Bank Zachodni WBK

Weekly economic update

27 September – 3 October 2010

The past week was rich in many important events. On Monday the NBER announced the end of 18 months-long recession in the US and on Tuesday the Fed said that it is ready to support the US economy, also due to very low inflation. In response to dovish message, EURUSD rose sharply, exceeding 1.33, the upper limit of the fluctuations indicated by us last week. Since the start of the week EURPLN was falling slightly, in line with our expectations. Later in the week, when the worse-than-expected data on the PMI for the euro area and Germany were revealed, zloty clearly lost, reaching even 3.98. Minutes of the Polish MPC meeting confirmed the council voted on the 50 bp rate hike in August. This caused a rise in short-term FRA and IRS rates. Data on retail sales for August were better than forecast.

This week, the attention of the domestic market will be focused on the MPC meeting on Wednesday. The most interesting days on global markets will be Thursday when the final reading of US GDP for Q2 will be announced and Friday when US consumer spending figure will be presented. Friday is also the day of publication of the PMI index for the Polish industry (its impact on the market is likely to be negligible) and the FinMin forecasts of CPI in September.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 September)					
10:00	EZ	Money supply	Aug	%YoY	0.3	-	0.2
11:00	**PL**	**Tender of 52-week T-bills worth PLN0.5-0.6bn**					
		TUESDAY (28 September)					
8:00	DE	GfK index	Sep	pts.	4.2	-	4.1
14:00	**PL**	**Current account balance**	**Q2**	**€ bn**	**-**	**-2.2**	**-1.1**
15:00	US	S&P/Case-Shiller home price index	Jul	%MoM	-0.1	-	0.3
16:00	US	Consumer confidence	Sep	pts.	52.5	-	53.5
		WEDNESDAY (29 September)					
	PL	**MPC decision**		**%**	**3.50**	**3.50**	**3.50**
11:00	EZ	Business climate	Sep	pts.	101.2	-	101.8
		THURSDAY (30 September)					
11:00	EZ	Flash HICP	Sep	%YoY	1.8	-	1.6
14:30	US	Core PCE	Q2	%QoQ	1.1	-	1.1
14:30	US	Final GDP	Q2	%QoQ	1.6	-	1.6
14:30	US	Initial jobless claims	week	k	459.0	-	465.0
15:45	US	Chicago PMI	Sep	pts.	55.8	-	56.7
		FRIDAY (1 October)					
9:00	**PL**	**PMI – industry**	**Sep**	**pts.**	**53.0**	**53.2**	**53.8**
9:58	EZ	PMI – industry	Sep	pts.	53.6	-	55.1
11:00	EZ	Unemployment rate	Aug	%	10.0	-	10.0
14:30	US	Consumer spending	Aug	%MoM	0.3	-	0.4
14:30	US	Personal income	Aug	%MoM	0.3	-	0.2
14:30	US	Core PCE	Aug	%MoM	0.1	-	0.1
15:55	US	Michigan index	Sep	pts.	67.0	-	66.6
16:00	US	ISM – manufacturing	Sep	pts.	54.5	-	56.3

Source: BZ WBK, Reuters, Dow Jones

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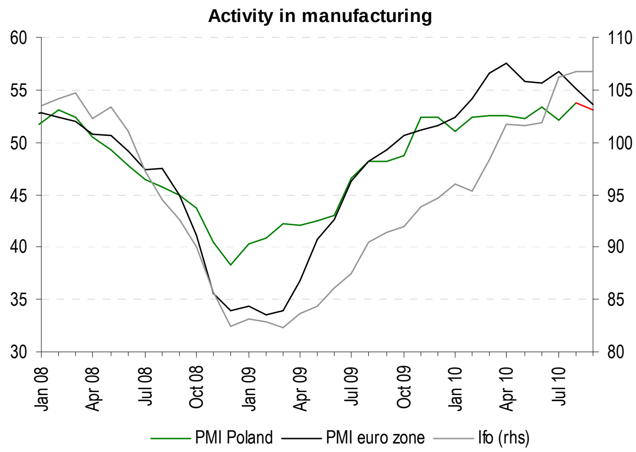
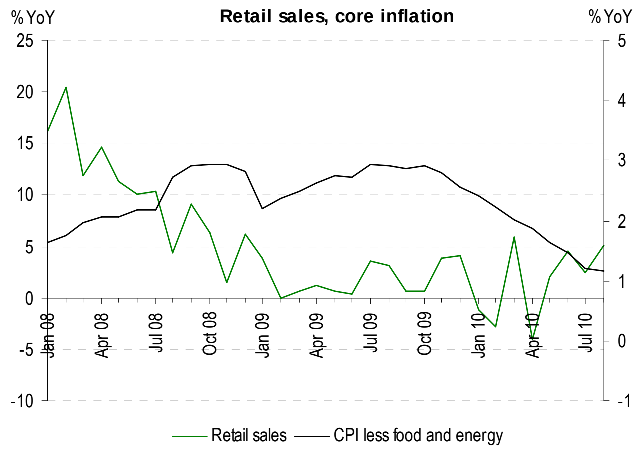
What's hot this week – MPC meeting amid key data releases abroad

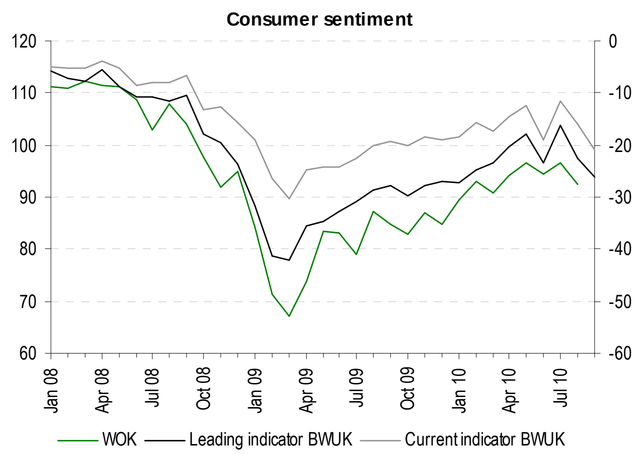


- We do not expect a change in interest rates at the nearest MPC meeting, although the rate-hike motion will be probably submitted again, like in August. Still, it seems that data coming from the domestic economy are gradually strengthening arguments calling for monetary tightening. The market will be seeking signs of those arguments in the MPC statement.
- At the September's meeting, the Council should also, as every year, approve the opinion to 2011 budget draft, and the monetary policy guidelines for 2011 (although the date of publication of those documents is not known).
- A clear drop in manufacturing PMI index for September in the euro zone suggests that also the index for Poland may deteriorate. Nevertheless, one should keep in mind that in August this regularity was broken.

Economy last week – Sales keep growing, unemployment keeps falling



- Retail sales growth in August was higher than expected and reached 6.6%YoY in nominal terms and 5.1%YoY in real terms. One should notice solid growth in sales of motor vehicles (23.2%YoY), and furniture and household appliance (33.7%YoY). Strong demand for durable goods suggests that consumer demand is well established, mainly due to pick-up in personal income and lower fears of unemployment.
- Slightly less optimistic were the results of consumer climate survey, which showed the second solid drop in a row in September. Further decline in consumer optimism could have negative effect on consumption and GDP growth, however we think that recovery in the labour market will prevent such scenario.
- Business climate in enterprises sector in September remained stable in manufacturing and retail trade, while declined slightly in construction.



- The unemployment rate fell in August to 11.3%, in line with expectations. We predict that positive trends in the labour market will continue, although at the end of the year the unemployment rate will record a slight seasonal increase to ca. 11.5%.
- Core inflation remained in August close to July's level (CPI excluding prices of food and energy at 1.2%). We expect two more months of stabilisation, and then a gradual upward trend in core inflation to the level of inflation target in 2011.
- According to minutes of the MPC meeting in August the Council voted the motion to raise the reserve requirement by 50 bp and to hike main interest rates by 50 bp. Both motions were rejected.

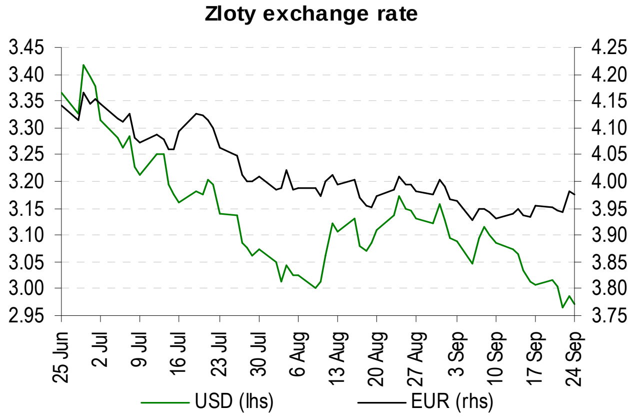
Quote of the week – Everyone knows deficit will be above PLN100bn

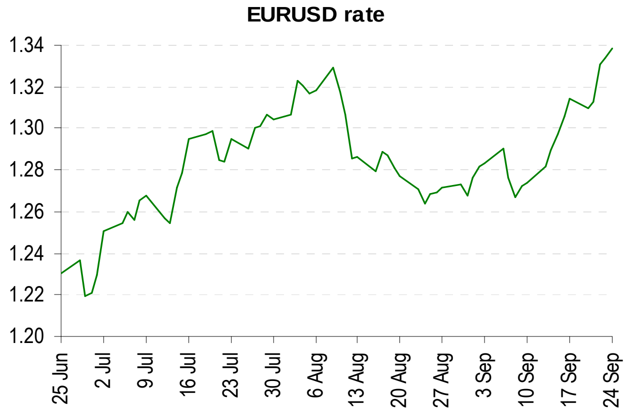
Jacek Rostowski, finance minister, TOK FM, 22 Sep

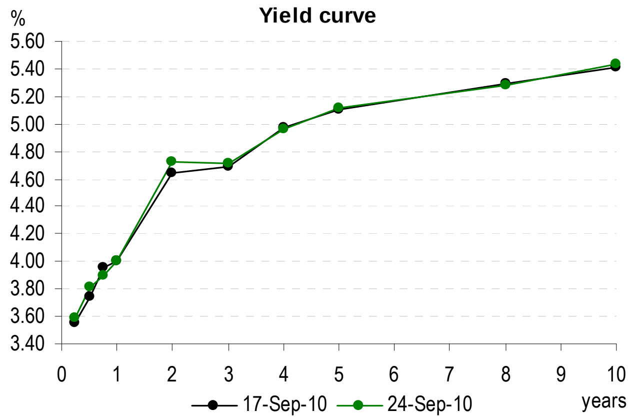
Everybody knows that the deficit of the public finance sector in 2010 will be slightly above PLN100bn. (...) I am concerned (about local governments' debt). We have a problem, as we are responsible for the total debt, including local governments. This year and last year local governments started borrowing heavily, and until they breach 60% of their revenue, there are no instruments (to stop this). (...) I would not like to engage in painful and unnecessary reforms, like extending retirement age. (...) We have introduced the system, which is already encouraging to stay longer in the labour market (...) and there is no need to increase the retirement age.

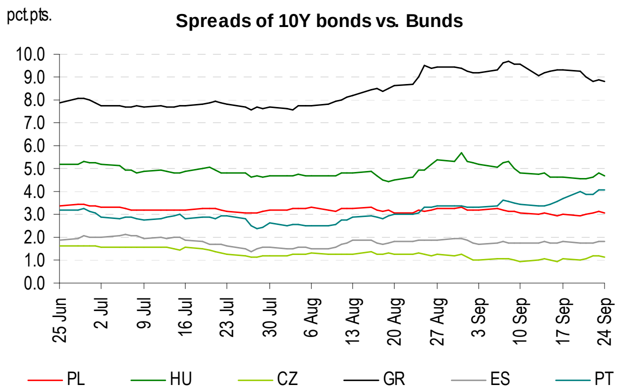
The minister of finance admitted in radio interview that the fiscal deficit this year could exceed PLN100bn. This means that the ratio of deficit to GDP probably will not fall as compared to 2010, when it stood at 7.1%. Now, indeed everybody knows that the process of deficit reduction, pledged in official government documents and required by the European Commission is delayed. But this prompts the next question: what will be the level of public debt at the year-end, as in the first half it rose by PLN51bn, to 52.4% of GDP. Higher than the previously announced year-end deficit increases the risk of exceeding the debt threshold of 55% of GDP, especially if in the last quarter there is some turmoil in the currency market and the weakening of the zloty.

Market monitor









Zloty weaker due to poor euro zone data

▪ EURPLN exchange rate in the first part of the past week was in line with our expectations: the zloty appreciated up to 3.925, which was encouraged by an upbeat mood that appeared on the market after the Fed ensured its readiness to further stimulate the economy. The rest of the week brought a clear increase in risk aversion, which was triggered mainly by worse-than-expected preliminary estimates of the PMI indices for the euro area and Germany. Nervousness in the market was fuelled by increasingly poor picture of the Irish economy. EURPLN rate increased up to 3.98. We believe that in this week the gradual rebound of the zloty will continue. It started already after better-than-expected reading of the German Ifo index. Zloty may strengthen this week, but achieving the level of our forecast (3.92) at the end of the month may be a difficult task.

▪ Since the beginning of the last week, EURUSD exchange rate fluctuated around 1.31, awaiting the publication of the FOMC communiqué. After the announcement of the Fed's readiness to expand the scale of stimulation to the economy and additionally motivating it with a very low inflation, the euro strengthened sharply against the dollar, and the EURUSD rose above 1.34. Worse than expected data on the PMI indices for the industry in the euro area and Germany brought the rate back to near 1.33. The end of the week, however, was favourable for to euro, which strengthened to 1.34 per dollar after better-than-expected reading of the Ifo index. This week the key issue for the EURUSD will be behaviour of the rate against the resistance zone 1.35-1.36. Confirmed increase above this range may herald a ride towards 1.38, while lack of power to defeat it may bring the rate down to 1.31.

Debt market pricing in monetary tightening

▪ In the past week, yields in the domestic debt market were relatively stable, mainly due to the low activity of investors at the beginning of the week. Later in the week, only yields of 2-year bonds increased clearly, among others due to publication of the minutes of the MPC meeting in August. The Council voted to raise main interest rate and minimum reserve requirement by 50 bp. Although both motions were rejected, there was a clear rise in short-term FRA and IRS rates (4-6 bp), as the start of the monetary tightening cycle is becoming more likely for the market.

▪ Beginning of the week in core fixed income markets was marked by stability as investors waited for the Fed's message after the meeting. Fed announced its readiness to increase the scale of stimulation for the economy. This was motivated by a slow pace of economic growth and secondly by low inflation. The announcement resulted in a sharp decline in yields of 10-year Bunds and Treasuries. The rest of the week was relatively stable, the data from the euro zone and the US did not affect the trade much.

▪ Peripheral country of the euro zone to which investors paid particular attention last week, was Ireland, Preliminary data revealed an unexpected decline of its GDP in Q2 by 1.2%QoQ. It completed the dramatic picture of the Irish economy, which still struggles with huge costs of rescuing its banking system . Spread of Irish 10-year bonds against Bunds rose to its highest level since the beginning of the euro zone (more than 420 bp) and CDS rates reached the level of more than 500 points.

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