

# Weekly economic update

19 – 25 September 2011

Through the first days of the week market sentiment was negative. During the weekend, the German press published information about a possibility of Greece default or even its exit from the euro zone. The increase in risk aversion was also supported by the decision of Moody's, to cut the ratings of two French banks (Crédit Agricole and Société Générale), as well as quite weak performance of the Italian bonds auction. Such a global environment has contributed to a sharp weakening of the zloty and domestic bonds. The turning point in the market came after the words of José Manuel Barroso. European Commission President said that the Commission will present various options for Eurobonds. In addition, the German Chancellor and French President rejected the possibility of Greece exiting the euro area. After the teleconference carried out with the Greek Prime Minister it was also assured that the country will manage to fulfill the necessary conditions for obtaining another tranche of financial aid. However the biggest support came at the end of the week, after the decision of the main central banks (ECB, Fed, BoJ, BoE and SNB) to restore their US dollar liquidity operations in the fourth quarter of this year. Marek Belka said on Friday that the NBP is also ready to provide banks with liquidity in foreign currencies (euro, dollar, franc) if the need arises.

The main event this week will be a two-day FOMC meeting as investors will await a decision of some form of quantitative easing. Before the publication of the Fed statement investors will be probably reluctant to react to the readings of macro indicators. Investors expectations ahead of Fed meeting may to some extent offset worries regarding euro zone sovereign crisis and economic slowdown. The tone of the statement together with set of important data releases will determine market moods at the end of the week. The key figures include flash PMI indices for China, the euro area and Germany. Domestic data will be certainly less important than developments on the global market.

## Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (19 September)</b>							
14:00	PL	Industrial output	Aug	%YoY	3.8	4.7	1.8
14:00	PL	Construction output	Aug	%YoY	16.2	16.7	16.4
14:00	PL	PPI	Aug	%YoY	6.4	6.9	5.9
<b>TUESDAY (20 September)</b>							
11:00	DE	ZEW index	Sep	pts	-45	-	-37.6
14:00	PL	Core inflation	Aug	%YoY	2.4	2.7*	2.4
14:30	US	House starts	Aug	k	590	-	604
14:30	US	Build permits	Aug	k	592	-	601
<b>WEDNESDAY (21 September)</b>							
16:00	US	Home sales	Aug	m	4.75	-	4.67
20:15	US	Fed decision		%	0.0-0.25	-	0.0-0.25
<b>THURSDAY (22 September)</b>							
4:30	CN	Flash PMI - manufacturing	Sep	pts	-	-	49.9
9:28	DE	Flash PMI - manufacturing	Sep	pts	50.1	-	50.9
9:58	EZ	Flash PMI - manufacturing	Sep	pts	48.5	-	49.0
11:00	PL	<b>WS/WZ bond auction</b>					
11:00	EZ	New industrial orders	Jul	%YoY	10.6	-	11.1
14:00	PL	<b>RPP Minutes</b>					
14:30	US	Initial jobless claims	week	k	420	-	428
16:00	EZ	Consumer confidence	Sep	pts	-	-	-16.6
16:00	US	Leading indicators	Aug	%MoM	0.2	-	0.5
<b>FRIDAY (23 September)</b>							
No important data releases							

Source: BZ WBK, Reuters, Parkiet \*forecast after inflation figure for August

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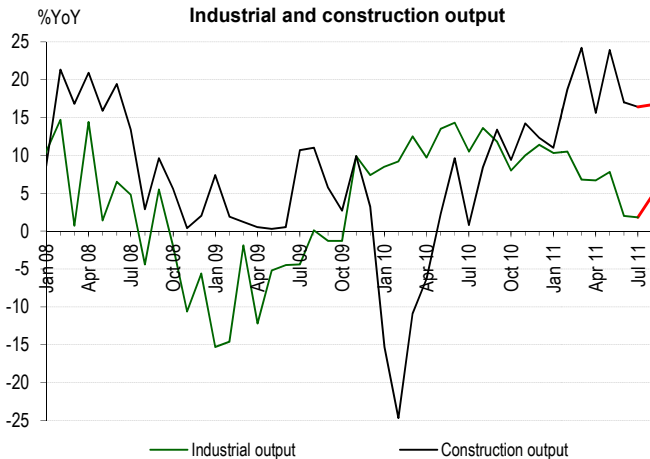
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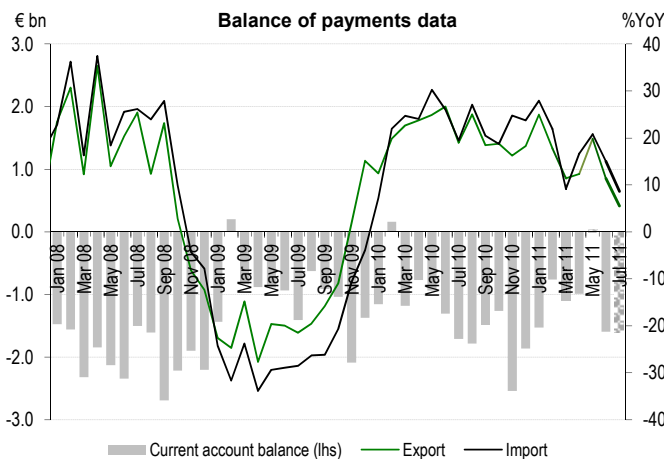
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## What's hot this week – Fed's decision more important than domestic data

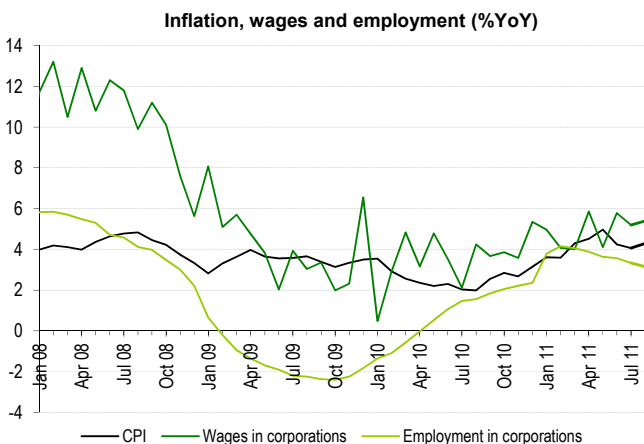


- We expect that in August the annual pace of growth of industrial output rebounded after July drop, as last month result was due to a lower number of working days as compared to July 2010. Some positive impact can also be exerted by a considerable annual increase in car output (which was shown by Samar). In spite of expected acceleration in industrial sector in August, the upcoming months will show, in our view, a gradual slowdown due to lower economic activity abroad.
- The construction output is still being supported by infrastructural projects. We expect the annual growth rate to stay above 15% until the end of the year.
- We expect a more considerable acceleration in PPI, as compared to market consensus. The main factor behind PPI increase was weakening of the zloty. Some downward risk to our forecast can be put by shrinking cost pressure suggested by the PMI survey.

## Last week in the economy – Exports and employment sharply decelerate, inflation above forecasts



- Current account deficit reached €1.6bn in July, exceeding forecasts by ca. €100m.
- Trade deficit widened, which resulted mainly from a sharp weakening in exports, (to 5.5%YoY, the lowest since November 2009).
- July was third consecutive month when the foreign direct investments recorded an outflow from Poland. Consequently, the ratio of coverage of current account deficit by inflow of long term capital reached new minimum. If that tendency is continued, that would create additional risk factor for the zloty.
- The weaker than predicted exports in July confirmed the significant impact of economic slowdown in the euro zone on Polish manufacturing sector. A factor alleviating this effect to some extent may be recently observed zloty weakening.



- The inflation rate rose to 4.3%YoY in August from 4.1% in July, exceeding all market forecasts, including our estimate of 4.2% and the market consensus of 4.1%. The main source of surprise was the strong increase of communication prices (4.8%MoM). According to the CSO, it resulted from the termination of promotions made by telecommunication operators.
- Wages by 5.4%YoY in August as compared to 5.2%YoY in July, markedly above our forecast and market consensus (both at 4.9%YoY). Employment surprised on the downside – its annual pace of growth slid to 3.1%YoY from 3.3% (market consensus and our forecast at 3.3%). Data on employment are in line with other signals indicating some deceleration of positive tendencies on the labor market.
- Data on CPI and wages supported view that the NBP rates will remain flat for an extended period of time.

## Quote of the week – No room for rate cuts

**Zyta Gilowska, MPC member, 14 September, Reuters**

Taking into account the scale of uncertainty, rising uncertainty on the global markets, currently I can see no room for rate cuts.

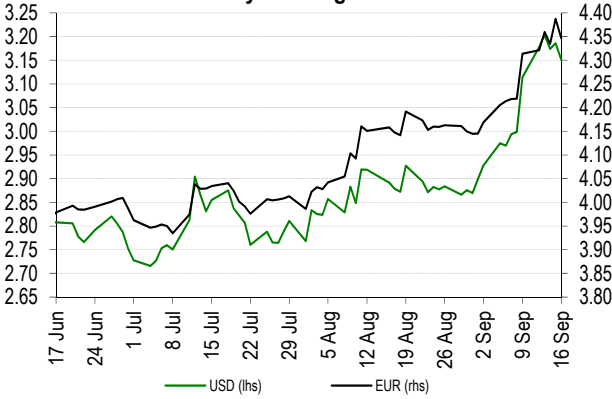
**Adam Glapiński, MPC member, 14 September, Reuters**

I personally support a restrictive bias. Rather hikes than cuts, if the inflation will persists on the elevated levels. With full consciousness that it can adversely affect the GDP growth. (...) Cuts are out if the inflation runs above 4%.

These comments support our expectations for flat interest rates for a longer time. As regards Glapiński's words, our scenario assumes that the headline CPI will remain above 4% until the end of the year. However, in face of economic slowdown, this will not provide any argument in favour of a hike. Taking into account that the views of many MPC members are sensitive to the level of current inflation, we should expect a more dovish tone provided that inflation eases in 2012. In our view, rate cuts next year are more probable than hikes, but we assume flat NBP interest rates in our base-case scenario.

**Market monitor**

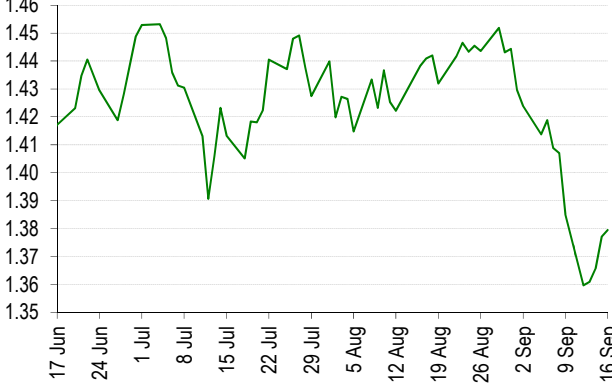
**Zloty exchange rate**



**Zloty to remain under pressure**

▪ Last week was extremely negative for the zloty. That's how we started this page in the previous report, summarising the week, in which the EURPLN rate soared from 4.18 to almost 4.35. The last week events have shown that the same sentence suits fine to the situation again. The EURPLN continued the upward trend in the first part of the week amid persisting high risk aversion. Consequently, it reached 4.401, the highest level for 26 months. Visible strengthening of the Polish currency below 4.30 occurred at the end of the week after the coordinated statement of major central banks. In broader context, the situation has not changed much and uncertainty regarding case of Greece still limits demand for risk. We expect that due to that factor the EURPLN will stay at elevated level. The support is at 4.26 while the first range of resistance on the road towards a possible further depreciation is at 4.32-4.35.

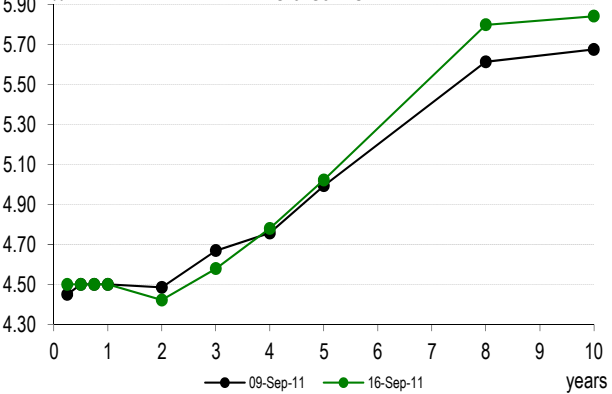
**EURUSD rate**



▪ The Czech koruna gained slightly (perhaps the effect of being perceived as CEE safe haven currency helped). Forint depreciated amid poor market sentiment and pressure from proposal of the Hungarian government on one-off repayment of currency loans at preferential rates (the market was worried over Hungarian banks).

▪ The EURUSD stayed in a stable upward trend. The poor results of Italian bond auction and uncertainty over Greece did not hit the single currency. At the end of the week, the upward momentum was fuelled by decision of central banks, as worries over spreading of the debt crisis to banking sector abated. This week the case of Greece and Fed's decision will be main factors driving the exchange rates.

**Yield curve**



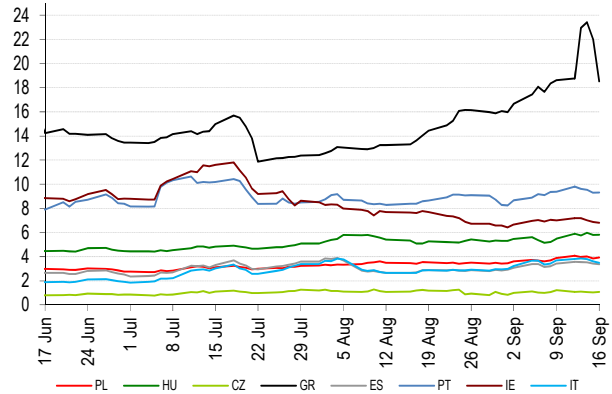
**Greece and the Fed to show direction for yields**

▪ Domestic yield curve steepened over the past week due to lowering yields of 2Y bonds and weakening at the long end of the curve. The 10Y bonds were under pressure due to poor global market sentiment and followed depreciation of the zloty. After the decision of central banks, some recovery was observed, but soon a profit taking occurred and yields continued to rise. In over a week since the MPC meeting (where there were no hints on rate cuts), FRA6x9 and FRA9x12 advanced and pulled slightly back market expectation for rate cuts. Thursday's release of minutes from that MPC meeting shall not have much impact on the market as latest comments of Council's members confirmed there is no willingness for monetary easing. In case of 5Y and 10Y bonds the case of Greece and decision of the Fed will play the main role.

▪ On the core fixed income markets only at the beginning of the week yields declined amid worries over Greece. In the following days bonds were under pressure i.e. due to decision of central banks. At the end of the week yields of the 10Y Bunds and Treasuries reached 1.92% and 2.10%, respectively.

▪ On the peripheries of the euro zone, debt market spreads of Greek bonds versus Bunds widened considerably at the beginning of the week as a natural consequence of uncertainty regarding next instalment of bailout package. At the end of the week some correction occurred. Spreads widened in case of Hungarian bonds that suffered due to controversial idea on currency loans presented by the government.

**Spreads of 10Y bonds vs. Bunds**



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