Bank Zachodni WBK

Weekly economic update

6 – 12 August 2012

Last week financial market paid most of its attention to the meetings of central banks. Bank of England, Fed and the ECB did not change interest rates. What is more important, both the ECB and Fed disappointed investors. Fed did not announce launching of the economic support's program and reiterated in its statement the sentence that rates will probably remain at exceptionally low levels through late 2014 and the Fed will support the economy if it is necessary. Although in the statement after the ECB meeting it was stated that the central bank may take direct open market operations and other non-standard actions in size that will provide success of these operations, the details regarding concrete intervention's modalities will be talked over in following weeks. In the context of earlier ECB President's wording that fuelled hopes for concrete actions, the August's ECB statement triggered rapid moods' deterioration including increase in yields of Spanish and Italian bonds. Last week's macroeconomic data remained in the shadow of central banks. Nevertheless, poor European PMI indicators reminded that slowdown/recession still persists. That did not have any impact on Polish market, the zloty continued its appreciation trend and ended the week at 4.06. Also domestic bonds gained, mainly on the short end of the curve. It is worth emphasizing that Polish PMI positively surprised, but in our opinion July's bounce will not be permanent.

Following week will not bring any significant information from the domestic economy. We expect yields of Polish bonds to stabilize, though in the short term developments at core market might impact the middle and long end of the domestic yield curve. Somewhat higher volatility may be observed regarding the EURPLN that in the past week reached lowest level for a year. Global investors will focus on macro data from US, Germany and China. Events and data released in the past days shall also be important.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (6 August)					
10:30	EZ	Sentix index	Aug	pts	-31.0	-	-29.6
		TUESDAY (7 August)					
12:00	DE	Factory orders	Jun	%MoM	-1.0	-	0.6
		WEDNESDAY (8 August)					
8:00	DE	Exports	Jun	%MoM	-1.5	-	3.9
12:00	DE	Industrial output	Jun	%MoM	-0.8	-	1.6
14:30	US	Labour productivity	Q2	%MoM	1.4	-	-0.9
		THURSDAY (9 August)					
3:30	CN	CPI	Jul	%YoY	1.7	-	2.2
7:30	CN	Industrial output	Jul	%YoY	9.8	-	9.5
14:30	US	Trade balance	Jun	$bn	-47.4	-	-48.7
14:30	US	Initial jobless claims	week	k	370	-	365
14:30	US	Wholesale inventories	Jun	%MoM	0.3	-	0.3
		FRIDAY (10 August)					
-	CN	Trade balance	Jul	$bn	34.3	-	31.73
14:30	US	Import prices	Jul	%MoM	0.0	-	-2.7

Source: BZ WBK, Reuters

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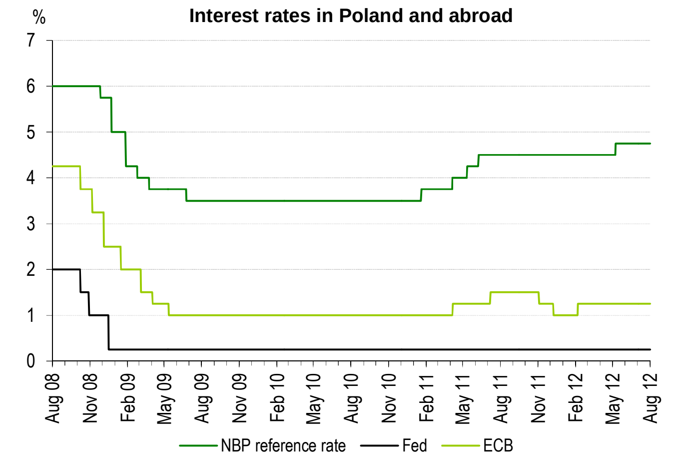
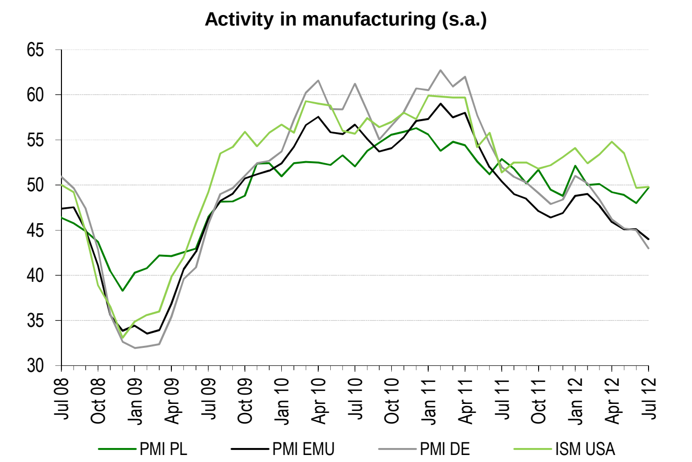
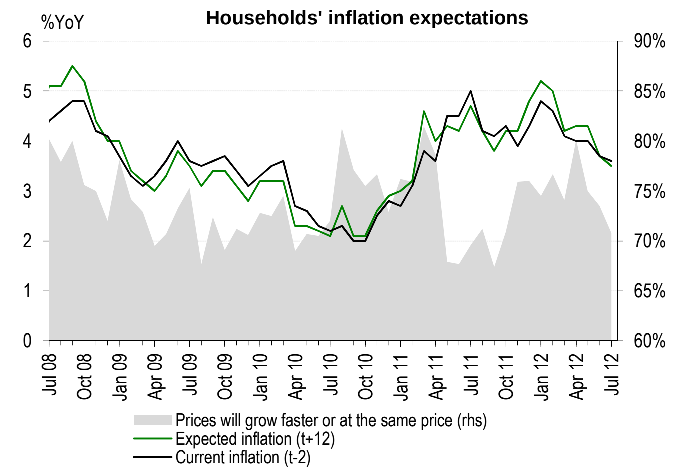
Last week in the economy – Central banks disappoint, Polish PMI surprises on the upside



- Fed, BoE and the ECB did not change their interest rates (Fed rate is at 0.0-0.25%, BoE at 0.5% and ECB at 0.75%). However, the fact that both ECB and Fed disappointed investors was more important. Fed did not announce the start of economic support's program and reiterated in its statement the sentence that rates will probably remain at exceptionally low levels through late 2014 and the Fed will support the economy if it is necessary.
- The ECB stated that yields of euro zone peripheries' bonds are too high and the central bank may undertake outright open market operations of a size adequate to reach its objective to lower the financing cost. Still, no details as regards this action were given while investors awaited some after the ECB President built a week earlier market' expectations for quick actions.





- After three months of fall, in July the PMI economic activity index for Polish manufacturing rebounded to 49.7pts from 48.0 pts. This was a major surprise, as almost all of analysts expected the index to show a further decrease.
- As regards subindices of Polish PMI, increase of employment, which is signalized by enterprises, is most positive information. On the other hand, LFS data, which have also recently been released, show that in June the employment in Polish economy decreased by 0.2%YoY and unemployment rate increased to 10.0% after 5 months of stabilization at 9.9%.
- It should be reminded that index is still below neutral level of 50pts with industrial output and orders still falling (exports orders very clearly), but slightly slower than a month earlier. Consequently, July's economic outlook improvement may turn out to be temporary and the risk of slowdown of GDP growth to below 2% in H2 is still considerable.
- On the other hand, indexes for Germany and the euro zone recorded further falls. European enterprises also strongly experience decrease of demand for their products and act with reduction of output and employment. On the other hand, output and employment in US companies are increasing despite falling orders.
- Households' inflation expectations measure declined in July to 3.5% from 3.7%. The decline was due to lower base inflation rate (3.6% headline CPI figure from May instead of 3.7%) and due to further improvement of respondents' answers' breakdown. Share of respondents expecting that prices will increase faster or at the same pace in the upcoming 12 months declined (from 73.5% to 70.8%).

Quote of the week – Budget assumptions will hold?

Dominik Radziwiłł, deputy minister of finance, 31.07 PAP

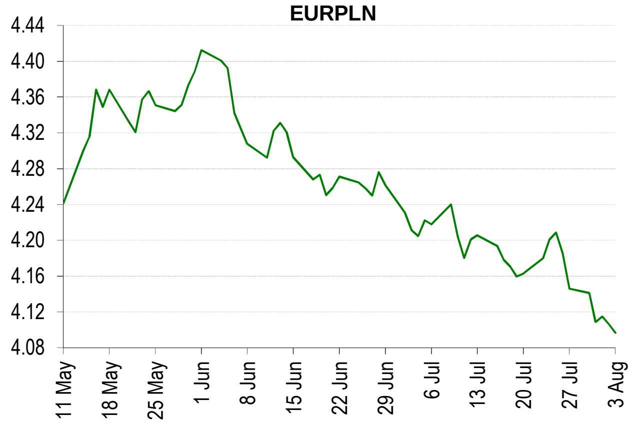
The slowdown is visible, but we still have strongly positive [macroeconomic] figures, far different from levels in other European countries. I think that there is no risk that increase of GDP is negative in any quarter, pace of growth will decelerate strongly, but it will certainly not become negative. 2013 will be a difficult year for the budget. We try to be conservative and I think that we manage it. This [budget] assumptions are conservative and probable to hold.

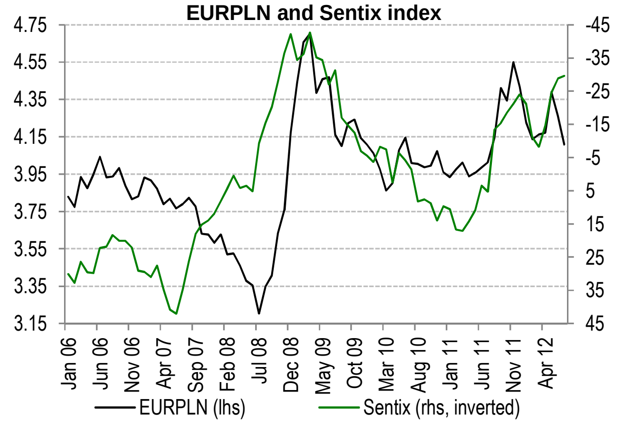
Ludwik Kotecki, Finance Ministry chief economist, 02.08 PAP

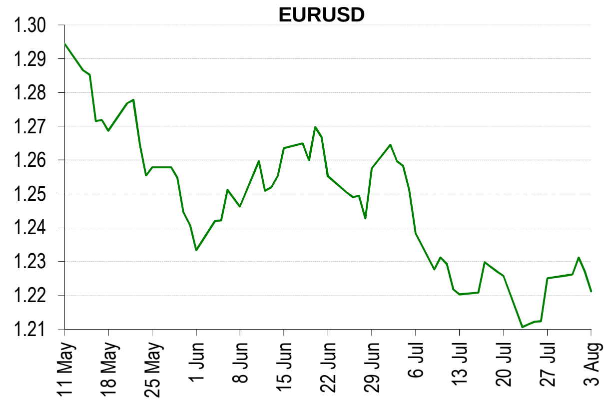
In late August we will present final budget assumptions for 2013. They must be made more realistic, adapted to changing external situation. A downward revision of economic growth forecast for 2013 cannot be excluded. Scenario must be internally coherent, so we will analyse all budgetary indicators. Of course we will consolidate public finance if we assess this step as not dangerous for the economy.

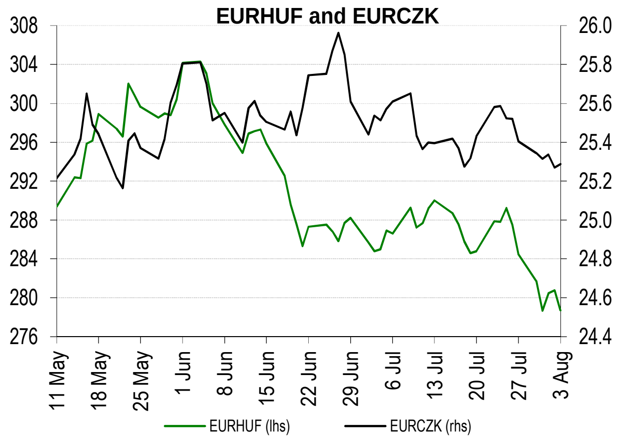
Finance Ministry expects that the Polish economy entered a path of weak economic growth in Q1 and will follow it at least for a couple of following quarters. Despite high resilience, Poland begins to suffer from deteriorating economic conditions in our main export markets, which is reflected by the data showing declining pace of export growth, slowing output and private investments. Deputy finance minister Dominik Radziwiłł said that the economic growth may slide below 2% in Q4. We also expect a deceleration of economic growth. As regards assumptions for budget for 2013 (economic growth at the level of 2.9%), Radziwiłł described them as conservative and possible to hold. In our opinion the economic growth's forecast at 2.9% is optimistic and this opinion seems to be shared by the chief economist of Finance Ministry – Ludwik Kotecki.

Foreign exchange market – EURPLN lowest for a year









EBC disappoints, but zloty gets stronger

▪ Moderate optimism that dominated on the market at the beginning of the week caused that the EURPLN oscillated during last 5 sessions slightly above local minimum at 4.097. However, range of trading was limited. Only during the ECB press conference the zloty depreciated temporarily to 4.13 against the euro and at the end of the week the EURPLN declined below 4.06, lowest for a year. The downward move was fuelled by US monthly non-farm payrolls data. The area at 4.05-4.07 is vital support on weekly charts. If it is broken, the exchange rate may decline further towards 4.0.

▪ Significantly greater volatility was observed in case of the USDPLN. It came from high volatility of EURUSD that occurred during ECB's conference. Thus on Thursday USDPLN set weekly low (almost 3.30) and peak (nearly 3.40). Trading range was still lower than a week earlier.

▪ This week there are no significant macro data releases. Publication of Sentix index should not have direct influence the zloty, but relation between the index and the EURPLN shows clear correlation between zloty and the euro-zone investors' moods over last several years. On the other hand, last months data point out that the zloty has recently been less dependant on negative events that took place in Europe (e.g. increasing yields of Spanish and Italian bonds and decreasing EURUSD). In other words, the zloty depends on cyclical economic fluctuations, but observed in last weeks appreciation does not match this pattern. It is worth to mention that divergences between EURPLN and the Sentix index that occurred in the past were temporarily and after some time the rate followed investors' moods' measure.

High volatility during the ECB press conference

▪ Until ECB's meeting the EURUSD was relatively stable. The rate hovered around 1.23 and awaiting for ECB's decision investors had prevented from any significant moves. Announcement of plan to take actions pushed the rate from 1.233 to 1.24, but when it was said that details will be discussed during the following weeks, the EURUSD rapidly decreased to 1.213. Monthly data from the US labour market surprised positively, with the better than expected reading, but the market reaction was muted and only temporary. At the end of the week the EURUSD was close to 1.232.

▪ This week there is no macro data releases, consequently investors will probably stay under influence of events from last days. We think that levels of 1.213 and 1.24 are important for EURUSD. If the resistance is broken then the exchange rate may reach 1.26 in coming weeks.

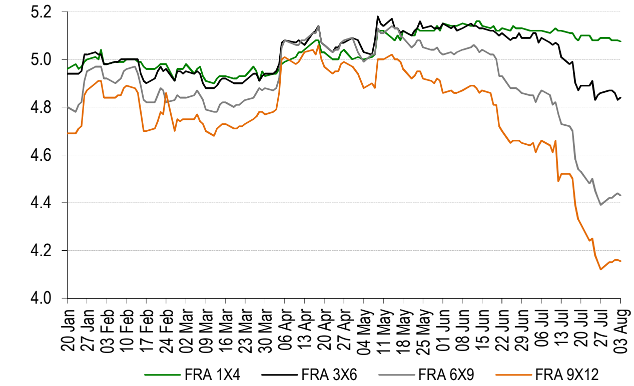
Forint gains further, Czech koruna stable

▪ Forint, similarly to the zloty, remained in appreciating trend. Consequently the EURHUF fell to ca. 272 at the beginning of the last week. Forint is still under positive influence of expectations for prompt government's agreement with IMF on loan.

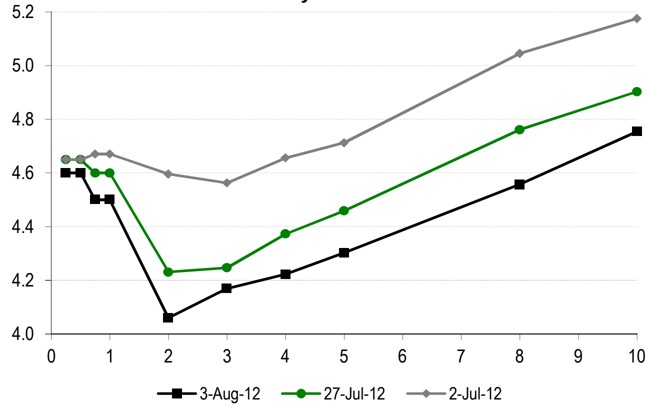
▪ Last week EURCZK oscillated between 25.2 and 25.4. Lower band of the range is significant support level. Since the middle of June the exchange rate did not manage to get through it.

Interest rate market – The short end of the curve still attracts strong demand

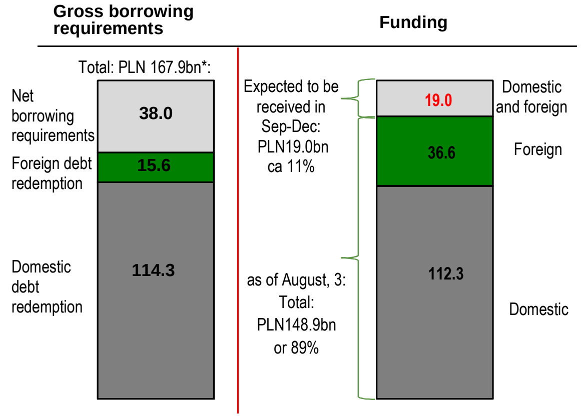
FRA



Bond yield curves

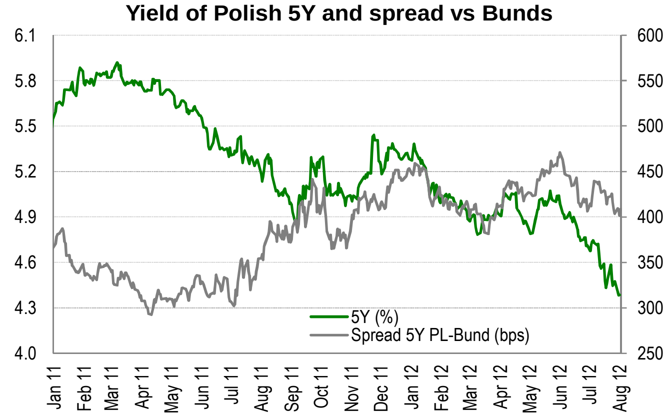


Financing gross borrowing requirements in 2012



*/ *including loan from the World Bank (€750m)*

Yield of Polish 5Y and spread vs Bunds



FRA rates slightly increase

- Last week brought slight rebound on the FRA market, mainly in case of 6x9 and 9x12. During week the rates increased by 4bps on average, but that does not change scenario of market expectations for rate cuts. The market prices-in that in one year horizon the official interest rates will be cut by 100bps (with the first reduction by 25bps in Q4 2012). This scenario is confirmed also by macroeconomic polls.
- This week we expect low activity of investors. Ahead of macroeconomic data release (the macro calendar will start at the beginning of next week) we expect stabilization of rates close to current levels.

Short-end of the curve still strong

- During the past week the Polish debt market gained considerably, mainly on the short and middle end of the curve. Despite ECB's disappointment, the Polish bonds have remained strong. Yield of 2Y bonds declined to slightly above 4.05 (lowest level since 2006), while 5Y benchmark tested 4.30%. 10Y benchmark reached this year new minimum (4.75%). On weekly basis the yield curve moved down by 15-17bps.
- On the IRS market slight falls of rates also continued. However, the scale of a decrease proved to be clearly lower than in case of bonds and amounted to no more than 5bps. The IRS curve remains quite flat with 2-10Y spread at the level of -4bps. It is worth mentioning that asset swap spread for 10Y sector has recently anchored close to 40bps.
- Auction of 5Y benchmark PS0417 was surely main event of the week. Tender attracted solid demand (PLN7bn), which allowed the Ministry of Finance to successfully launch bonds worth PLN4.41bn with auction yield at 4.361% (the record low for 5Y bonds at auction). It is worth to emphasize that 5Y bonds were placed on the market at the exactly same level of yield as 2Y benchmark OK0714 in July.
- The auction was the only one in August. The Ministry announced that after this auction and taking into account loan from the World Bank (EUR750m) it has completed almost 90% of annual borrowing needs. What is more, until the end of Q3, the Ministry wants to fully cover this year's needs and in Q4 start to pre-finance borrowing requirements for 2013 if market conditions are favourable.

Markets in holiday moods

- We are facing very holiday week without significant domestic events and macro data's releases. It suggests low investors' activity and slight changes in yields.
- However, impulse for domestic market may come from core markets, what will have impact mainly on the long end of the curve. Even if profit-taking takes place after last quite significant appreciation, in our opinion it will be rather short-term phenomenon.
- According to our expectations last week brought strengthening of middle-term bonds. The spread between 5Y domestic and German bond' yields approached 400bps and it seems that at the moment it is strong support level. In our opinion that means the yield of 5Y bond should oscillate around 4.30% assuming relative stabilization of the German curve, however, with the possibility of testing this bounce.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl