

Weekly economic update

8 – 14 November 2010

The key event last week was the Fed meeting. The US central bank has not disappointed the markets and decided to buy additional long-term government bonds worth \$600bn until the end of Q2 2011. Together with strong macro figures from major economies, this led to increase in risk appetite and sent EURPLN below 3.90. The domestic currency was also supported by hawkish comments from MPC members and domestic macro figures – surprisingly high PMI for Polish manufacturing and higher than market consensus estimate of the FinMin for CPI inflation in October. Such news from the domestic economy fuelled expectations for interest rate hikes by the MPC and thus the local debt market weakened, the most at the short end of the curve, which led to flattening of the yield curve. In our view, the recent hawkish comments from some MCP members does not necessarily mean that we will see the first rate hike in November.

This week activity in the Polish financial markets may be limited due to holiday on Thursday. Key events abroad, i.e. the G20 meeting and important macro data from the US, China and the euro zone, will take place in the later part of the week. With limited liquidity of the domestic financial market, volatility may be increased in case of possible surprising news. Unit then, however, we expect stabilisation of the zloty and local bonds.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (8 November)							
10:30	EZ	Sentix index	Nov	pts	9.5	-	8.8
12:00	DE	Industrial output	Sep	%YoY	0.5	-	1.7
TUESDAY (9 November)							
16:00	US	Wholesale inventories	Sep	%MoM	0.7	-	0.8
WEDNESDAY (10 November)							
3:00	CN	Trade balance	Oct	\$bn	25.5	-	16.88
11:00	PL	Bonds switching auction					
14:00	PL	Current account	Sep	€m	-1 180	-1 030	-1 129
14:00	PL	Exports	Sep	€m	11 262	11 644	9 603
14:00	PL	Imports	Sep	€m	11 874	11 999	10 389
14:30	US	Initial jobless claims	week	k	450.0	-	457.0
14:30	US	Import prices	Oct	%MoM	1.2	-	-0.3
14:30	US	Trade balance	Sep	\$bn	-45.6	-	-46.35
THURSDAY (11 November)							
	PL	The Independence Day					
3:00	CN	CPI	Oct	%YoY	4.0	-	3.6
3:00	CN	Industrial output	Oct	%yoY	13.5	-	13.3
	US	Market holiday					
FRIDAY (12 November)							
11:00	EZ	Flash GDP	Q3	%QoQ	0.4	-	1.0
11:00	EZ	Industrial output	Sep	%YoY	7.1	-	7.9
14:00	PL	Money supply	Oct	%YoY	6.8	7.0	8.9
15:55	US	Flash Michigan	Nov	pts	69.0	-	67.7

Source: BZ WBK, Reuters, Parkiet

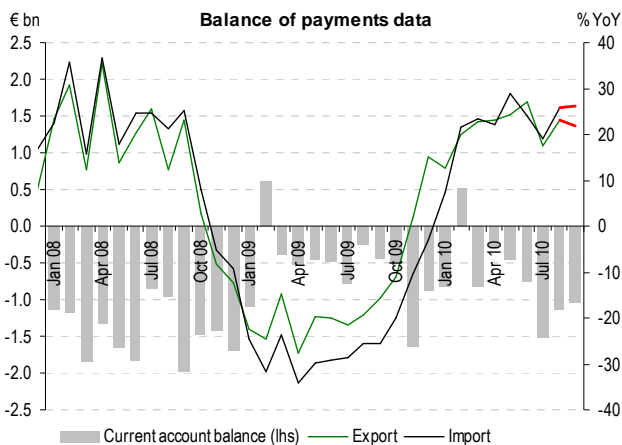
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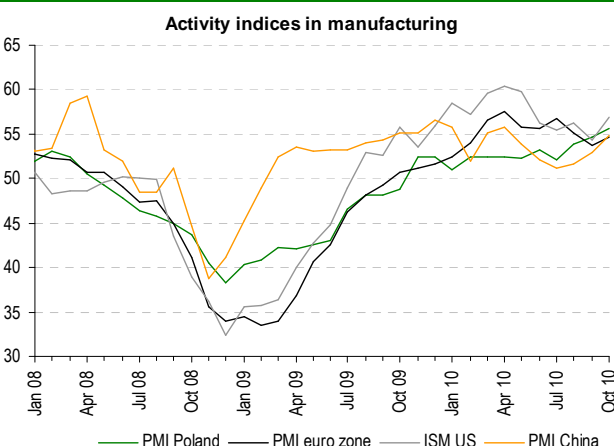
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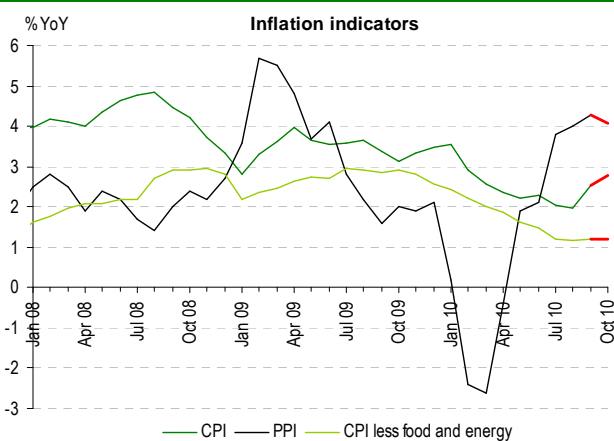
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What's hot this week – Domestic balance of payments, data abroad and G20 summit

- In the first days of this week there will be little to offer direction for the markets. Investors will wait for G20 summit on November 11-12 and crucial data from the US, China and the euro zone in the later part of the week.
- Domestic balance of payments for September due for release before the long weekend should confirm the picture of the Polish economy indicated by earlier published other data for that month. We forecast slight deceleration of exports growth and stabilisation of strong imports growth. Despite narrower trade gap, C/A deficit will remain strongly negative due to still high income deficit and lower surplus in the current transfers (lower transfers from the EU).
- Domestic monetary statistics for October will be disturbed by the effect of IPO of the WSE and by the FX effect (the zloty appreciation).

Economy last week – Strong improvement in manufacturing and rise in CPI inflation

- Poland's PMI manufacturing in October rose to 55.6, the highest level in over 6 years, well above market expectations. According to the HSBC/Markit report, in October companies recorded considerable acceleration of industry production and new orders, including export orders, among others due to expansion to new markets. The industrial output reached the highest level in 77 months, exceeding production capacity of firms. Employment increased again. At the same time, companies reported rising costs of production and higher prices of final goods.
- Strong rise in Poland's PMI manufacturing justifies expectations for another considerable increase in industrial output. The market consensus is at 9.7%YoY and it seems that even despite one working day fewer than a year ago and one-week production downtime at Fiat factory at the end of October there is a risk that industrial output growth may be again at double-digit level.



- The final PMIs manufacturing for the euro zone and Germany were better than initially estimated and reached 54.6 and 56.6, respectively (versus flash estimates of 54.1 and 56.1). In October, the improvement of PMI was also seen in the majority of major emerging markets (among others, China, India and Turkey). This suggests that at the beginning of Q4, the economic activity in manufacturing abroad was still accelerating, which weakens concerns about a slowdown in the global economy.
- According to the FinMin's estimate, CPI inflation in October accelerated to 2.9%YoY after 0.6%MoM rise in prices. Our forecast (and market consensus) is 2.8%YoY. The key factor pushing CPI up is food prices (the FAO data showed the dollar-based index of global food prices rose 4.5%MoM in October). Slight rise probably occurred in fuel prices. Over time, the consumer prices will be also affected by rising producer prices, which is signalled in the recent PMI report.

Quote of the week – One has to consider interest rate hikes

Jan Winięcki, członek RPP, Reuters, 2 XI

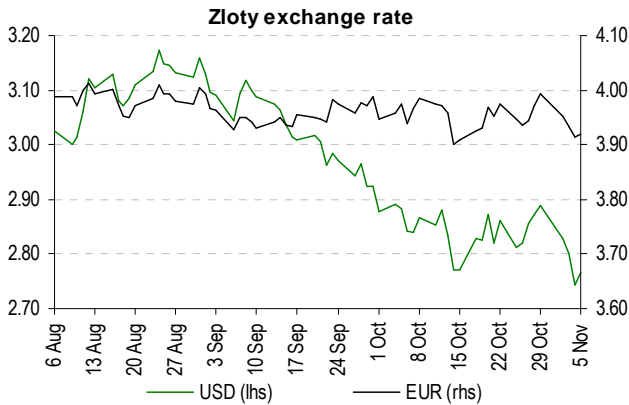
[Whether in the current macroeconomic situation are you in favour of rate hikes?] From my perspective, there is no doubt one should seriously consider it. (...) August was not a good moment to counteract inflationary expectations, as this was the holiday month.

Anna Zielińska-Głębocka, członek RPP, Reuters, 3 XI

There is a lot of factors, which are still uncertain, but in my opinion these macroeconomic factors should induce the Council to consider whether this is a good moment to not be late with a possible reaction with rates. (...) This is a good moment to consider such decision. (...) It seems to me that hiking rates to 4% could be enough to anchor inflationary expectations, but it is hard to say whether this will happen now or in some time.

Taking into account the already known results of MPC votes, it seems that the key for decision of the first rate hike is at hands of J.Hasner, J.Winięcki and A.Zielińska-Głębocka. The latter two suggested recently that one should seriously consider rate hikes. If they joined those who earlier voted for hikes, this group may be now in majority. However, comments from Winięcki and Zielińska-Głębocka arise many questions. Why they were not for more hawkish statement in October? Why they did not vote for an interest rate hike in October? These questions has a sense only assuming that all four MPC members who voted for a hike in August are still in favour of the hike. Possibly someone changed his or her mind (although it would be strange) or it is enough for someone that reserve requirement ration was increased?

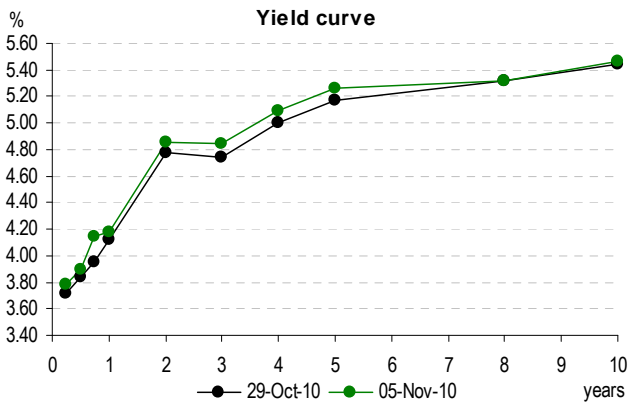
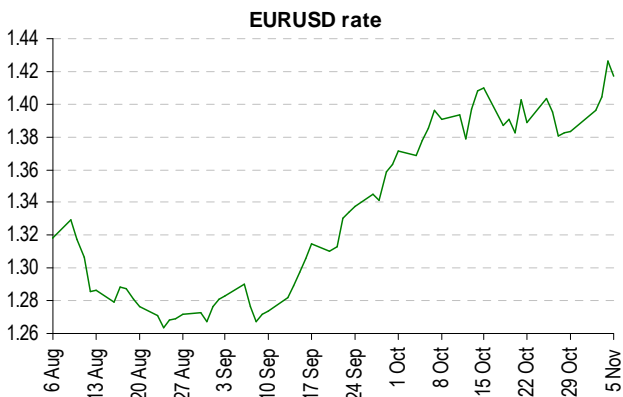
Market monitor



Zloty much stronger

▪ After Monday's stabilization at around 3,965 due to All Saints Day in Poland, the zloty appreciated visibly later in the week. The domestic currency was supported by the Fed's decision on launching quantitative easing, better than expected data (FinMin's forecast of CPI and final data on PMI indices for the manufacturing sector in the euro zone and Germany as well US payrolls data published on Friday) and hawkish comments of the MPC members. Due to visible increase of risk appetite, the EURPLN temporarily plunged even below 3.89 and ended the week at ca. 3.90. This week we expect that the currency will be relatively stable in the range of 3.89-3.92.

▪ Since the beginning of the week the EURUSD was slightly rising and just before the announcement of the Fed's decision it stabilized at just above 1.40. After revealing the scale of Treasuries purchase programme the EURUSD soared from 1.404 to 1.4175 and later in the week the dollar's depreciation was continued (temporarily even to nearly 1.43). Only on Friday some correction occurred as the greenback was supported by the better than expected data from the US labour market. Though the EURUSD was pretty volatile during the past week, the overall picture of the market did not alter much. This week again shall not bring any major changes, we anticipate that the prospect of the G20 group meeting and market holiday on Thursday will constrain the volatility. The exchange rate is expected to remain in the broad horizontal trend (which is maintained for four weeks) ranging from 1.37 to just above 1.42.

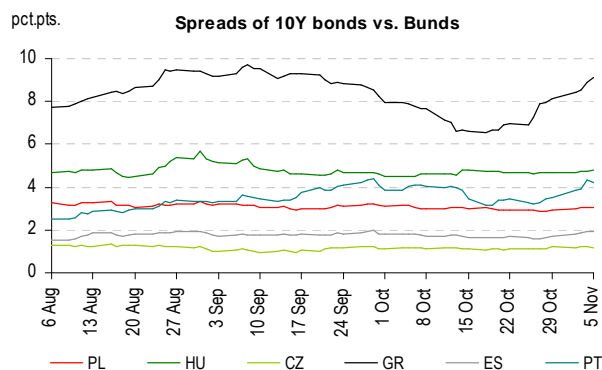


Domestic bonds weaker

▪ On the domestic fixed income market the yields started the week well above the Friday's closing levels, that was due to higher than expected FinMin's inflation forecast for October. There were also some hawkish comments of the MPC members that pushed yields further up. Later in the week the upward trend was fuelled by rising yields on the core fixed income markets after the Fed's decision.

▪ On the core fixed income markets yields were decreasing in the first part of the week, as investors started to price in the expected Fed's decision on buying long-term securities. But as it was revealed that the US central banks plans to focus on 4-7 year tenor the yields of 10Y Bunds and Treasuries surged. Later in the week the yields declined among rising worries over the fiscal situation in Ireland.

▪ The spread of bonds issued by the euro zone's peripheral countries increased during the past week. That was particularly visible in case of Ireland, because investors assessed that plans of cutting the budget deficit ratio to GDP to 3% until 2014 are not manageable. Additionally, further fiscal tightening actions may put more severe negative pressure on the GDP growth. Consequently, the CDS rates increased to record high at 606 pts while spread versus 10Y Bunds established new all time high at 536 pts. In case of Portugal there is still unresolved issue of next year's budget plan that clearly weighs on the bonds prices.



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