Bank Zachodni WBK

Weekly economic update

17 – 23 September 2012

Last week was rich in important decisions, which may be limiting potential for a marked rise of risk aversion for a couple of weeks. The US central bank stepped in and announced a long-awaited third round of quantitative easing (QE3) one week after the ECB decision, which considerably improved the market sentiment. Fed plans to purchase mortgage-backed securities (MBS) worth USD40bn on a monthly basis (until US labour market situation improves), maintain so-called Operation Twist (this operation will continue until the year-end) and to keep interest rates on exceptionally low levels until mid-2015 (slightly longer than previously announced). Moreover, German constitutional court opened the door for ESM ratification, while in Netherlands a euro-sceptical party recorded a drop in support during general election. Recent weeks have significantly reduced number of risk factors for the global financial markets. The threat of marked fiscal tightening (fiscal cliff) in the USA in 2013 is still valid, but in our view both main parties have interest in solving this issue successfully. Additionally, according to rumours from the IMF, Greece may need another (third) bailout.

In spite of a considerable improvement of investors' moods, data from the real economy are (and will be) weak. This week will see releases of flash PMI indices for the main economies, data of US housing market data and German ZEW index. In our view, they will show that economic revival is still a rather distant prospect. At the beginning of the week the market may focus on results of euro zone finance ministers' meeting. We will also see a row of figures from the domestic economy and minutes from September's MPC meeting. In our view, data from the Polish economy will be weak and will deliver further arguments for the MPC to cut interest rates already in October, which is our baseline scenario. Improvement of market sentiment after central banks' decisions has supported demand for risky assets, including the zloty. We think that a test of local minimum at 4.026, or even 4.00 by the EURPLN exchange rate cannot be ruled out, but a consolidation in 4.05-4.10 is a more probable scenario. As regards debt market, the upcoming data from real economy should support the front end of the curve, strengthening expectations for cuts in October.

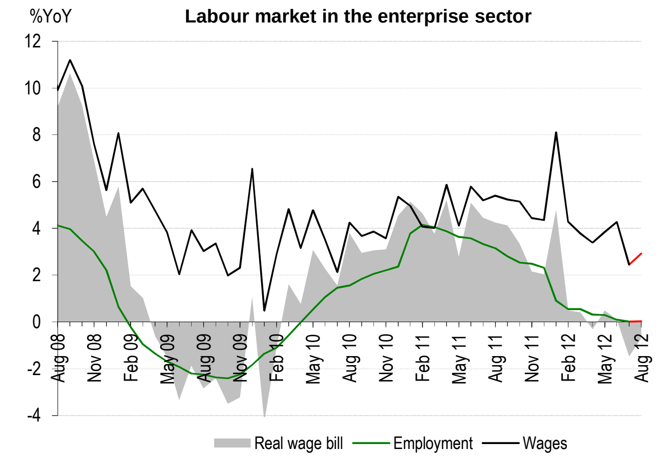
Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 September)					
		No important data releases					
		TUESDAY (18 September)					
11:00	DE	ZEW index	Sep	pts	-19.0	-	-25.5
14:00	**PL**	**Wages in corporate sector**	**Aug**	**%YoY**	**3.1**	**2.9**	**2.4**
14:00	**PL**	**Employment in corporate sector**	**Aug**	**%YoY**	**0.0**	**0.0**	**0.0**
		WEDNESDAY (19 September)					
11:00	**PL**	**Bond auction**					
14:00	**PL**	**Industrial output**	**Aug**	**%YoY**	**1.9**	**1.9**	**5.2**
14:00	**PL**	**Construction and assembly output**	**Aug**	**%YoY**	**-8.2**	**-5.6**	**-8.8**
14:00	**PL**	**PPI**	**Aug**	**%YoY**	**3.0**	**3.0**	**3.7**
14:30	US	House starts	Aug	k	760	-	746
14:30	US	Building permits	Aug	k	792	-	811
16:00	US	Home sales	Aug	m	4.55	-	4.47
		THURSDAY (20 September)					
4:30	CN	Flash PMI – manufacturing	Sep	pts	-	-	47.6
9:28	DE	Flash PMI – manufacturing	Sep	pts	45.3	-	44.7
9:58	EZ	Flash PMI – manufacturing	Sep	pts	45.5	-	45.1
14:00	**PL**	**Core inflation**	**Aug**	**%YoY**	**2.0**	**2.0**	**2.3**
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k		-	382
16:00	US	Leading indicators	Aug	%MoM	-0.1	-	0.4
		FRIDAY (21 September)					
		No important data releases					

Source: BZ WBK, Reuters, Parkiet

Maciej Reluga Chief economist +48 22 586 8363 e-mail: ekonomia@bzwbk.pl
Piotr Bielski +48 22 586 8333 **Marcin Sulewski** +48 22 586 8342
Agnieszka Decewicz +48 22 586 8341 **Marcin Luziński** +48 22 586 8362

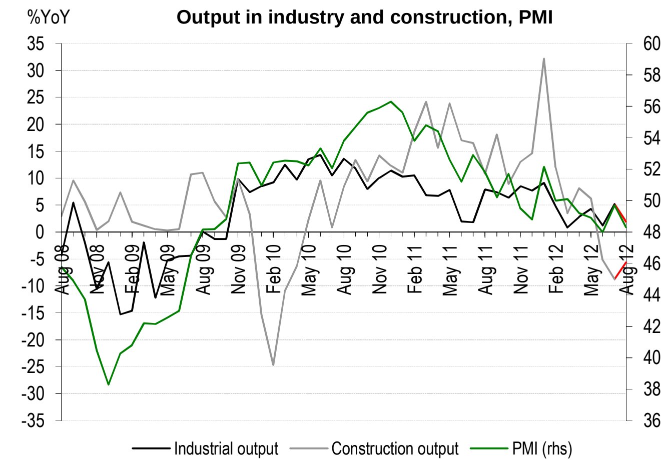
What's hot this week – Further signals of economic slowdown



▪ A bunch of domestic economic data due for release this week should help the MPC to cut interest rates at the upcoming meeting.

▪ We expect that employment in corporate sector declined in August (and its annual pace of growth maintained at zero). This, accompanied by a moderate (and negative in real terms) growth rate of wages will confirm that there is surely no improvement on the labour market and thus no threat of expanding inflationary pressure.

▪ This will also be showed by following readings of inflation indicators – decline of PPI to 3%YoY (lowest in more than two years), reflecting decreasing cost pressure on enterprises, and fall of core inflation excluding food and energy prices to 2.0%YoY (lowest in 1.5 years).

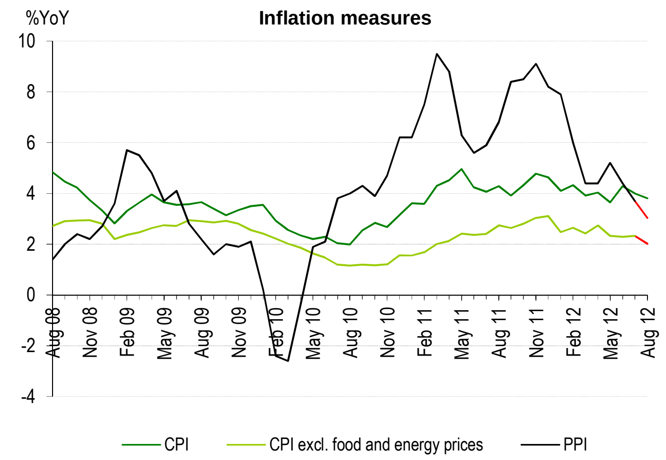


▪ After a temporary rebound in July, mainly caused by favourable calendar effects, industrial output most likely decelerated in August, affected by declining domestic and foreign orders (which is showed by the PMI report).

▪ Troubles of construction companies and halt of infrastructural investments mean that one should expect deep drops of construction and assembly output (even though our forecast is one of the most optimistic on the market).

▪ After Friday's unofficial Reuters information that two hawks (Zyta Gilowska and Jan Winiecki) did not attend the September's MPC meeting, minutes for this sitting may show some interesting hints about the discussion.

Last week in the economy – Drop of inflation, (temporary) rebound in foreign trade



▪ CPI inflation fell in August to 3.8%YoY, more or less in line with expectations. The drop was partially due to high base effect (hikes of telecommunication services prices in August 2011). We expect the inflation to rise again to ca. 4% in September, while a more persistent downward trend will begin in the following months and will bring CPI down to 3% in December and to inflation target at 2.5% and the end of 2013Q1.

▪ Annual pace of growth of exports and imports rose in July (to 12.7%YoY and 4.2%YoY, respectively). However, this was mainly due – similarly as rebound in industrial output – to temporary factors (e.g. low base) so we expect a return to downward path in the upcoming months. Some hints about prospects of exports will be delivered by August's results of industry.

Quote of the week – Interest rate cuts are justified

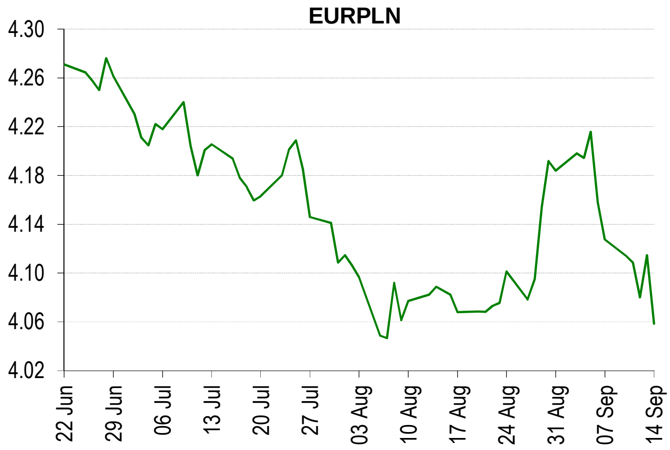
Andrzej Bratkowski, MPC member, 13.09, Reuters
In my opinion there is a high change that colleagues will decide for cuts this year, but I do not know when (…). My colleagues are not really eager to do any radical moves.

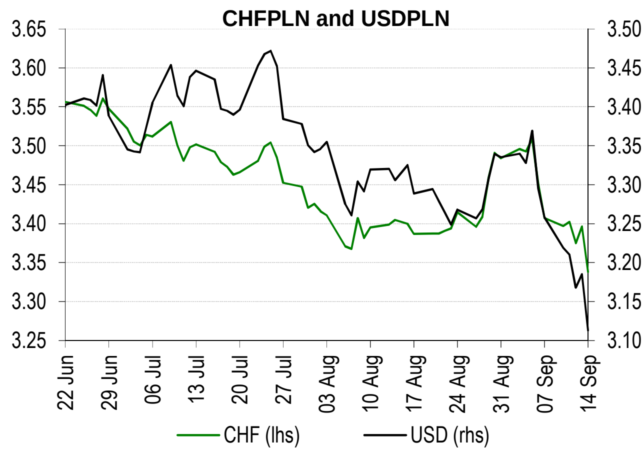
Elżbieta Chojna-Duch, MPC member, 13.09, Reuters, TVN CNBC
The Council should act pre-emptively and such a pre-emptive interest rate cut in October would be justified.

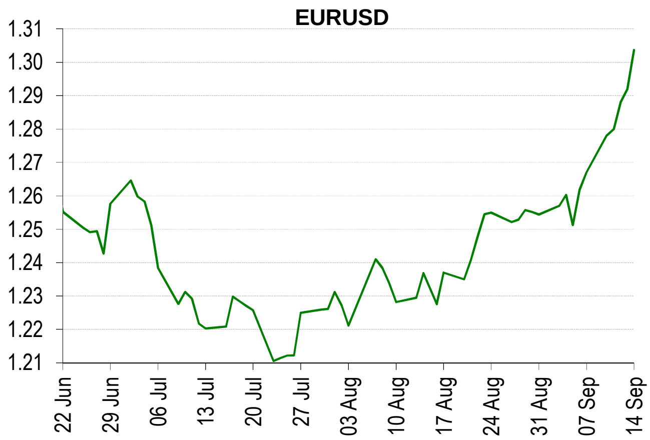
At the beginning of H2 I thought that more moderate and distributed in time cuts would be reasonable (…) now, as negative data from many economic sectors are confirmed, I think that the decision should be more radical. [50bps cut] is one of possible moves. (…) As for the time being, one deeper cut would be justified.

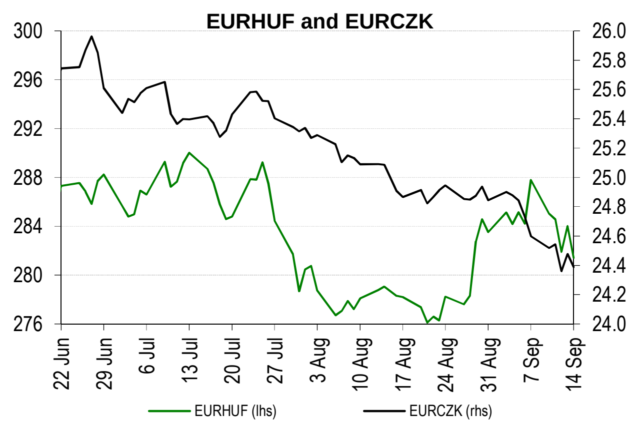
Last week Andrzej Bratkowski and Elżbieta Chojna-Duch again reiterated that interest rate cuts are justified in their opinions. Comment of A. Bratkowski is suggesting that majority to support interest rate cuts is building up in the MPC, but one should not expect a move stronger than 25bps, even though a more decisive action (50bps) can possibly be supported by E. Chojna-Duch. We also agree with Elżbieta Chojna-Duch that the MPC should act pre-emptively. In our view cut would actually be pre-emptive if implemented in October, but… October 2011. As regards this matter, we are closer to view of A. Bratkowski, who said recently that the Council is already late with cuts.

Foreign exchange market – The central banks' action supports zloty and other region currencies









Zloty strenghtened due to central banks' action

- Last week the zloty was under pressure of external factors. Prior to the Fed decision the EURPLN was traded between 4.07-4.12, strongly depending on news flow. Market uncertainty ahead of Fed decisions caused the EURPLN to stay near the lower level of the trading range.
- Fed's announcement of its QE3 action has supported risk-on mood on the financial markets. Zloty strengthened in relation to the main currencies (more against the US dollar than the euro) due to higher risk appetite. The EURPLN at the beginning of Friday's session tested support level at 4.05 (down from ca. 4.10 at the end of Thursday's session), reaching the weekly minimum at 4.047. We expect that a break of 4.05 will open the room to decline towards 4.026, local minimum from the beginning of August.
- Recent central banks' decisions (ECB, Fed), but also the German Constitutional Court verdict about the ESM have intensified appreciation trend of emerging markets currencies, including the Polish zloty. Notwithstanding, risk factors, with the situation in Greece at the first place are still valid (Troika will present its report about Greece at turn of September-October). We do not exclude the EURPLN to test 4.00, but a consolidation between 4.05-4.10 in coming days is a more probable scenario.

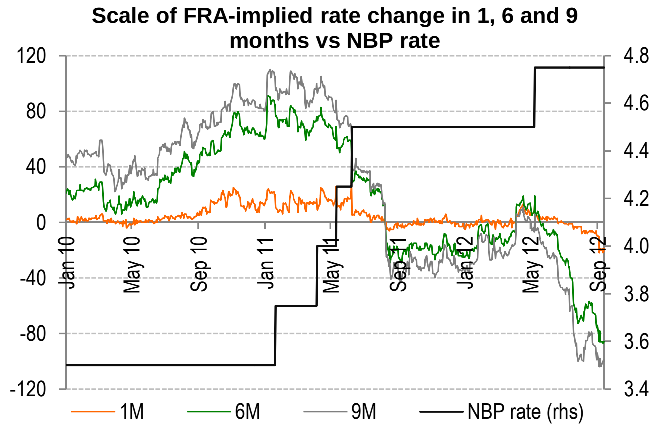
EURUSD is heading north

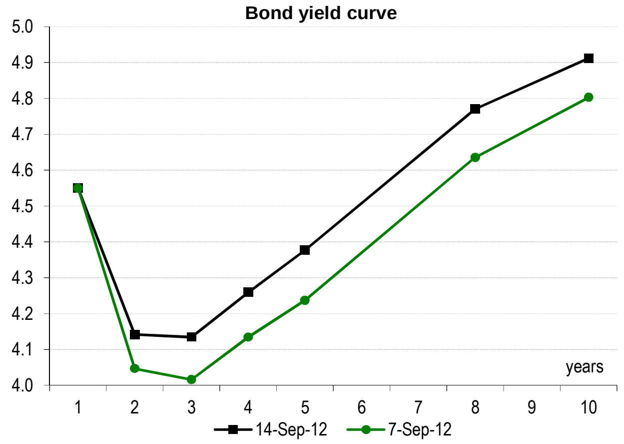
- Main events of the last week (decision of German constitutional court, Fed) have supported the single currency. Information that Greece may need another bailout only temporarily "disrupted" the march towards north. The EURUSD exchange rate, after consolidation in 1.28-1.29 range (with tests of both lower and upper border) broke 1.30 after the Fed decision to launch another, third quantitative easing (QE3) programme. The rate tested 1.31 during Friday's session, session peak was at 1.312.
- EURUSD is continuing its upward trend for a fifth week in a row. A similar situation occurred last time in 2010, after Bernanke's suggestions about QE2. An important resistance for EURUSD is located at 1.314. Break of this level would open door towards 1.34.
- The Swiss central bank (SNB) meeting was another important event of the last week. SNB maintained floor for the Swiss franc at 1.20 per euro, sticking to its declaration to purchase unlimited amounts of foreign currencies. This means that rumours that the SNB planned to raise floor to 1.22 or even 1.25 were not confirmed. After this decision EURCHF remained slightly above 1.21.

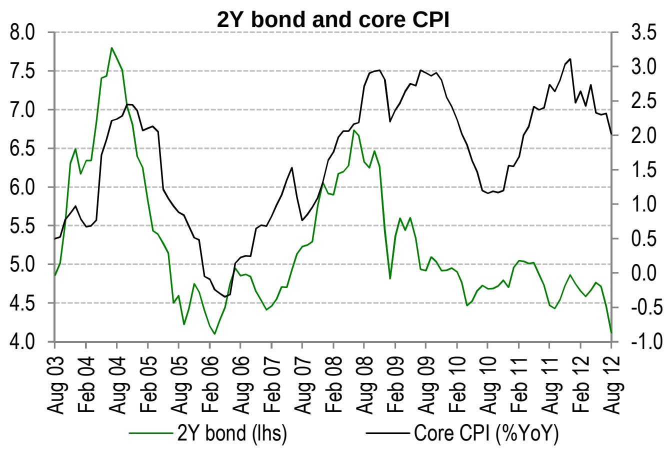
Strengthening of CEE currencies

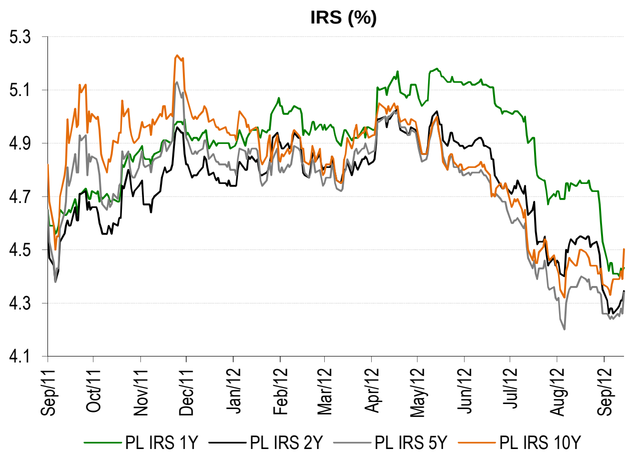
- CEE currencies, similarly as the zloty, were gaining over the last week. EURHUF descended to 281 from ca. 288 at the end of the previous week. At the same time, Czech koruna strengthened against the euro, with EURCZK sliding from 24.60 to ca. 24.42. In weekly terms most considerable gains were posted by the forint (0.8%), while the zloty and the Czech koruna strengthened by 0.7% versus the single currency.
- In the upcoming days, the CEE currencies will remain under influence of external factors. We do not rule out a short-term profit-taking after a considerable strengthening over the course of last days. A key support for EURCZK lays at 24.40 and for EURHUF at 280.

Interest rate market – Minutes and macro data may support the shorter end of the curve









WIBOR and FRA without major changes

▪ WIBOR and FRA rates remained relatively stable during the past week. Money market rates declined slightly (by 1-2bps for 3-12M). Data on domestic CPI had no impact on the market.

▪ Currently FRA market prices-in a rate cut by 25bps in October with probability of ca. 75%. Whole cycle of monetary policy easing shall bring NBP rates – according to investors – down to 3.75% in coming 9 months. In our view the MPC will cut rates by 75bps and thus the room for further decline of longer FRA (9x12, for example) is currently rather limited. On the other hand, we see some potential for a more marked decline in case of short term FRA (1x4) and the impulse may be provided this week by data on industrial output (as they will show deceleration versus July's level) and release of minutes from last MPC meeting. In our opinion there has been at least one voting on rate cuts in September and if our suspicion proves correct this publication may strengthen expectations that the Council will cut rates as soon as next month.

Domestic bonds weaker despite Fed's decision

▪ Polish bonds weakened quite visibly after announcement of decision of German Constitutional Court on the ESM. Yields on the middle and long end of the curve increased by ca. 6-7bps, also the trade volume picked up. Such a marked reaction on news from Germany might have been to some extent related to further appreciation of Spanish and Italian debt amid decision on ESM. Yields of Spanish and Italian bonds are clearly higher than domestic ones (in case of 10Y these are 5.6% and 5.0%, respectively) and perhaps hopes for stabilization of situation on the peripheral debt market prompted investors to switch toward higher yielding debt. At the end of the week bonds recovered lightly due to Fed's decision.

▪ The IRS curve flattened slightly as short term rates did not recover after an increase triggered by decision on the ESM.

Industrial output and MPC minutes

▪ The chart with the 2Y yield and core CPI shows that since the beginning of financial crisis price developments were not the most important factor for the bond market. Additional support for Polish debt was provided by lower supply from the FinMin. Release of data on core CPI excluding food and energy prices shall not have much impact on the market, data on industrial output will be much more important. We anticipate that the data due for release this week will support market expectations for a rate cut already in September and will underpin 2Y bond. In the following weeks yield of 2Y bond may decline below 4% for a longer period amid next rate cuts by the MPC. Relying on comments of Bratkowski and Chojna-Duch we expect minutes from September's Council meeting to show that there has been at least one motion for a rate cut presented. That shall support short end of the bond and IRS curve.

▪ This week the FinMin will offer DS1021, WZ0121 and IZ0823 bonds, final supply will be shown on Monday and will rely on market situation. Until now, the ministry has already sold DS1021 worth PLN20.9bn, WZ0121 worth PLN19.5bn and IZ0823 worth PLN6bn.

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