Bank Zachodni WBK

Weekly economic update

11 – 17 October 2010

Last week the correlation between EURPLN and EURUSD was disrupted. This was due to the fact that the key driver of the upward move in EURUSD were expectations for another stimulus from the Fed (negatively affecting the dollar) and not changes in the risk sentiment. With a rise in major stock indices the zloty gained versus main global currencies, but given surge in EURUSD the Polish currency lost to the euro and strengthened to against the dollar. The Friday's comment from Fed's James Bullard, that probability of the double-dip scenario and additional stimulus may not be needed, has not weakened expectations for continuation of monetary easing by the US central bank (weaker than expected data on employment in the US neutralised his comments). Comments from Polish central bankers (Belka, Bratkowski and Chojna-Duch) indicated that one should not expect the first interest rate hike in Poland at the next MPC meeting in October, but it is still possible by the year-end.

This week the key domestic factor, especially in the context of expectations regarding future MPC actions, is CPI for September. In the global markets the start of the week may be under impact of possible comments from the weekend's meeting of IMF, World Banks and decision makers from major economies. Later in the week markets will focus on minutes of the Fed meeting, earnings reports for Q3 (Intel, JP Morgan, General Electric) and Friday's data from the US on retail sales and consumer confidence.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 October)					
	US	Market holiday					
		TUESDAY (12 October)					
8:00	DE	CPI	Sep	%YoY	1.3	-	1.3
14:00	**PL**	**Current account**	**Aug**	**€bn**	**-1077**	**-1107**	**-1539**
14:00	**PL**	**Exports**	**Aug**	**€bn**	**9400**	**9638**	**9744**
14:00	**PL**	**Imports**	**Aug**	**€bn**	**10210**	**10295**	**10609**
20:00	US	Fed minutes	-	-	-	-	-
		WEDNESDAY (13 October)					
11:00	**PL**	**Tender of 5Y bonds PS0416**					
11:00	EZ	Industrial output	Aug	%YoY	7.5	-	7.1
14:00	**PL**	**CPI**	**Sep**	**%YoY**	**2.3**	**2.3**	**2.0**
14:30	US	Import prices	Sep	%MoM	-0.2	-	0.6
		THURSDAY (14 October)					
14:00	**PL**	**Money supply**	**Sep**	**%YoY**	**9,0**	**8,5**	**9,3**
14:30	US	Initial jobless claims	week	k	448.0	-	445,0
14:30	US	Trade balance	Aug	$bn	-44.00	-	-42.78
14:30	US	PPI	Sep	%MoM	0.2	-	0.4
		FRIDAY (15 October)					
11:00	EZ	Trade balance	Aug	€bn	-0.7	-	6.7
11:00	EZ	HICP	Sep	%YoY	1.8	-	1.6
14:30	US	CPI	Sep	%MoM	0.2	-	0.3
14:30	US	NY Fed	Oct	pts	6.9	-	4.14
14:30	US	Retail sales	Sep	%MoM	0.4	-	0.4
15:55	US	Flash Michigan	Oct	pts	68.4	-	68.2

Source: BZ WBK, Reuters

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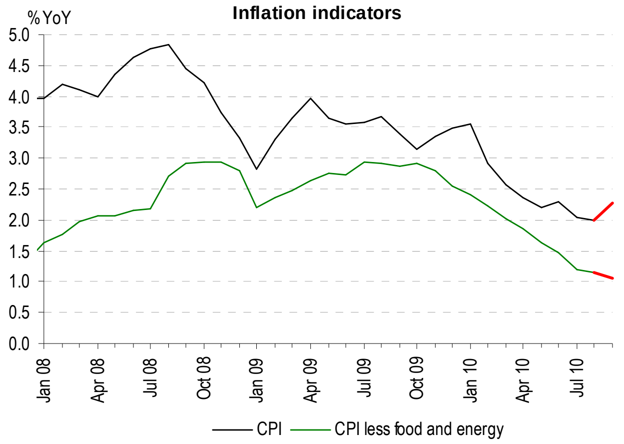
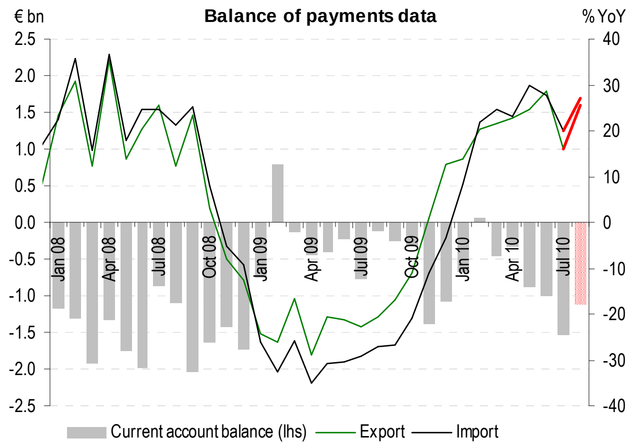
What's hot this week – Next data, FOMC minutes and earnings reports

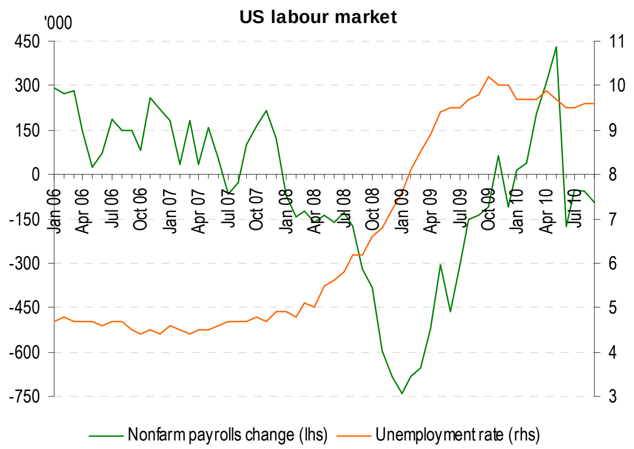


- Most of events in the calendar this week are inflation indicators (CPI for Poland, Czech Rep., Hungary, euro zone and US), but key drivers for the markets include the US retail sales, FOMC minutes and earnings reports.
- Our forecast of the CPI in September is in line with the market consensus and the MinFin's estimate. Forecasts of the annual CPI inflation in a survey by the Parkiet daily range from 2.1% to 2.4%.
- According to our estimates, the rise in CPI in September was triggered mainly by the increase of the food prices. Also increase of fuel prices could have pushed the CPI up. With such structure of price changes, we estimate that the CPI excluding food and energy prices lowered to 1.1%YoY in September from 1.2% in August. That would limit the hawkish interpretation of the September's CPI data.



- We predict that the domestic balance of payments for August will show a rebound of foreign trade turnover (acceleration in exports rise to ca. 25%YoY from 16% in July and in imports to 27% from 20% in July). However, the holidays months were under the impact of base effects (high base effect in July and low base effect in August), so the changes in annual growth rates do not mean a change in underlying trend in Polish foreign trade. Our forecast of a moderate narrowing of the C/A gap is based on the assumptions that deficits on the goods and income accounts narrowed while surpluses in the services and current transfers were broadly stable.
- We expect that monetary statistics for September will show a moderate deceleration in growth of M3 and credit. Particularly in case of the credit, FX effect played a role (clear appreciation of the zloty versus the Swiss frank).

Economy last week – Mixed data from the US labour market



- The US non-farm payrolls report for September was mixed. Total employment outside farming clearly disappointed, falling by 95k against expected stabilisation. At the same time, there was downward revision of data for August. The statistics for September was still under negative impact of developments in the public sector, i.e. drop in temporary Census 2010 employment as well as job losses in local governments.
- In the private sector alone there was rise in payrolls by 64k against expected increase of 75k, but there was significant upward revision in data for August (from rise of 67k to 93k). All in all, over the past two months increase in the private sector employment was stronger than assumed. Moreover, the unemployment rate remained at 9.6% posted in August against the expected rise to 9.7%.

Quote of the week – Polish plans do not comply with EC recommendations

Jacek Rostowski, Finance Minister, PAP, 7 Oct

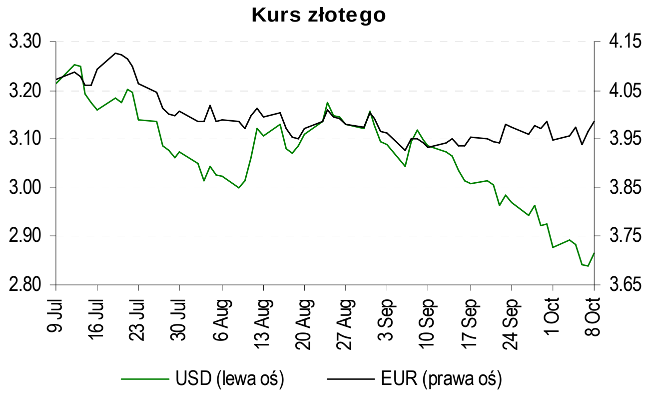
Public finance deficit calculated according to the EU definition should reach 6.5% of GDP in 2011, 4.5% in 2012 and 2.9% in 2013. According to our domestic definition the deficit will amount to 5% of GDP in 2011, 2.8% in 2012, and 1.4% in 2013.

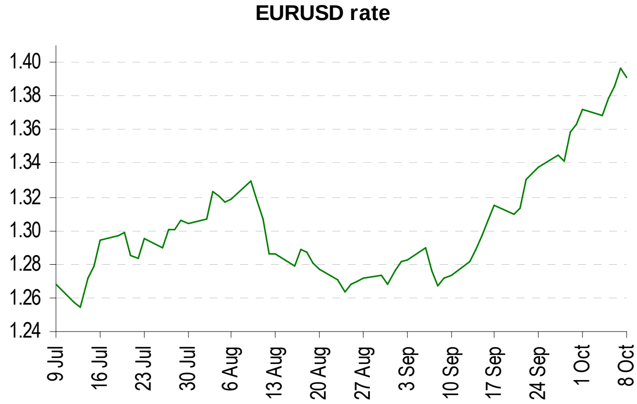
Amadeu Altafaja Tardo, EC spokesman for Economic and Monetary Affairs, PAP, 7 Oct

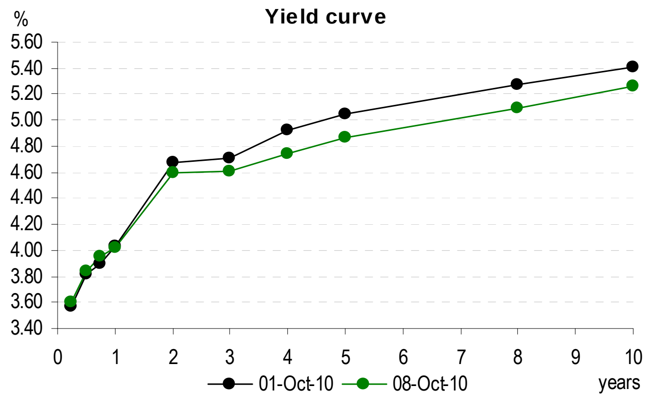
The deadline for improving the excessive deficit agreed by the EU Council for Poland is 2012. Therefore, it seems that the Polish plans are not consistent with current recommendations. If and when this is confirmed, the EC will judge the situation, taking into consideration all relevant factors. Only the EU Council may amend this date at the request of the European Commission.

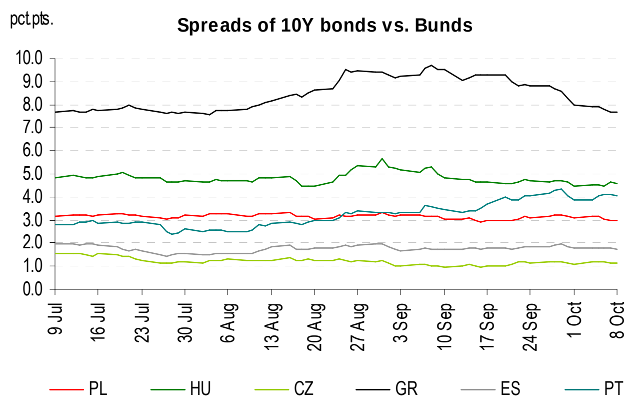
On Thursday, during the first reading of the 2011 budget draft in the Sejm, finance minister Jacek Rostowski presented the predicted path of general government deficit after 2010 (both according to ESA'95 and domestic methodology). At the same time, anonymous source cited by PAP said that this year the general government deficit is estimated at 7.9-8.0%. The European Commission' spokesman for Economic and Monetary Affairs commented Rostowski's plans, saying that they are inconsistent with the Commission's recommendations issued after launching the Excessive Deficit Procedure against Poland (by which we should reduce the deficit below 3% of GDP by 2012).

Market monitor









Zloty and dollar weaker versus the euro

▪ During first days of the past week the zloty appreciated, just as we expected. The EURPLN dropped and briefly hovered just above 3.92. Later in the week there was a correctional rebound of the EURPLN, although the market sentiment was pretty good. During the past week the upward trend of the EURUSD was not accompanied by the declining EURPLN, because the main driver of the EURUSD surge were hopes for the next round of the quantitative easing by the Fed in order to stimulate the US economy (higher money supply depreciates the dollar), and not due to any changes in the risk sentiment. Consequently, the EURPLN reached the levels seen in late September. The mixed data from the US labour market were neutral for the zloty. This week we expect unsuccessful testing of the resistance at 3.98 and then the return to ca. 3.94-3.96.

▪ The dollar was depreciating versus the euro during the major part of the past week. That was mainly due to hopes for further monetary stimulus from the Fed (Ben Bernanke said that the actions carried by the Fed so far lowered the costs of loans and supported the Us economy). The upward trend of the EURUSD was not constrained by weaker data on the retail sales in the euro zone and the Irish debt rating downgrade by the Fitch. After the slight correction due to the comment from the Fed's James Bullard that during the past few weeks the double-dip scenario waned, the EURUSD rose after the payrolls data. All in all, EURUSD climbed above the resistance at 1.38, but the extended consolidation around that level increases the chances for the dollar to recover a bit in the coming days.

Domestic yield curve lower

▪ Yields in the domestic debt market started the past week below levels seen at the end of the previous week and the downward move in yields across the curve was continued later in the week. The biggest decline of yields was recorded in the middle and at the long end of the curve. The short end was driven mainly by weakening expectations for rate hikes after dovish comments from MPC members following their meeting in September, while the long-term bonds were purchased as the yields of 10Y Bunds and Treasuries declined amid expectations for further monetary stimulus by the Fed. Additionally, the Polish debt was supported by rising risk appetite in the global markets This week the core driver for the short-term bonds will CPI data for September.

▪ Yields on the core debt markets declined versus the Friday's closing levels, mainly due to hopes that the Fed would buy some securities on the market. Additionally, the downward trend was supported by the Irish debt rating cut and the mixed data from the US labour market.

▪ The past week was pretty inconsistent regarding changes of the spread of the long-term bonds of peripheral euor zone countries versus the 10Y Bunds. The Greek spread plunged last week, which may be connected with the declaration of the China government, that announced that if the Greece wants to sell its long term bonds, China is willing to purchase them. The biggest gain on the weekly basis was recorded in case of Portugal. It seems that its economic situation does not calm investors' concerns about the country's fiscal problems.

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