

Weekly economic update

25 – 31 October 2010

At the beginning of last week the world markets were dominated by disappointment of the lack of information on specific Fed measures to stimulate the US economy. The Bernanke's statement that present condition of the US economy warrants further quantitative monetary easing was not a sufficient response to investors' uncertainty about the scale and intensity of the planned actions. Data released in Poland were moderately hawkish and did not support the zloty against euro. The EURPLN rose sharply from 3.89, due to profit taking and an increase in risk aversion following the interest rate hike in China. Also, the publication of the minutes of the September MPC meeting was not a breakthrough, although the new sentence that according to some Council members the recent zloty appreciation will limit inflation rise was another argument why the Council did not raise rates at its last meeting.

Last week's information confirmed our view that there should be no change in interest rates at the Wednesday's MPC meeting. Quite dovish minutes and moderately hawkish data are unlikely to convince the Council to proceed with monetary policy tightening, similarly as the new NBP projection. In the world the start of this week will pass under influence of the results of a weekend meeting of finance ministers and central bankers of the G20. Nevertheless, market volatility should be limited by the prospect of Friday's publication of the first estimates of GDP growth in the US in the third quarter.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (25 October)							
11:00	PL	Tender of 52-week T-bills worth PLN500-600m					
11:00	EZ	Industrial orders	Aug	%YoY	17.1	-	11.2
16:00	US	Home sales	Sep	m	4.3	-	4.13
TUESDAY (26 October)							
8:00	DE	GfK index	Sep	pts	5.1	-	4.9
10:00	PL	Retail sales	Sep	%YoY	6.6	7.2	6.6
10:00	PL	Unemployment rate	Sep	%	11.3	11.4	11.3
15:00	US	S&P/Case-Shiller home price index	Aug	%MoM	-0.5	-	-0.1
16:00	US	Consumer confidence	Sep	pts	49.0	-	48.5
WEDNESDAY (27 October)							
	PL	MPC decision		%	3.50	3.50	3.50
10:00	EZ	Money supply	Sep	%YoY	1.3	-	1.1
14:30	US	Durable orders	Sep	%YoY	2.0	-	-1.5
16:00	US	New home sales	Sep	k	0.3	-	0.288
THURSDAY (28 October)							
11:00	EZ	Business climate	Oct	pts	103.2	-	103.2
14:30	US	Initial jobless claims	week	k	455.0	-	452.0
FRIDAY (29 October)							
11:00	EZ	Unemployment rate	Sep	%	10.1	-	10.1
11:00	EZ	Flash HICP	Oct	%YoY	1.8	-	1.8
14:30	US	Core PCE	Q3	%QoQ	1.1	-	1.0
14:30	US	Advance GDP	Q3	%QoQ	2.0	-	1.7
15:45	US	Chicago PMI index	Oct	pts	58.0	-	60.4
15:55	US	Michigan index	Oct	pts	68.0	-	67.9

Source: BZ WBK, Reuters, Parkiet

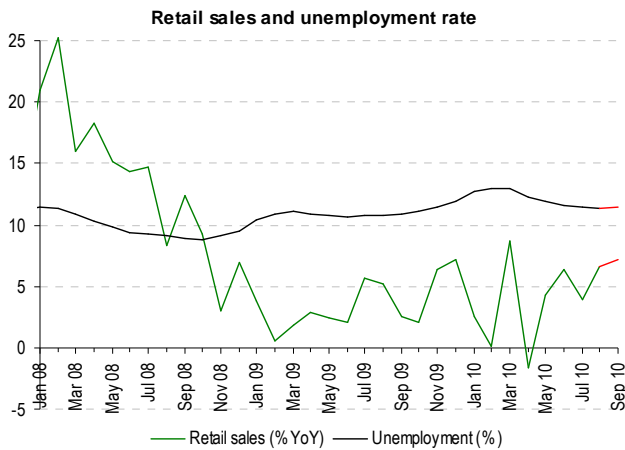
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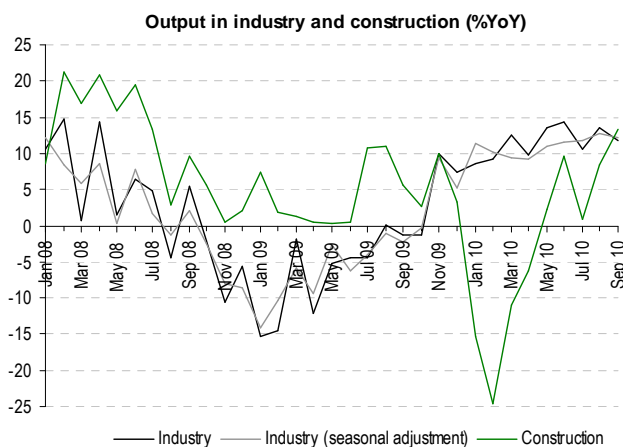
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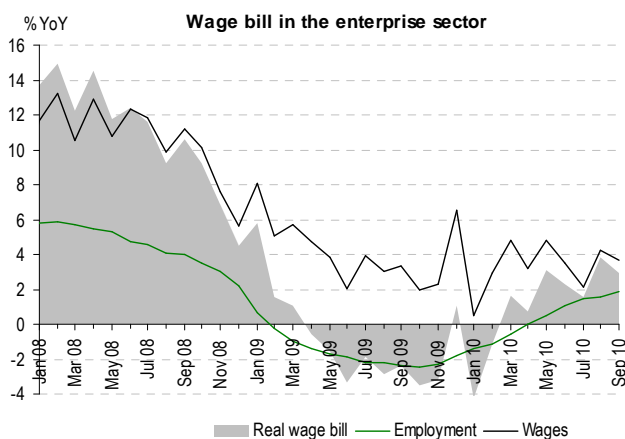
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What's hot this week – MPC decision, first estimate of US Q3 GDP

- This week we will see the next set of data from the Polish economy. We expect a seasonal increase in the unemployment rate (to 11.4%) and a further acceleration in retail sales growth (to 7.2%YoY).
- It will be interesting whether the set of September's data had any effect on the tone of the MPC's communiqué, as we expect that interest rates will remain on hold. In contrast to the previous month, when almost no one expected the rate hike, nearly half of analysts bet that rates may be increased this time.
- Abroad, particularly interesting will be Friday, mainly due to publication of the first estimates of US GDP growth in the third quarter. Earlier in the week there will be publication of data from the US real estate market (price index, home sales).

Economy last week – Hawkish data, yet not enough

- Production growth in manufacturing and construction rose more than expected in September (11.8%YoY and 13.4%YoY), confirming that economic slowdown abroad in Q3 was not strong enough to harm Polish exporters and there was an investment rebound in the domestic economy. This supports our predictions of GDP growth acceleration in Q3 to above 3.5%YoY. At the same time, better than expected leading indicators of economic activity in the euro zone may imply that a slowdown in Polish industrial output growth at the end of the year may be smaller than assumed earlier.
- PPI growth accelerated in September to 4.3%YoY, in line with our expectations. Prices in manufacturing fell marginally (-0.1%MoM), due to slight zloty appreciation.



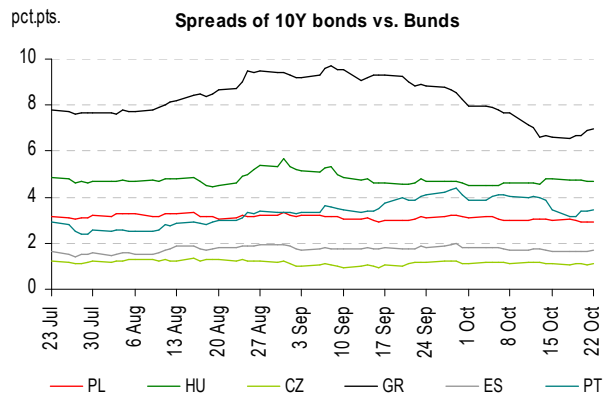
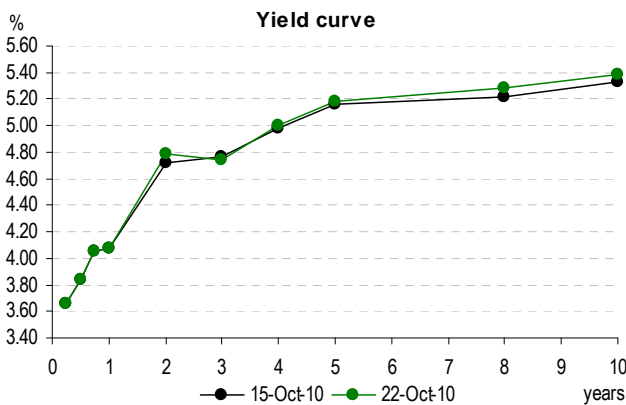
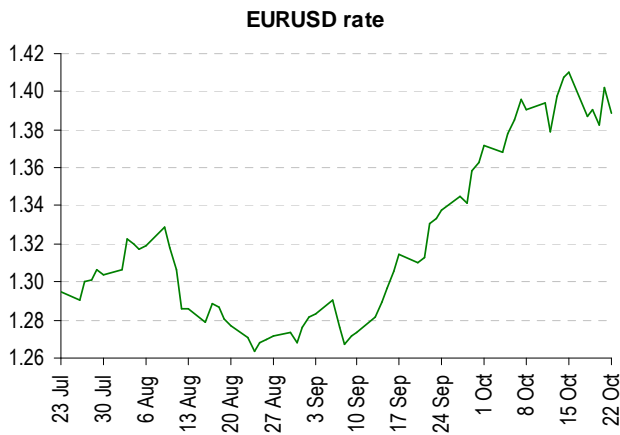
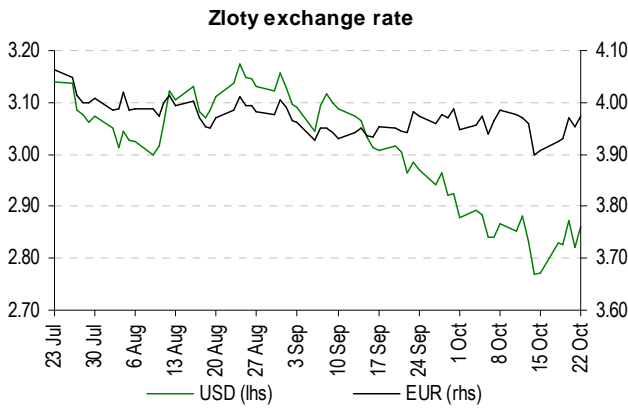
- Labour market data for September were mixed – average wages disappointed, slowing down to 3.7%YoY, while employment growth by 1.8%YoY was a positive surprise. Acceleration in employment growth led to improvement in wage bill growth, which bodes well for consumption demand and may be seen by the MPC as a threat to the inflation target in the medium-term.
- Core inflation excluding food and energy prices rose in September by 1.2%YoY, the same as in August. Other measures of core inflation increased slightly.
- CSO indicator of business climate in manufacturing fell in October to 4 from 8 in September, mainly due to worse forecasts of new orders and production. Business climate in construction also deteriorated (from -1 to -5), while in retail trade the index remained unchanged (at 4).

Quote of the week – The correction of low interest rates is needed**Andrzej Bratkowski, MPC member, Polska, 21 Oct**

In a situation when the inflation and inflationary expectations are rising, a clear correction of very low currently interest rates (of at least 50 bp) is needed.

Although the minutes of the latest MPC meeting published last week showed that a motion of 50 bp rate hike was voted again, we get the impression that the document was slightly more dovish than last month. More attention was devoted to the issue of prospects of economic growth abroad and investment, which rebound is not visible, according to MPC doves, in the available data. Importantly, the MPC was anticipating a rise in inflation to 2.5% in September, so the latest CPI data was not a surprise for the Council. The last minutes confirmed our impression that arose after the September's MPC meeting, that in October the interest rates are likely to remain unchanged. MPC members sharing Bratkowski's view are in minority, even though the latest NBP report on business climate showed that inflation expectations may rise sharply.

Market monitor



Pronounced correction of the EURPLN decline

▪ After the zloty's considerable appreciation below 3.92 and further gain to 3.89 that occurred two weeks ago, past few days brought clear rebound of the EURPLN. It seems, that the first part of the euro's recovery do 3.92 was due to profit taking. Additionally, controversial decisions of the Hungarian government on reducing the budget deficit and no confidence motion for the Romanian government also put a negative pressure on the zloty. Second round of the zloty's depreciation, from 3.92 to 3.97 (temporarily even to 3.98) was due to high risk aversion after the decision of China central bank on rising the interest rate. During the last two days of the past week the EURPLN was pretty stable despite obvious improvement of the global market sentiment. This week we expect that the zloty may try to catch up its appreciation arrears and head towards 3.89.

▪ The dollar appreciated visibly at the beginning of the week, what was due to disappointment after revealing no details on second round of quantitative easing run by Fed and the risk aversion after the interest rate hike in China. After that, the EURUSD rebounded, supported by the better than expected data on the ZEW index and flash estimates of PMI indices for manufacturing in euro zone and Germany, and the common currency managed to pare substantial part of losses. Finally, just as we expected, the dollar appreciated slightly versus the euro. For the second consecutive week the EURUSD was hovering at ca. 1.40 and it seems that the prospect of the quantitative easing is not that strong to push the exchange rate further higher. This week there will be many comments of the Fed members, which may affect the EURUSD. We do not expect the dollar to depreciate permanently above 1.40-1.41.

Higher yields due to interest rate in China

▪ The yields on the domestic fixed income market increased during the past week (particularly on the short and long end of the curve) what was the result of rise of risk aversion after the decision in China. The visible sell-out of Polish bonds triggered by the deterioration of the global market mood means that domestic securities are attractive in terms of interest paid, but at some level of uncertainty on the market the premium does not compensate the risk connected with Polish bonds. This week we expect some stabilization until the MPC meeting. Then some yields decline may occur.

▪ On the core fixed income markets the yields of 10Y Bunds were rising all week long. Only after the Chinese interest rate hike and stronger demand for safe assets yields decreased slightly. The yields of the 10Y Treasuries stayed on the low levels reached after the decision in China for a longer period of time and increased only at the end of the week as the market sentiment clearly improved.

▪ Considering the long term euro zone's peripheral bonds, the biggest sell-out was recorded of the Greek ones (and consequently the biggest increase of spread versus Bunds was seen). That was due to announcements, that despite the expected upward revision of budget deficits in 2006-2009, Greece still is obliged to keep the path of reducing the budget deficit established while signing the fiscal saving plan worth €110bn. Some rumours emerged on the market, that facing higher historical budget deficits, the saving plan may be too small, to enable Greece returning to the debt market as a credible bonds issuer. The spreads of other countries were pretty stable.

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