Bank Zachodni WBK

# Weekly economic update

## 10 – 16 September 2012

**Market holiday in the US at the start of the week and expectation for ECB meeting caused that the financial markets were calm for a while. Appearance of unofficial hints about possible ECB actions to fix monetary policy in the euro zone triggered slight optimism and fuelled hopes that this time the central bank would not surprise. The plan outlined by the ECB president at the press conference was consistent with earlier rumours (unlimited in scale, focused on bond yield curve up to three years, and conditional) and was positively perceived by the market. The zloty appreciated as well, and continued strengthening trend started after MPC meeting.**

**While the ECB didn't waste time since the previous meeting and worked-out a plan to support euro zone peripheral states, Polish MPC decided to wait with monetary easing (after much worse than expected GDP data for Q2) for next data from domestic economy, and only changed the tone of the official statement towards more dovish. The communique opens door for interest rate cuts and in our view such move may take place already in October (we expect to see weak economic data for August). In general, we think the MPC will trim rates by 50bps in Q4 and by further 25bps in Q1 2013.**

**Maintaining optimism connected with the ECB's new plan will surely depend on Wednesday's ruling of the German Constitutional Court on whether the ESM is not violating the German constitution. Meanwhile, launching the ESM is one of conditions required for running the ECB support programme. Also, conditions that will have to be met in order to activate bond purchases by the ECB are vital, but these have not been agreed so far. The day after the German Court the FOMC will hold its meeting. The last data from US labour market (much worse than forecast) boosted expectations that the bank will suggest increasing the scale of support of the US economy. Additionally, central bank will present its new GDP and inflation forecasts and that shall also have some impact on the market. For the EURPLN wide range of 4.10-4.22 is still valid. If our inflation forecast materializes, that may support short end of the domestic yield curve (FRA, IRS and bonds). We do not exclude that 2Y bond may test again support at 4%.**

### Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (10 September)** | | | | | |
| 3:00 | CN | Trade balance | Aug | $bn | 19.8 | - | 25.1 |
| 10:30 | EZ | Sentix index | Sep | pts | -30.7 | - | -30.3 |
| | | **TUESDAY (11 September)** | | | | | |
| **14:00** | **PL** | **Exports** | **Jul** | **€m** | **11 446** | **11 437** | **11 738** |
| **14:00** | **PL** | **Imports** | **Jul** | **€m** | **12 125** | **12 000** | **12 150** |
| **14:00** | **PL** | **Current account** | **Jul** | **€m** | **-1285** | **-1247** | **-1240** |
| 14:30 | US | Trade balance | Jul | $bn | -44.0 | - | -42.9 |
| | | **WEDNESDAY (12 September)** | | | | | |
| | DE | Constitutional court ruling on the ESM | | | | | |
| 11:00 | EZ | Industrial output | Jul | %MoM | 0.0 | - | -0.6 |
| 14:30 | US | Import prices | Aug | %MoM | 1.5 | - | -0.6 |
| 16:00 | US | Wholesale inventories | Aug | %MoM | 0.2 | - | -0.2 |
| | | **THURSDAY (13 September)** | | | | | |
| **14:00** | **PL** | **CPI** | **Aug** | **%YoY** | **3.8** | **3.7** | **4.0** |
| 14:30 | US | Initial jobless claims | week | k | 370 | - | 365 |
| 18:30 | US | Fed decision | | % | 0.0-0.25 | - | 0.0-0.25 |
| | | **FRIDAY (14 September)** | | | | | |
| 11:00 | EZ | HICP | Aug | %YoY | 2.6 | - | 2.4 |
| **14:00** | **PL** | **Money supply** | **Aug** | **%YoY** | **9.8** | **9.9** | **11.1** |
| 14:30 | US | Core CPI | Aug | %MoM | 0.2 | - | 0.1 |
| 14:30 | US | Retail sales ex autos | Aug | %MoM | 0.6 | - | 0.8 |
| 15:15 | US | Industrial output | Aug | %MoM | 0.1 | - | 0.6 |
| 15:55 | US | Flash Michigan | Sep | pts | 74.0 | | 74.3 |

Source: BZ WBK, Reuters, Dow Jones

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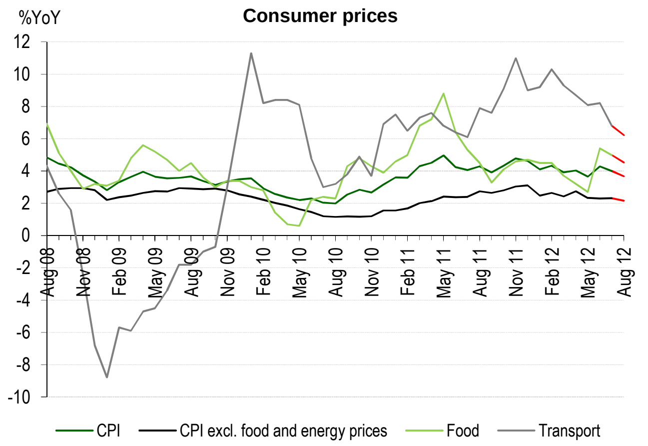
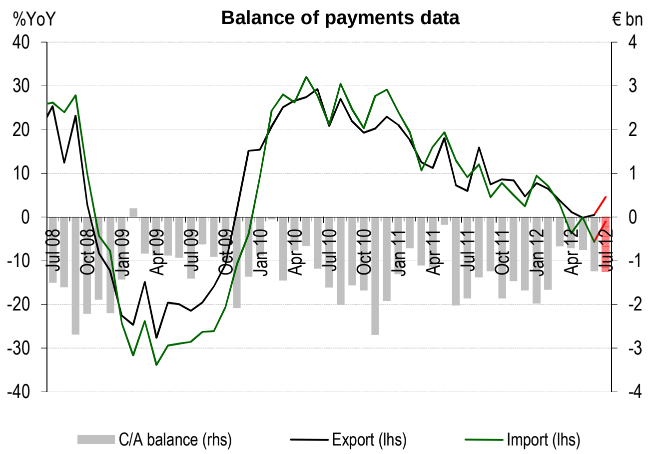
## What's hot this week – Decline of inflation, current account deficit stable




▪ We expect that the CPI inflation declined in August to 3.7%YoY from 4.0%YoY in July. We are a bit more optimistic on that matter than the market, which is expecting a decline to 3.8%YoY, so a reading in line with our forecast can cause some market reaction and amplify expectations for interest rate cut in October. A reading at 3.7% will not be fully satisfactory for these MPC members, who are focused on current CPI, but weak data from the economy should encourage them to support a cut at the upcoming meeting.

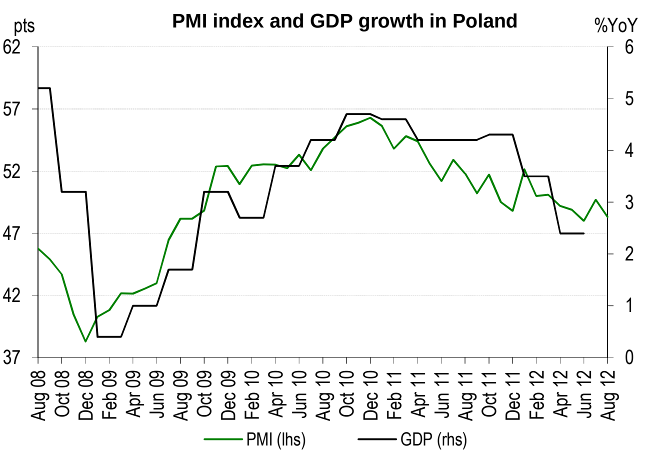
▪ Inflation will decline mainly due to seasonal drop of food prices, mostly vegetables and fruit. In our view, inflation will rise again in September and then will follow a downward trend to reach MPC's target at 2.5% at the turn on Q1 and Q2 2013.




▪ In our view current account deficit in July maintained at level similar to that seen in June. A deeper trade deficit and smaller surplus on services balance were offset by higher inflow of funds from the European Union. We are expecting a further decline of imports (-1.1%YoY), while exports can record a one-off rebound (+4.5%YoY) due to low statistical base of July 2011 and good result of industry in July 2012. Still, both export and import will show negative pace of growth in the upcoming months in face of economic slowdown.

▪ Pace of growth of M3 money supply picked down in August to 9.9%YoY from 11.1%YoY in July, which was partly due to high statistical base from August 2011. We forecast a further slowdown of growth rate of loans and deposits.

## Last week in the economy – PMI indices give no hope




▪ PMI for Polish manufacturing plunged in August. The level of 48.3pts (versus 49.7pts in July) is lowest since June (48pts) and second lowest since September 2009. Manufacturing output contracted in August at fastest pace since June 2009 and already for the fourth month in a row. Domestic and foreign demand continued to weaken (subindices for this categories are below neutral level of 50pts already for 7 and 5 months, respectively). Some positive impact on the PMI was provided by rising employment in enterprises.

▪ PMI indices for the euro zone and Germany record an increase as compared to last months (to 45.1 and 44.7, respectively). A slight improvement was recorded by subindices for output, new orders and employment, but declines of new export orders accelerated.

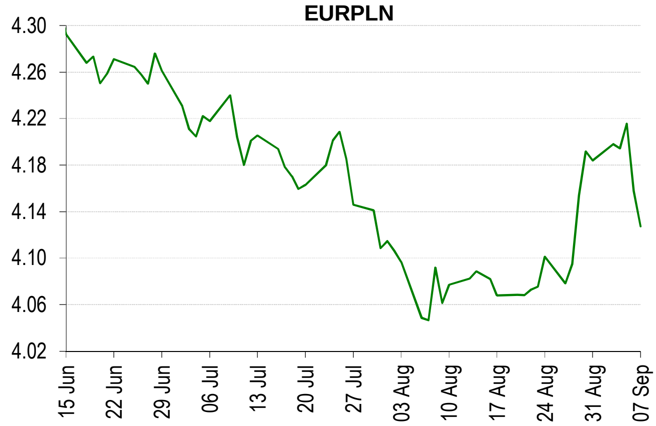
## Quote of the week – Possibility of rate cut is open

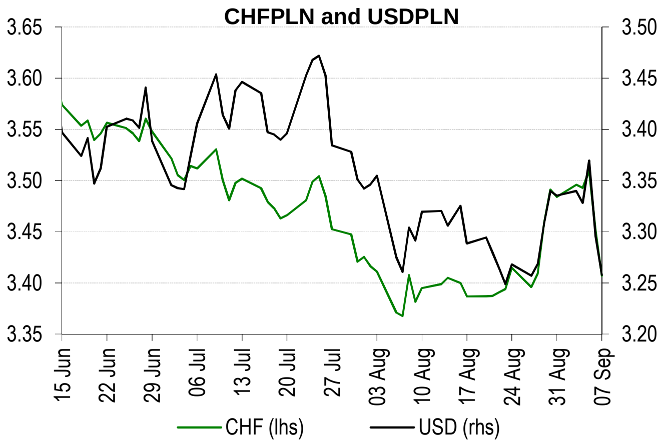
**Statement after MPC decision, 05.09, NBP**
Should the incoming data confirm further weakening of economic conditions, and should the risk of increase in inflationary pressure be limited, the Council will consider adjustment of monetary policy.

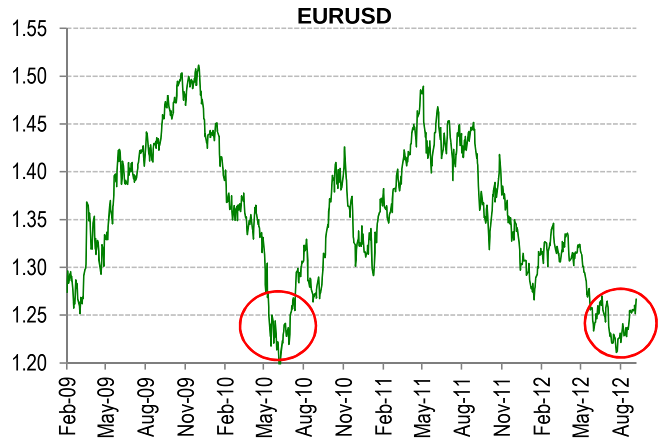
**Marek Belka, NBP President, 05.09, post-meeting MPC conference**
The last sentence of the statement should be interpreted as an opening of possibility of such an event [interest rate cut]. (…) Such a possibility is open. In November we will have a handful of important information, new GDP and CPI projection but this does not mean that we will not have enough information in October already, supporting this negative tendency outlined in the economy. (…) One of the main characteristics of monetary policy is its stability, predictability and no rapid changes. The most important feature of monetary policy is basing it on prospects, on projections.

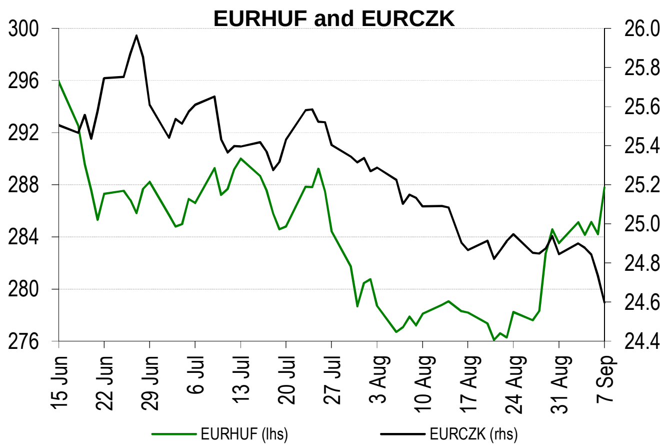
The Council eased tone of its communiqué, but did not change the rates. Well, maintaining July's statement about a possibility of further hikes would be rather ridiculous. On the other hand, a rate cut already at September's meeting would have been fully accepted and justified by current and expected economic developments. Apparently the MPC prefers gradual changes of parameters regardless considerable change of economic outlook since July's meeting. The MPC may find itself in hot water over the rate hike decision taken in May and finally will have to cut rates. Any postponing of this move will not make it more pleasant. Apparently, for the majority of the MPC current inflation is vital obstacle in voting for a rate cut. We would like to stress "most important feature" of the monetary policy mentioned by the NBP Governor– basing monetary policy on medium-term outlook. We can't resist an impression that there is a lack of this element lately.

## **Foreign exchange market** – ECB met market expectations, now it is time for Fed




**Zloty stronger due to decision of MPC and ECB**

- Past week was pretty volatile regarding the EURPLN. As the risk of a rate cut already at September's MPC meeting increased, the zloty depreciated temporarily to nearly 4.22 per euro. Still, at the end of the week there strong recovery occurred as the MPC left rates unchanged. The EURPLN broke first support indicated last week (4.14) and backed additionally by higher risk appetite after ECB decision the exchange rate ended the week close to 4.12. All in all, during two days the of week the zloty recovered by PLN0.1 versus the euro.
- High volatility was also recorded in case of USDPLN. Before the decision of the MPC the exchange rate hovered close to 3.36 while at the end of the was close to 3.25. It is also worth to mention zlotys' appreciation versus the Swiss franc by PLN0.1. That was due to increase of the EURCHF to ca. 1.214 amid rumours of SNB's activity on the market.
- Wide range of trading observed last week in case of the EURPLN did not change the situation on that market. Wide range of 4.10-4.22 is still valid. This week decision of the German constitutional court and Fed's decision will have biggest impact on the zloty.

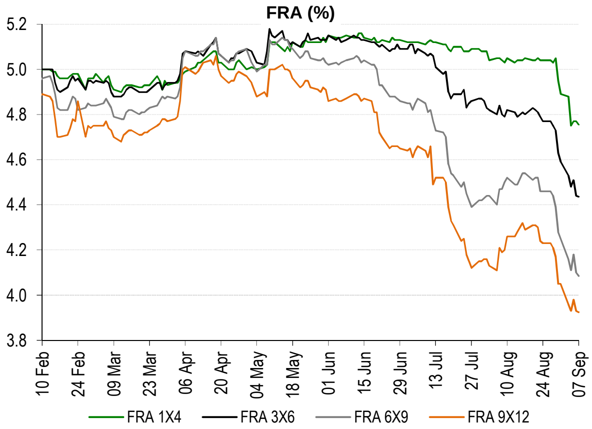
**The EURUSD awaits Fed meeting**

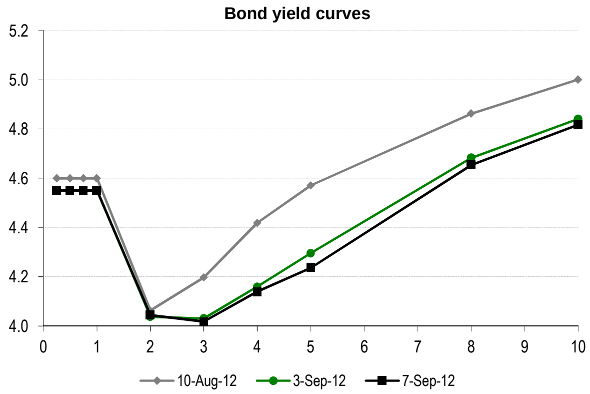
- Since the beginning of the week The EURUSD was stale close to local peak at 1.264. The euro was supported by hopes that this time the ECB will not disappoint and will show details of new bond buying program. The market interpreted conditions of ECB planned activity very well and consequently pushed the EURUSD up. Additionally, monthly US pay-rolls was much weaker than expected and that fuelled expectations for QE3. At the end of the week the EURUSD reached 1.2775, highest level since second half of May.
- Most important events of this week for the EURUSD are decision of German constitutional court and the decision of the Fed. It is worth to notice that currently the EURUSD is close to level seen in August two years ago when Ben Bernanke suggested in Jackson Hole launching QE2. The second round of monetary stimulus was then announced in November and as depicted on the chart, in the following months the dollar was under clear pressure. Even if on the chart the situation is similar, the situation regarding the debt crisis has deteriorated significantly. Even if the Fed does announce QE3 soon, but the moment of launching the ESM will be postponed (and this is only one of existing risk factors) then the single currency does not necessarily have to be sentenced to such visible appreciation versus the dollar as in the past.

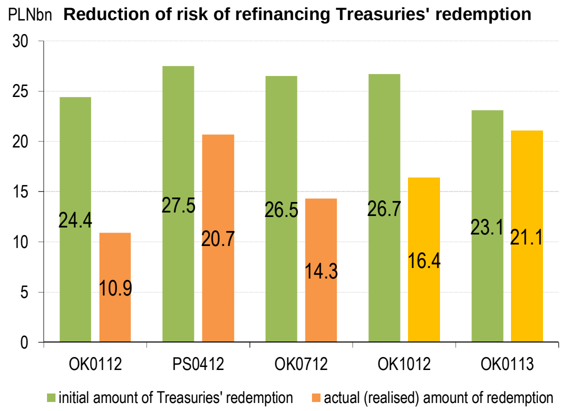
**Weaker forint after decision of Hungarian government**

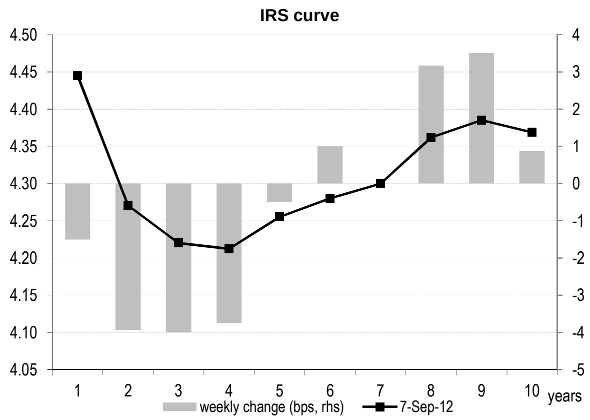
- The forint did not benefit from clear improvement of the global market sentiment that occurred at the end of the week. Hungarian currency was under pressure as national government rejected conditions presented by the IFM in talks about a loan. Consequently, the EURHUF increased on weekly basis from 284 to 289.
- Czech koruna, just like zloty, gained amid improvement of market sentiment. The EURCZK declined temporarily to ca. 24.52, lowest level since April. Since the beginning of Q3 koruna gained 3.6% versus the euro (zloty gained 2.3%, forint lost 0.9%).

## **Interest rate market** – Inflation data supportive for short end of the curve




### Expectations for quick interest rate cuts still present

▪ Wednesday's MPC meeting was the main important event on the interest rate market. Market was pricing-in a cut by 25bps already this month. In period between end of August and Council's decision FRA rates declined by 11-14bps, with 1x4 posting the most considerable decrease (to 4.75%, the lowest since October 2011). However, decision to keep rates on hold caused a corrective move of FRA rates (by 2-7bps). This move proved to be short-lived and end of the week brought a further decline of these rates.

▪ WIBOR 3M and longer tenors continued their gradual decline. In weekly terms rates slid by 2-3bps, with 6M falling below 5.0%.

### Bullish steepener still valid

▪ Expectations for September's cut of interest rates provided a strong impulse for the yields to decline along the curve. Prior to the Council's decision, yield of 2Y benchmark fell below 4.0%, reaching the new this year's minimum (but also all-time low) at 3.98%. However, this decline proved to be short-lived and after the MPC decision (in spite of easing of the tone of communiqué), yields returned above 4%, stabilising slightly below 4.05%.

▪ Last week was made by 5Y bonds. In weekly terms yields of this paper declined by 15bps to 4.20% (and reached the all-time low), but this move was partially corrected on Friday. It is worth noting that investors purchases also 5Y benchmark with 4.18% yield during the auction. Currently 5Y bonds is representing the shorter end of the curve as 2Y lacks in offer. As a result, the last week has brought a further narrowing of 2-5Y spread to 17bps from ca. 30bps at the end of August.

▪ IRS rates also fell along the curve, but weekly changes were less considerable than in case of bonds. Rates from the shorter end gained by most (by ca. 4bps), thus causing a continuation of 2-10Y spread widening.

▪ Switch auction proved to be a huge success of the Finance Ministry. The resort bought back OK1012 and OK0113 bonds worth PLN5.78bn, reducing this year's redemptions by PLN3.8bn. High demand for WZ0117 bond can be a sign of active participation of domestic banks in the auction.

### Inflation data to support the shorter end

▪ We have an interesting week ahead, with a lot of events and macro data releases. As regards domestic market, investors' concern will be focused on August CPI inflation reading. Materialisation of our scenario (decline to 3.7%YoY) can deliver a support for the shorter end of the curve (FRA, IRS and bonds). Yields of 2Y bond may again test support at 4.0%.

▪ Changes of yields at the longer end of the curve will be mostly dependent on situation on the core market. After release of technical details of euro zone peripheries' bonds purchase programme the investors will be awaiting decision of the German constitutional court about the ESM (12.09), which can introduce some uncertainty to the market. Key support for yields of 10Y bond are at 4.80%, with another at 4.75%. We cannot rule out profit-taking at these levels.

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