Bank Zachodni WBK

Weekly economic update

24 – 30 October 2011

Last week was another one when market moods remained volatile. Overall, a risk aversion was prevailing, which was mainly driven by diminishing market expectations as regards possibility of breakthrough decisions during the EU summit over the weekend. Moreover, some contradicting news emerged concerning the enhancement of the EFSF. The publication of the unofficial document regarding rules of functioning of the Fund has improved the sentiment only for a while. Demand for safe assets has been additionally supported by the warning by Moody's that France's rating may be under threat and the decision to cut rating of Spain. Data from China have shown that in the third quarter the economy was expanding at the slowest pace in two years, which boosted concerns about global economic outlook. Increased optimism of market participants at the end of the week was among others due to information that on Wednesday the next EU summit will be held. This could have increased investors' hopes that finally some constructive decisions will be made. Persisting uncertainty was negative for the Polish currency and EURPLN rose above 4.42. Weakening of the Polish debt market was additionally triggered by Moody's warning on possible cut in outlook for Polish rating. It was stressed that such a decision would be possible if the market negatively perceives a delay in fiscal deficit reduction. Data from the Polish labour market were below expectations and confirmed a halt in positive trend. Meanwhile, production data surprised on the upside, showing no signs of slowdown in activity.

The beginning of the week will be under the influence of decisions taken by the EU over the weekend and investors' expectations for the result of Wednesday's meeting. Given that market is very sensitive to any news on expanding the EFSF and banks' recapitalisation, a higher volatility shall not be surprising. Over the week many vital macro data is due for release, including flash PMI indices for manufacturing and advance estimates of US GDP growth in Q3. These publications may help to assess the pace of global slowdown. Domestic data will be overshadowed by global developments. The factor that currently has the biggest impact on the domestic market is at the same time most volatile and unpredictable. That makes this week very interesting.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (24 October)					
4:30	CN	Flash PMI – manufacturing	Oct	pts	-	-	49.9
9:28	DE	Flash PMI – manufacturing	Oct	pts	50.0	-	50.3
9:58	EZ	Flash PMI – manufacturing	Oct	pts	48.0	-	48.5
11:00	EZ	Industrial orders	Aug	%MoM	0.3	-	-2.1
		TUESDAY (25 October)					
8:00	DE	GfK index	Nov	pts	5.1	-	5.2
10:00	**PL**	**Retail sales**	**Sep**	**%YoY**	**9.9**	**9.8**	**11.3**
10:00	**PL**	**Unemployment rate**	**Sep**	**%YoY**	**11.6**	**11.7**	**11.6**
15:00	US	S&P/Case-Shiller home price index	Aug	%YoY	-3.8	-	-4.1
16:00	US	Consumer confidence index	Oct	pts	46.0	-	45.4
		WEDNESDAY (26 October)					
		EU Summit					
14:30	US	Durable goods orders	Sep	%MoM	-0.4	-	-0.1
16:00	US	New home sales	Sep	k	300	-	295
		THURSDAY (27 October)					
14:30	US	Advance GDP	Q3	%QoQ	2.0	-	1.3
14:30	US	Initial jobless claims	week	k	402	-	403
16:00	US	Pending home sales	Sep	%MoM	0.0	-	-1.2
		FRIDAY (28 October)					
14:30	US	Consumer spending	Sep	%MoM	0.5	-	0.2
14:30	US	Personal income	Sep	%MoM	0.3	-	-0.1
14:30	US	Core PCE	Sep	%MoM	0.1	-	0.1
14:30	US	Michigan index	Oct	pts	58.0	-	59.4

Source: BZ WBK, Reuters, Parkiet

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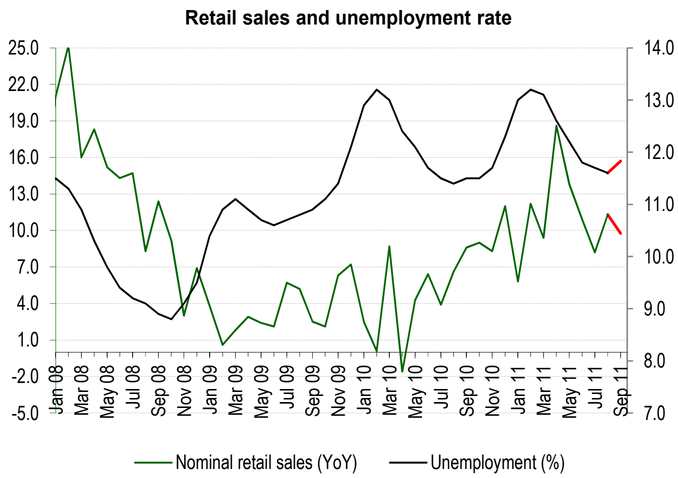
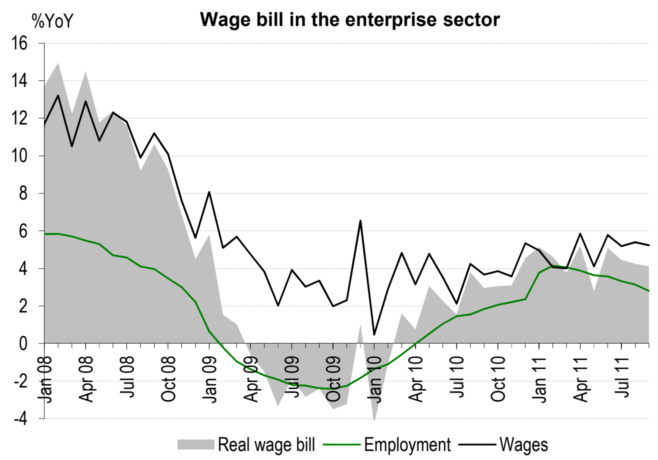
What's hot this week – Domestic retail sales and unemployment rate

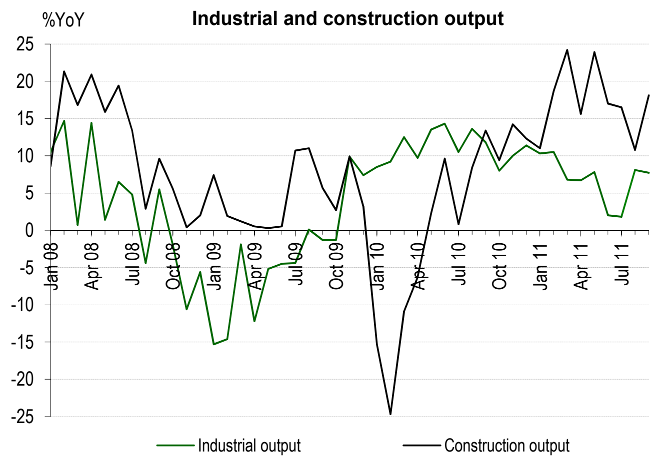


- We expect that September's retail sales data will show slower pace of annual growth, which came mainly from weaker sales of cars, signalled by Samar's data on car registration. Lower growth of retail sales in nominal terms also resulted from slower inflation rate growth. We predict that in Q3 2011 retail sales increased by ca. 10%YoY, while in the last three months of this year the pace of retail sales growth will decrease to ca. 7%YoY.
- Disappointing data about employment in enterprise sector suggest that registered unemployment rate could beat our forecast at 11.7% in September (market is slightly more optimistic looking at 11.6%). We expect the registered unemployment rate to increase further in coming months as a consequence of weak economic activity abroad, but also due to seasonal effects.

Last week in the economy – Labour market getting weaker, manufacturing still robust



- September's employment data surprised on the downside, with growth only by 2.8%YoY, down from 3.1%YoY in August. Wages in enterprise sector increased by 5.2%YoY, lower than expected.
- The number of job decreased by 5k compared with August, while compared with July it fell by 13k in total vs an increase by 14k in the same period of 2010. In our opinion it is still a gradual drop of employment, but these data show that companies are starting to limit their demand for labour due to expected economic slowdown.
- Wages growth is still moderate, but we think that weaker economic activity will cause lower scope for further wage hikes, therefore we foresee slower growth of salaries in coming months.
- Only slight deceleration in wage bill growth supports forecast of strong private consumption growth in Q3.



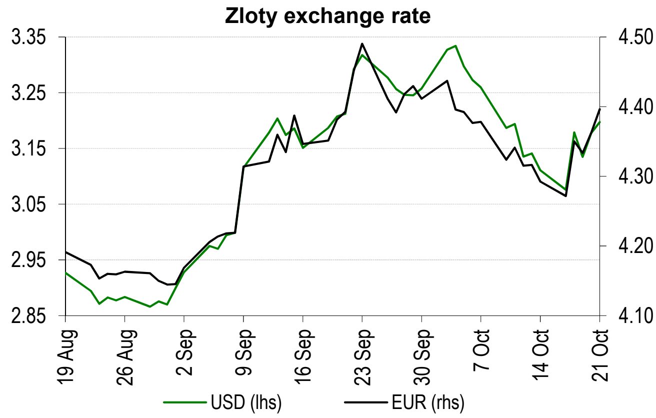
- The annual pace of industrial output accelerated in September to 7.7%, well above expectations
- This was the second consecutive month with a positive surprise delivered by the industrial output data. The signals from PMI survey, indicating a slowdown due to declining foreign orders, were not confirmed again. Probably the high momentum of output in some branches is an effect of continuing realization of contracts agreed before recent wave of weaker business climate abroad. However, one should expect that this effect will be dying off over time and a waning foreign demand will translate into slowdown of Polish industry in the upcoming quarters.
- Data suggest that the GDP growth in Q3 has probably remained slightly above 4%YoY.
- PPI inflation accelerated to 8.1%YoY, in line with our forecast, which was mainly due to the zloty weakening.

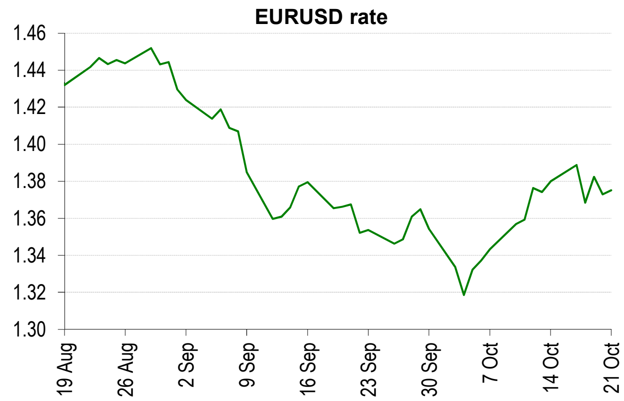
Quote of the week – Rates unchanged in near term

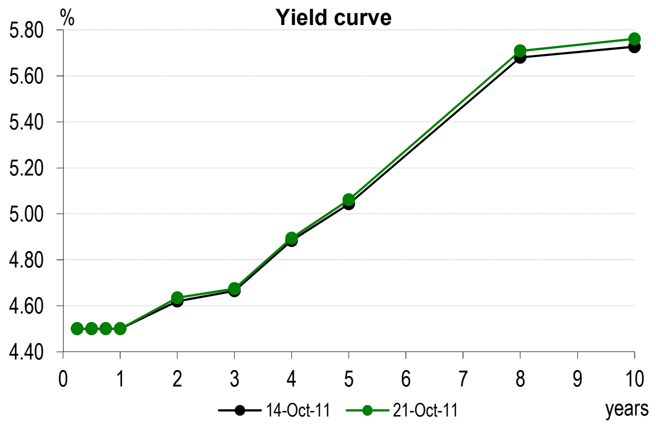
Elżbieta Chojna-Duch, MPC member, 19.10.2011, Reuters
Some MPC members – given the GDP slowdown and gradual decline of inflation – recognize that a stabilization of interest rates at the current level in possible in the upcoming quarters. (…) However, some members said that after this period of stabilization, in 2012 the probability of hike in greater than of cut, should the inflation persist above target due to zloty weakening.
Anna Zielińska-Głębocka, MPC member, 21.10.2011, Reuters
There is no need to make any changes in the upcoming months, or even quarters.
Andrzej Kaźmierczak, MPC member, 21.10.2011, Reuters
First we have to go down to inflation target and later on to think about stimulating the economy.

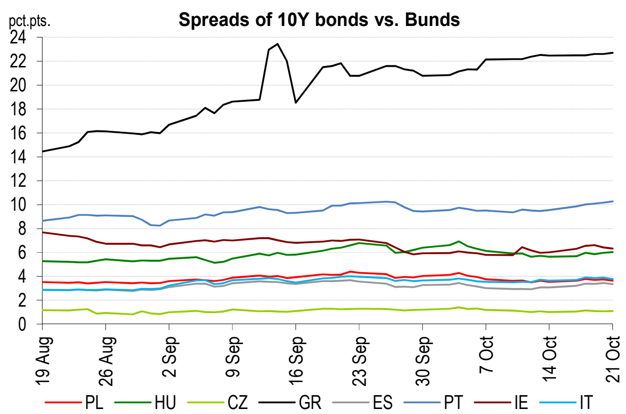
Comments of Chojna-Duch, Zielińska-Głębocka, Kaźmierczak did not bring any new information concerning the monetary outlook in the reminder of the year. They have only confirmed that the MPC agrees that the interest rates should remain stable until the end of the year; Marek Belka had already said during the October's post-meeting conference that chances for a hike are greater than for a cut. We stick to our forecast that MPC will implement rate cuts in 2012H1 (in two moves by 25bp), and the current relatively hawkish bias is maintained, among others, to support the zloty amid still elevated inflation. Our scenario was further supported by Kaźmierczak, as we expect the CPI to return to the inflation target in late Q1 or in early Q2 2012.

Market monitor









The zloty still under impact of news from abroad

▪ The zloty has weakened systematically since the beginning of the week. The uncertainty and volatility of global sentiment were not favourable for the risky assets. The peak of zloty depreciation occurred on Thursday, when EURPLN increased to 4.4235 and USDPLN to almost 3.24. The mood improvement, which took place at the end of the week, has dragged EURPLN down from the local peak and anchored it close to 4.40. The latest maximum constitutes the first resistance for the upcoming days. If this level is broken, the rate can climb even to 4.50. This week will be the another one, when the exchange rate will fluctuate moved under influence of global factors, so it is promising to be really interesting.

▪ The Czech koruna and Hungarian forint have also failed to resist the persisting uncertainty on the global market. The EURHUF exchange rate has surged to the highest level since March 2009, while EURCZK moved away from the upper border of horizontal trend, where it has been settling since February (24.5). The theoretical range of rebound from the band is 25.4. This level constitutes the first resistance for EURCZK.

▪ The EURUSD exchange rate hovered dynamically in 1.365-1.387 band over the week. The rapid changes were mainly due to confusing comments of the euro zone policymakers about measures and timing regarding solution of the euro zone crisis. This week is likely to be very interesting, among others in face of results of the EU summits and macro data due for release.

EU summits and macro data will affect debt market

▪ On the domestic debt market yields increased, mainly on the mid and long-end of the curve. It came from demand decrease for risky assets as a consequence of high volatility on the global market. The upward move was supported by Moody's statement; the agency warned it may cut the outlook on Poland's A2 rating to negative if possible slippage in the country's deficit reduction plan sparks a significant rise in the government's funding costs. However, increase of the IRS rates was higher than on the bond market and consequently asset swap spread narrowed. As expected, the auction of a new five-year benchmark was successful, and attracted solid demand. We foresee this week to be equally interesting as the previous one. Expectation for the results of the EU summit during weekend and the next meeting of the EU on Wednesday imply that the crucial factor for the Polish debt market (change in global risk appetite), is also hard to predict.

▪ On core markets yields decreased at the beginning of the week due to cooled hopes for breakthrough decisions at the EU summit. In the following days yields were moving in horizontal trend, very quick changes of investors' mood supported demand for "safe heaven" assets. At the end of the week yields of 10Y Bunds and the US Treasuries were at 2.11% and 2.21%, respectively.

▪ Spreads to 10Y Bunds widened as a result of market disappointment that the EU summit will not deliver a definitive solution for the euro zone crisis.

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