Bank Zachodni WBK

Weekly economic update

20 – 26 August 2012

Peak of holidays season causes that markets have been working in slow motion for last weeks, and last week activity in Poland was additionally limited because of bank holiday on Wednesday. Consequently, reactions to domestic data releases were quite limited. To a larger extent domestic market reacted to changes of moods abroad, where after not so optimistic beginning of the week investors' optimism started slowly to dominate as a result of data indicating stabilization of economic situation in the USA, hopes for more stimulus from main central banks and politicians' statements (among others Angela Markel who expressed support for the ECB's policy). Problems of euro-zone receded to the background for the while. Consequently, stock exchange indexes in Europe and Asia increased near multi-month highs.

In spite of weak external trade data, slowdown in labour market, and lower than forecast inflation, the scale of interest rate cuts priced-in by domestic market slightly decreased last week. Indicators, which are due for release in coming days, may contribute to continuation of this correction, showing slight bounce of industrial output and retail sales growth (although temporary improvement will in our opinion result mainly from calendar effects). Minutes of July's MPC meeting, to be released on Thursday, may prove to be useful in assessment of future actions of the MPC. One day earlier minutes of the last meeting will be released by Fed, what will be carefully analysed by investors, who await next round of QE3. In second half of the week new dose of indicators from the largest world economies will appear. It can significantly influence moods on global markets.

Zloty has remained under stronger influence of external factors rather than domestic information. This week we foresee the EURPLN to stay between 4.026-4.10. Investors on the domestic bond market will focus on upcoming macro data. Materialization of our scenario, assuming rebound in both industrial output and retail sales, could push yields on the front end of the curve upward, with yield of 2Y benchmark toward 4.20%. We predict 5Y yields to move within 4.45-4.60% range and 10Y in 4.90-5.05%.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (20 August)					
14:00	**PL**	**Industrial output**	**Jul**	**%YoY**	**3.8**	**5.4**	**1.2**
14:00	**PL**	**Construction and assembly output**	**Jul**	**%YoY**	**-0.5**	**1.7**	**-5.1**
14:00	**PL**	**PPI**	**Jul**	**%YoY**	**3.8**	**3.6**	**4.4**
		TUESDAY (21 August)					
14:00	**PL**	**Core inflation**	**Jul**	**%YoY**	**2.3**	**2.3**	**2.3**
		WEDNESDAY (22 August)					
16:00	US	Home sales	Jul	m	4.53	-	4.37
20:00	US	FOMC minutes					
		THURSDAY (23 August)					
4:30	CN	Flash PMI-mfg	Aug	pts.	-	-	49.3
9:28	DE	Flash PMI-mfg	Aug	pts.	43.4	-	43.0
9:58	EZ	Flash PMI-mfg	Aug	pts.	44.1	-	44.0
14:30	US	Initial jobless claims	week	k	365	-	366
16:00	US	New home sales	Jul	m	0.36	-	0.35
16:00	EZ	Consumer confidence	Aug	pts.	-21.8	-	-21.6
		FRIDAY (24 August)					
10:00	**PL**	**Retail sales**	**Jul**	**%YoY**	**6.5**	**7.6**	**6.4**
10:00	**PL**	**Unemployment rate**	**Jul**	**%**	**12.4**	**12.3**	**12.4**
14:30	US	Durable goods orders	Jul	%MoM	3.5	-	1.3

Source: BZ WBK, Reuters, Parkiet, Bloomberg

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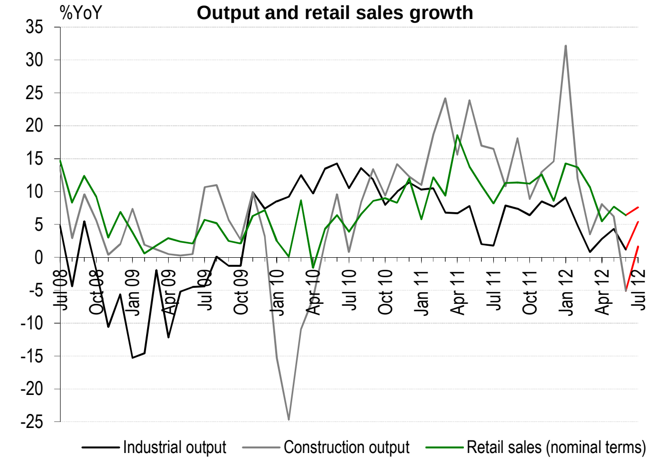
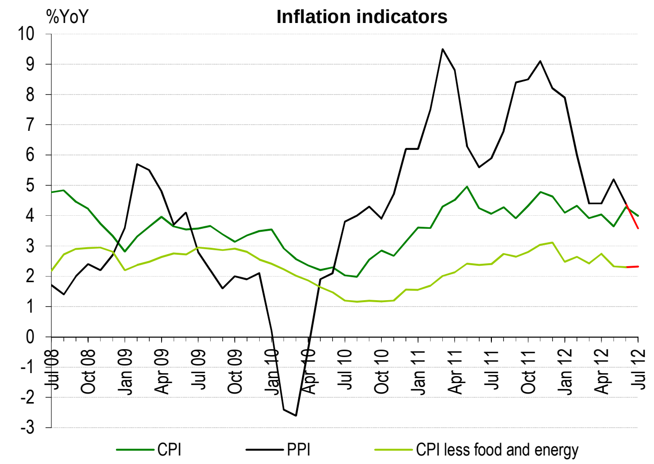
What's hot this week – Slight rebound in sales and production, lower unemployment

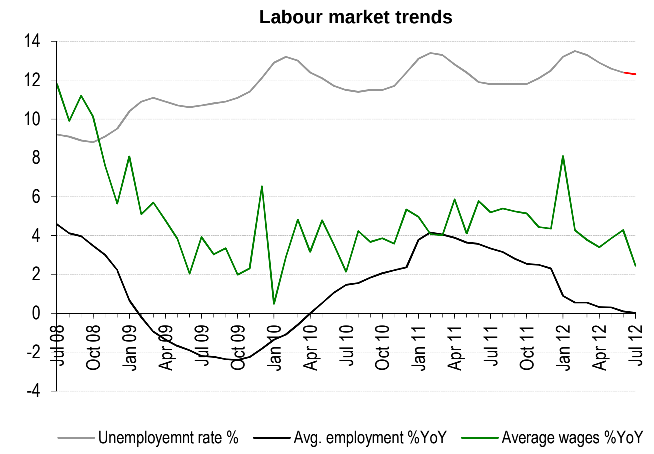


- We expect that industrial and construction output in July will record slightly better outcomes than in previous month, but it will be, to a large extent, caused by positive effect of higher number of working days. The seasonally- and calendar-adjusted increase will remain roughly unchanged in comparison with June, but decreasing export orders from Western Europe will have negative impact on Polish industry in forthcoming quarters.
- We expect slight rebound also in case of retail sales, but we see moderate downward risk for our forecast due to weak SAMAR data about the number of registered cars.
- We estimate that core inflation (after excluding food and energy prices) remained unchanged at 2.3%, while registered unemployment rate decreased to 12.3% because of seasonal effects.

Last week in the economy – Lower inflation, slowdown in foreign trade and labour market



- CPI inflation decreased in July to 4.0%YoY, falling below our forecast (4.3%) and market consensus (4.1%). Main factor responsible for that was deeper than expected fall in food prices: by 2%MoM, what is the strongest price drop in July in the last decade. In comparison with June also prices of clothing and fuel decreased significantly (in both categories by 2.4%MoM). In other categories prices inched up marginally or stabilised, in line with expectations. We expect CPI to stay closed to 4% until October and than start decreasing to 3% in December and next to NBP's target in 2013.
- M3 Money supply growth rate remained in July at June's level (11.1%YoY) and proved to be higher than our and market expectations. Data showed further deceleration of loan growth. FX-adjusted growth of households' loans slowed to 3.6%YoY from 4.8%YoY in June and corporate loans decelerated to 12.9%YoY from 13.0%YoY.



- Current account deficit in June reached €1.24bn, and was slightly smaller than expected, as exports' stagnation (0.5%YoY) was accompanied by deeper than forecast slump in imports (-5.7%YoY). The data confirmed weakness in domestic demand, which does not bode well for the Polish economy in the coming quarters. Nevertheless, lower than we assumed deficit in balance of goods and services may imply an upward risk to our forecast of GDP growth in Q2 (2.5%).
- July's labor market data proved to be the weakest for the last two years – the increase of employment slowed down do zero and wage growth to 2.4%YoY (well below market expectations). These are next dovish data this week that confirm that May's interest rate hike delivered by the MPC was not a good idea.

Quote of the week – Interest rate cut not excluded this year

Elżbieta Chojna-Duch, MPC member, 14.08 TVN CNBC

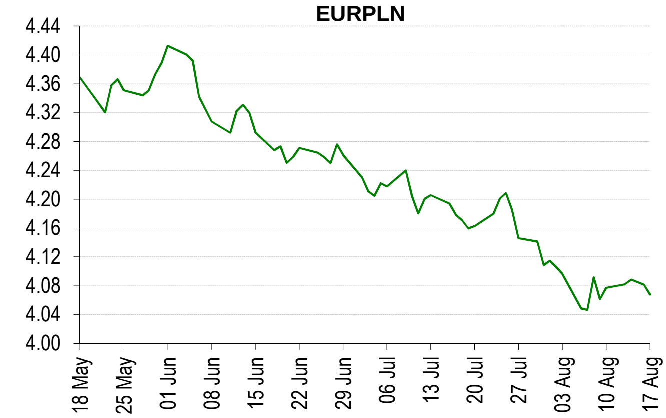
I still think that situation in Poland and in the USA entitles to some monetary policy easing. Main world central banks ease monetary policy, so also this situation will be the object of deliberations and analysis on September's sitting of the MPC.

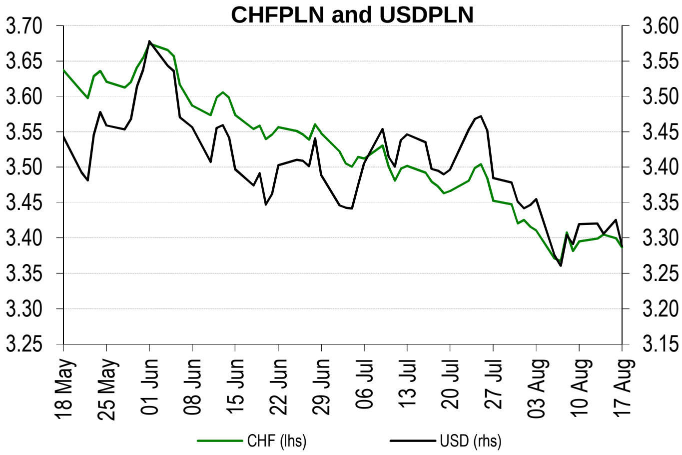
Anna Zielińska-Głębocka, MPC member, 14.08 PAP

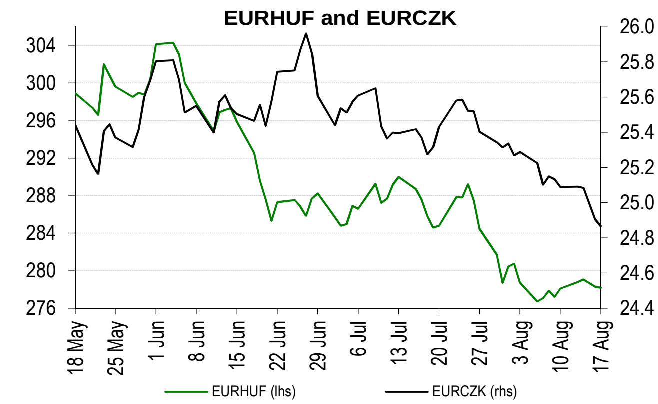
I would not exclude the necessity of interest rates' reduction this year, but I do not claim that it will certainly happen. At the moment economic situation of Poland depends practically only on the external situation. Economic slowdown, corporates refraining from investing and employing means transfer of this weakening in euro-zone. Question, to what extent domestic economic policy can influence these?

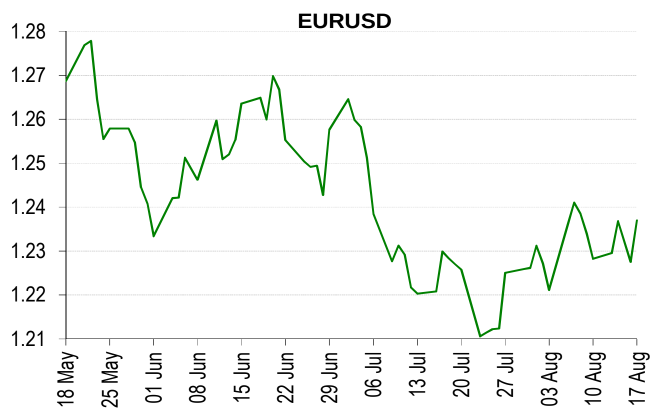
Elżbieta Chojna-Duch confirmed in interview for TVN CNBC her readiness to cut interest rates on September's sitting. Additionally, Anna Zielińska-Głębocka joined dovish duet of Bratkowski and Chojna-Duch and said that this year the necessity of interest rates' reduction may appear. This is sign of gradual easing of standpoints by next MPC members as a result of lower inflation releases and weak real economy data. However, in our opinion there will be no majority supporting rates' cuts until the year's end mainly because of higher CPI inflation rate, which will remain close to 4% until late autumn.

Foreign exchange market – Slight improvement on FX market









Increase of risk appetite supported zloty…

▪ Coming domestic macroeconomic data, but also situation of EURUSD did not change tendencies observed on EURPLN graph. In spite of several attempts the rate did not manage to get through the resistance at 4.10 and consolidated in the range 4.026-4.10.

▪ USDPLN was more sensitive to coming data, mainly from global economy. The profit-taking on EURUSD after US economy data and statement of German chancellor, which supported ECB's actions, contributed to increase of risk appetite. It generated strong impulse for fall of USDPLN, which after getting through 3.30 decreased to 3.27.

▪ It is also worth mentioning that in spite of several attempts CHFPLN did not manage to get through 3.40. Consequently this level remains to be strong resistance for the rate. Additional impulse of deterioration of investment moods will be necessary in order to get through this level.

▪ Zloty is still remaining under stronger influence of external factors rather than domestic information. Coming pieces of information did not bring settling on EURPLN and USDPLN graphs. Oscillations' range of EURPLN of 4.026-4.10 remains also valid for this week. Further increase of risk appetite may move the rate closer to lower limit of the range, after earlier breaking short-term support at 4.047.

… and other CEE3 currencies

▪ This week among CEE3 countries CZK was positively distinguished. Weaker than expected GDP data for Q2 (Czech economy shrank by 1.2% YoY) caused increase of expectations for next interest rates' cut. Consequently Czech debt as well as currency gained on value. EURCZK decreased below 25, reaching the lowest level in last 3 months. 24.60 is the significant support for the rate.

▪ Hungarian currency, similarly to zloty, gained as a result of increase of risk appetite. However, EURHUF remained in the range of 276.6-280.0. It is current range of oscillations for the rate also in following week.

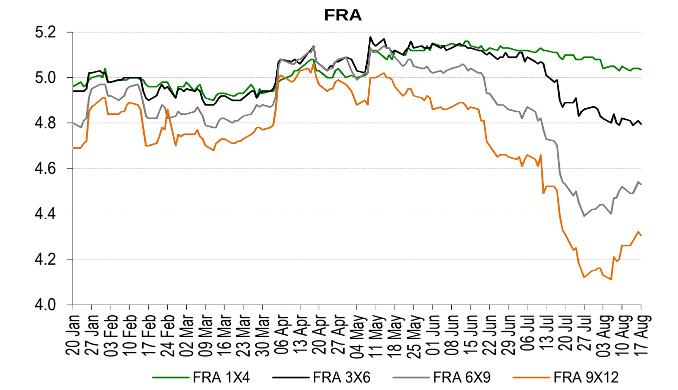
Consolidation of EURUSD in expectation for Sep

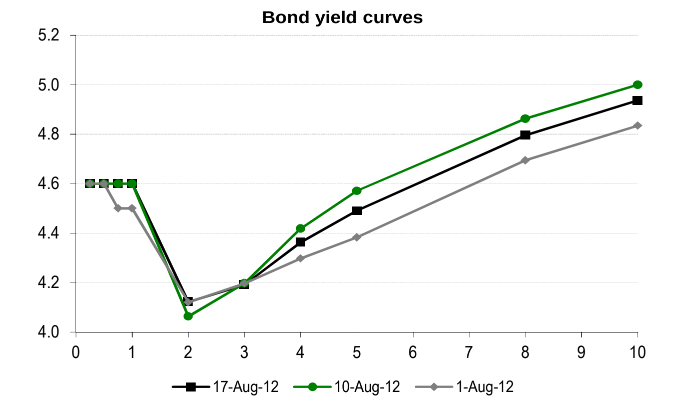
▪ Last week coming information and data from euro-zone and the USA induced to consolidation of EURUSD in the range of 1.224-1.239. US labor market and real estate market data persuaded investors to profit-taking, what generated move towards upper limitation of the range. European currency was also supported by statement of German chancellor, who supported ECB's actions that have recently been introduced.

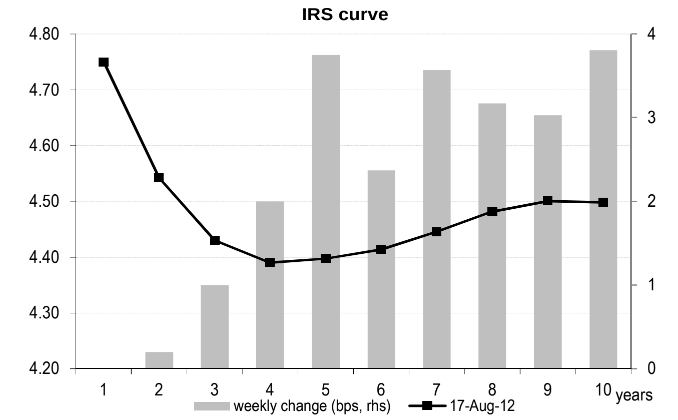
▪ Uncertainty about future decisions of central banks and development of situation in euro-zone peripherals (especially after information that Greece will apply for 2 year lengthening of implementation of public finance's consolidation's schedule and Spanish banks remains in difficult situation) is still accompanying the market. Consequently, increases of EURUSD above 1.24 are limited.

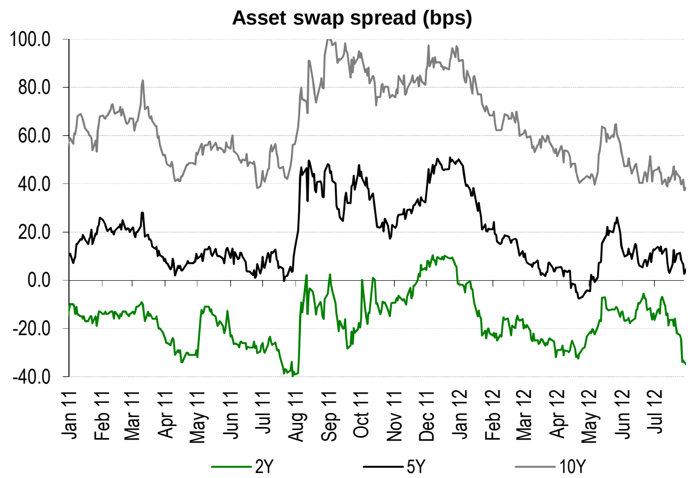
▪ Technical situation on EURUSD remains unchanged. The rate is in upward trend, however, currently strong resistance level is located at 1.239, which breaking would generate upward impulse towards 1.244. However, some additional impulses are necessary to reach it.

Interest rate market – Higher yields activate demand side









Market has revised its expectation on NBP's rates

- FRA rates, especially for longer terms (6M and longer) have continued upward move. It suggests that investors revised their monetary policy outlook in one year period as a response to macroeconomic data. While at the beginning of August investors had strongly priced-in cuts by 100bps, currently they expect that the MPC will trim official rates by 75bps in total in one year horizon. OIS market also confirm changes in monetary easing scenario. Last week OIS rates moved up by 5bps on average.
- One should notice that expectations on starting the monetary policy easing did not change. Market still has priced-in the first rate cut (by 25bps) in 3 months period.

Demand side remains still strong

- Last week the key event on the debt market was CPI inflation publication. Ahead of July's CPI release yields on the front end of the curve moved up (with 2Y benchmark yield increase towards 4.20%) due to worries that final reading could higher than expected as in Hungary. However, in July inflation rate slowed down to 4.0%YoY, below market predictions. It generated demand on the short-end of the curve, trimming earlier loses. Next days, in thin trade, brought further gradual decrease of 2Y yield below 4.10%. However, it is interesting that the yield of 2Y benchmark has remained above the level before the July's CPI reading.
- On the long end of the curve we observed some sell-off. However, investors have taken advantage to accumulate long-term bonds as their yields rose above 5.0% (with weekly maximum near 5.05%). Global investors' mood improvement at the end of the week resulted in 10Y benchmark yield decrease below 4.95%. In the same time yield of 5Y benchmark ended the week below 4.50% (after earlier increasing towards 4.65%).
- IRS market followed changes on the bonds' yields, however, the scope of weekly changes was much lower. In weekly terms IRS curve moved up by 1-4pb. As a consequence asset swap spread narrowed for all main tenors. In case of 10Y sector the support level at 40bps is still valid.

Industrial output and retail sales are the key event

- This week investors focus on industrial output and retail sales data, which should show the first view of real economy in Q3. We expect it to rebound after week data in June, however, the improvement in real economy will be only temporary.
- Materialization of our scenario, showing higher than market consensu growth in both industrial output and retail sales could result in some increase on the short end of curves (both bond and IRS). We also do not exclude further muted growth of FRA rates (especially in case of 6M and longer). In our opinion level of 4.20% has remain strong resistant for 2Y.
- The mid and the long end of the curve will be more vulnerable to global mood (and as a consequence the zloty quotation) than macroeconomic data. We foresee that probable yields increase will attract investors to purchase that bonds. We predict yields to move within 4.45-4.60% in case of 5Y and 4.90-5.05% in case of 10Y.