monetary tightening.



- Industrial output growth in August (13.5%YoY) was slightly lower than we expected, yet strong enough to put aside the worries over GDP growth in the Q3. Additionally, growth in construction output (8.5%YoY) was stronger than anticipated. In the subsequent months we may expect a gradual slowdown of growth in industry to single-digit level and further rebound in construction and investments. A shift of growth momentum from foreign to domestic demand, together with quite high dynamic of producer prices, will be supportive for monetary tightening decision.
- PPI rose by 4.1%YoY in August. That was mainly due to the low base effect of last year when the prices declined by 0.4%MoM (a 0.2%MoM decline this time). The prices in the manufacturing dropped by 0.3%MoM, first time since March, which was caused mainly by the stronger zloty that lowered the export prices.

Quote of the week – Different views in the MPC

Adam Glapiński, MPC member, Reuters, 14 Sep

We should act decisively, i.e. not dripping by 25 bp, and act preemptively. After such decisive rate hike, there should be longer period of stability.

Anna Zielińska-Głębocka, MPC member, TVN CNBC, 14 Sep

At this moment I do not see inflationary pressure, taking into account CPI. Let's wait patiently. I do not see a clear argument (for a rate hike) right now, but we will see after all data releases.

Elżbieta Chojna-Duch, MPC member, PAP, 14 Sep

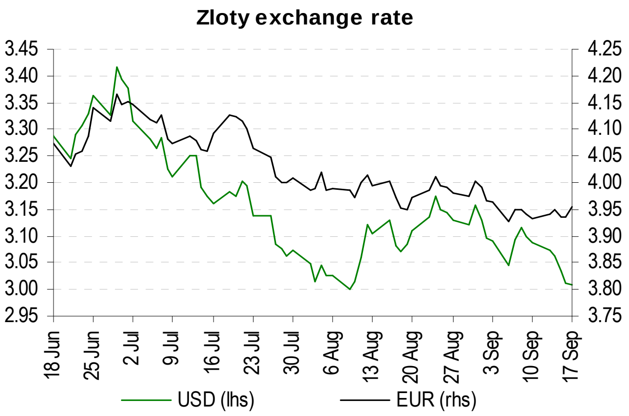
August CPI reading at 2.0% is a very good information from the MPC point of view, it suggests a need for rate stabilisation in the short run.

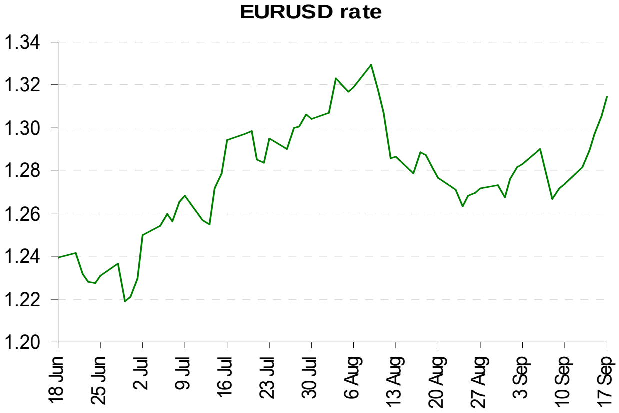
Andrzej Kaźmierczak, MPC member, Reuters, 13 Sep

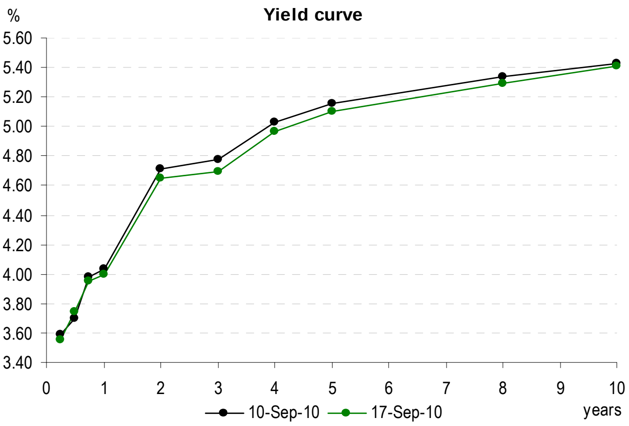
Exceeding 2.5% is not an argument for me to hike rates.

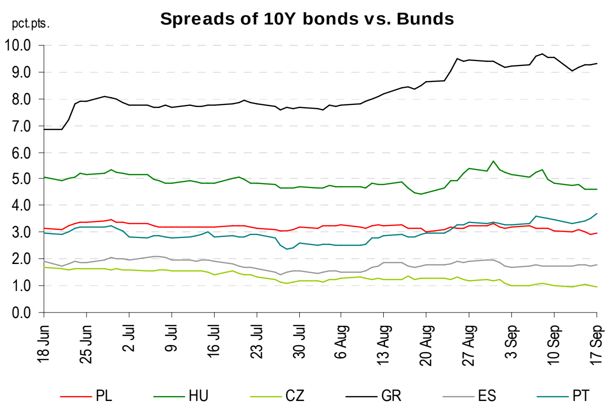
Recent comments of the MPC members indicate that opinions on how and when monetary policy should react to macroeconomic developments is quite diversified within the Council. Most of the comments last week were quite dovish, but please note that many MPC members avoided any public comments recently. Also, please remember that at the August meeting the motion to hike rates was put under vote. In this context, the minutes of the MPC meeting in August to be published this week are worth attention, as it is possible that the document will reveal a bit more about the arguments of supporters and opponents of rejected the proposal. Our expectations about the future MPC decisions do not change and we still expect that interest rate hike by 25 bps will take place in October.

Market monitor









The zloty depreciation on weak data from abroad

- Since the beginning of the week EURPLN was pretty volatile. In the first part, the zloty strengthened considerably against the euro (exchange rate dropped from 3.95 to 3.92). This might have been linked to the Wednesday's auction of Polish bonds which saw high interest of foreign investors. The rest of the week showed a clear upward trend. The market participants assessed the US macro figures as rather negative, consequently, just as we expected, the zloty weakened against the euro over the week. We believe that EURPLN rate reached maximum for September last week. In this week we expect that zloty will be gradually strengthening towards 3.92.
- During the whole week the euro was considerably gaining versus the dollar, the EURUSD surged from 1,272 to 1.31 at the end of the week. Despite the negative data from the euro zone (lower than expected data on industrial output and ZEW index) and US (disappointing data on retail sales and the Philly Fed and Michigan indexes) the market sentiment did not deteriorate that much to trigger the worries over the realization of the double-dip scenario in the global economy, that would have obviously support the greenback. Still, despite the strong upward trend the EURUSD did not manage to break the long-term support level at 1.312. This week we expect that the exchange rate market will be affected mainly by the large amount of crucial data and the Fed's communiqué issued on Tuesday. It is hard to assess the market reaction to this set of new information. We expect that during this week the EURUSD will remain in range 1.27-1.33.

Strong demand for Polish bonds

- Over the past week, yields on domestic debt market fell all along the curve. Initially, it was a response to lower than expected inflation. Another factor which contributed to the lowering of yields at the long end was a very high demand for 10-year bonds sold on Wednesday. Macroeconomic figures published within the last week were not particularly hawkish, which lowered somewhat expectations regarding future cost of money. At the end of the week, Moody's rating agency suggested that it could increase the Polish debt rating, which additionally supported the market. We believe that this week yields at the short end may increase a bit, while the long end should remain stable with slight chances for a further decline.
- At the outset of the last week, yields on core debt markets fell visibly due to the worse than expected macro data from the US and euro zone. However, the rest of the week brought a reverse reaction which was caused, among others, by successful auction of Spanish bonds. The accumulation of the disappointing data from the US dragged the yields of 10Y Bunds to Monday's opening, while the Treasuries below that level. This week, important figures from US housing market will be published, which may affect the direction of core markets' movement.
- In the last week, the biggest decrease in spread against Bunds was recorded for Hungarian and Greek bonds. It was mainly a result of a drop in yields of their securities. This can be found puzzling as S&P agency warned again that it may lower Hungarian debt rating and unemployment in Greece increased to the highest level in 10 years. The biggest increase in spread was recorded for bonds of Portugal whose fiscal condition is apparently unfavourably accessed by the market.

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