

Weekly economic update

1 – 7 October 2012

Moods on the global markets were quite volatile during the last days. After an initial rise of pessimism about prospects of economic growth and efficiency of rescue actions in the euro zone, a moderate optimism returned at the end of the week, among others thanks to approvals of new austerity measures in Spain and France. Expectations about decisions of the Polish Monetary Policy Council were rallying to a similar tune - comments of the hawkish MPC members initially calmed expectations for cuts, showing that the recent weak macro data did not impress them much, but an interview with the NBP president caused another wave of expectations that rates will be reduced as early as in October.

Direction for the sentiment of global investors will be set in the upcoming days by other important macroeconomic data, including monthly report from the US labour market and activity indices for manufacturing and services, showing the trend of economic climate in world's main economies. Investors will also focus on actions of central banks - meeting of ECB, Bank of England and MPC are scheduled for this week, Fed will release its minutes of the meeting when QE3 was launched. As for domestic market, result of the MPC meeting is the key event. A vast majority of market analysts expect a rate cut and we belong to this group. In our view such a decision will be justified, though we are aware that the result of voting is not prejudged and gathering the majority among MPC members may not be easy. We maintain our forecast that NBP rates will be reduced by 50bps until the end of the year and if this does not happen this week, we expect rates to be cut in November and December. In case of an interest rate cut, short end of the bond and FRA curves may decline further amid expectations for further easing of monetary policy. Still, there is a room for some (temporary) correction of the zloty's exchange rate and yields on the long end of the bond curve. Some bigger correction on the interest rate market may occur if NBP rates remain unchanged this week.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (1 October)							
9:00	PL	PMI – manufacturing	Sep	pts	47.9	47.6	48.3
9:53	DE	PMI – manufacturing	Sep	pts	47.3	-	44.7
9:58	EZ	PMI – manufacturing	Sep	pts	46.0	-	45.1
16:00	US	ISM – manufacturing	Sep	pts	49.8	-	49.6
TUESDAY (2 October)							
No important data releases							
WEDNESDAY (3 October)							
	PL	MPC decision		%	4.50	4.50	4.75
9:53	DE	PMI – services	Sep	pts	50.6	-	48.3
9:58	EZ	PMI – services	Sep	pts	46.0	-	47.2
11:00	EZ	Retail sales	Aug	%MoM	-0.1	-	-0.2
14:15	US	ADP report	Sep	k	135	-	201
THURSDAY (4 October)							
11:00	PL	Bond auction					
13:00	GB	BoE decision		%	0.5	-	0.5
13:45	EZ	ECB decision		%	0.75	-	0.75
14:30	US	Initial jobless claims	week	k	-	-	359
16:00	US	Industrial orders	Aug	%MoM	-1.9	-	2.8
20:00	US	Fed minutes					
FRIDAY (5 October)							
12:00	DE	Industrial orders	Aug	%MoM	-0.6	-	0.5
14:30	US	Non-farm payrolls	Sep	k	120	-	96
14:30	US	Unemployment rate	Sep	%	8.2	-	8.1

Source: BZ WBK, Reuters, Parkiet

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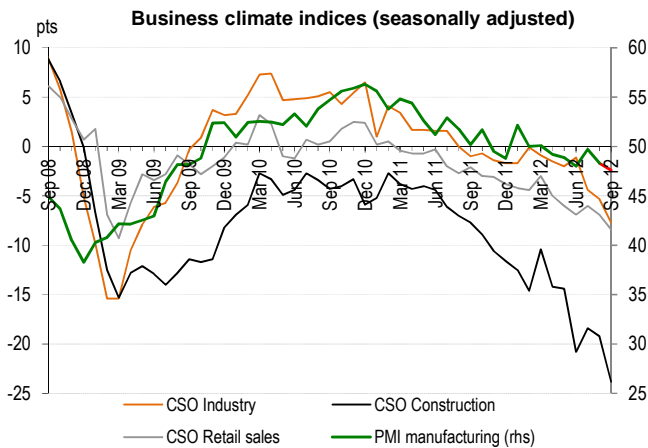
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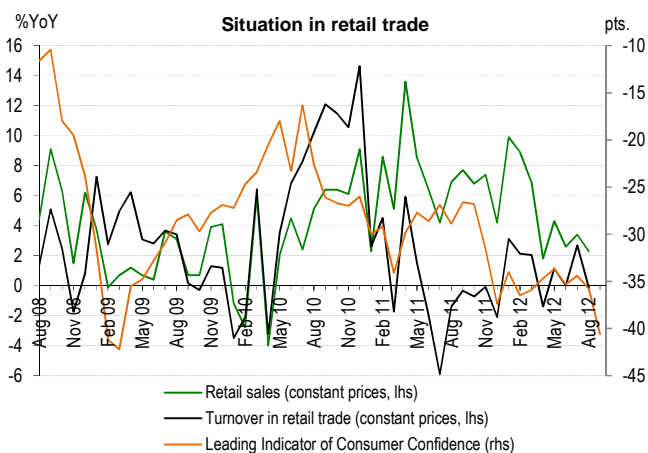
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What's hot this week – Rate cut now or in November?

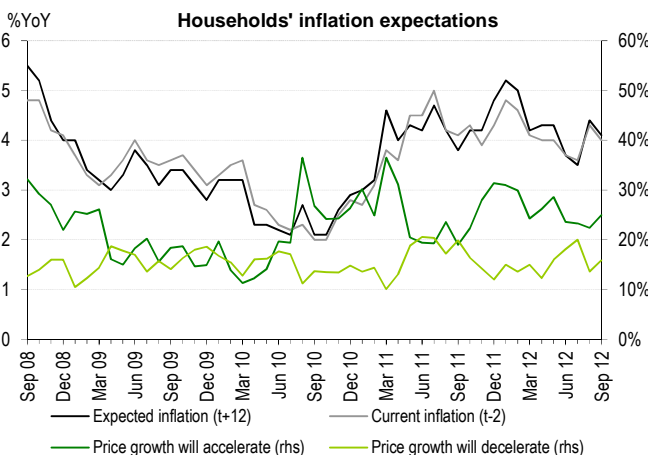


- Will the MPC follow suit of other CEE central banks (Czech Republic, Hungary) and cut interest rates this week? In our view it definitely should. However, even though the NBP president is most probably ready for such a decision and one of the hawks (Z. Gilowska) will be missing on the upcoming meeting, it will be difficult to gather a majority for a cut (5 votes), as some MPC members seem clearly unimpressed by recent weak macro data. If the Council does not cut rates now, it will surely do it in November, as the upcoming macro data (for Sep) will be really bleak.
- The PMI index is probably going to confirm declining activity in manufacturing in September. CSO economic climate indicators recorded another month of strong declines in all sectors, with most considerable falls in construction (worst ever) and trade (close to trough from 2009).

Last week in the economy – Retail sales decelerate, unemployment rises



- Retail sales growth decelerated in August to 5.8%YoY in nominal terms and to 2.3%YoY in real terms. Biggest drag on sales was put by poor demand for autos (-9.5%MoM, -2%YoY). Still, even in other categories the deceleration of consumption demand growth is visible – according to our estimates, retail sales ex autos and fuels rose 3.8%YoY (the same as in July, less than in previous two months). Additionally, data on turnover in retail trade (which in contrast to retail sales data include also units hiring less than 9 employees and do not cover some categories, e.g. car sales) showed that consumers' demand stagnated – annual growth is close to zero. Deteriorating consumer confidence, declining real incomes and uncertainty about employment prospects will be constraining upward momentum of consumer demand in the upcoming months and quarters.



- The unemployment rate rose to 12.4% in August, which is rather untypical as for this month and is confirming that the labour market situation is gradually deteriorating.
- Inflation expectations of households declined slightly in September to 4.1% (from 4.4% in August), which is mainly due to a decrease of headline inflation figure, being a base of the index calculations (answers' breakdown was similar as is the previous month).
- Monetary policy guidelines for 2013 did not bring any important changes as compared to earlier editions. It is worth noting that in the MPC's view the inflation expectations in Poland are not anchored enough, which can affect the MPC decisions.
- Quarterly data on BoP showed considerable revisions of last years' data – current account deficit for 2010 and 2011 jumped by 0.5% of GDP.

Quote of the week – We are in for some cycle of monetary policy easing

Marek Belka, NBP president, 26.09, PAP

Now the MPC has to choose a direction for its monetary policy and this is quite obvious that this will be a downward move. Moreover, it will not be a one-off action but rather a cycle. I think that market members should take into consideration such a scenario: we are in for some cycle of monetary policy easing

Anna Zielińska-Giębocka, MPC member, 25.09, TVN

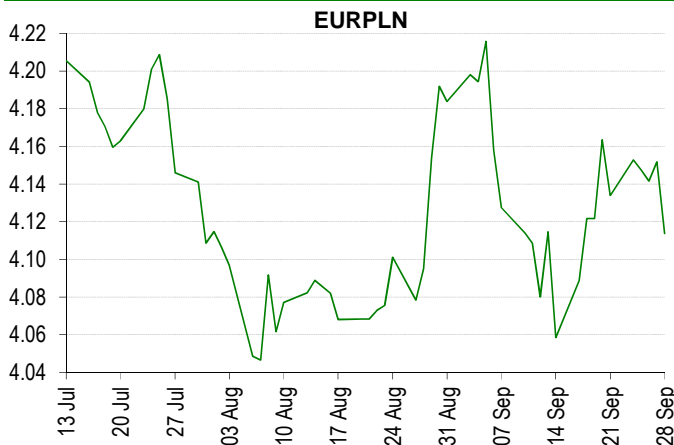
Yes, we surely will consider [possibility of monetary policy easing in October] but this does not mean that we will make such a decision.

Adam Glapiński, MPC member, 27.09, Reuters

I see no reasons to start an interest rate cuts cycle. Inflation is stabilising on a high level with an upward potential in the upcoming year. In my view the MPC should adopt a 'wait and see' strategy and stabilise rates by the end of this year

Last week has brought a break-through in the MPC members' comments. The NBP president Marek Belka clearly suggested that monetary policy easing cycle is likely to begin. This means that there are three MPC members eager to support cuts (Bratkowski, Chojna-Duch, Belka). Kaźmierczak and Glapiński suggested recently that they are still against. In our view Winiecki, Rzońca and Gilowska are of similar opinion. They will probably change their minds when they will see a considerable easing of inflation, which is likely to come in a few months' time. Absence of Gilowska at the upcoming meeting does not change the simple fact that you still need 5 votes to implement a cut. Even though Zielińska-Giębocka suggested that she may support such a decision, Hausner's point of view is still unknown.

Foreign exchange market – Zloty under influence of global factors and the MPC meeting



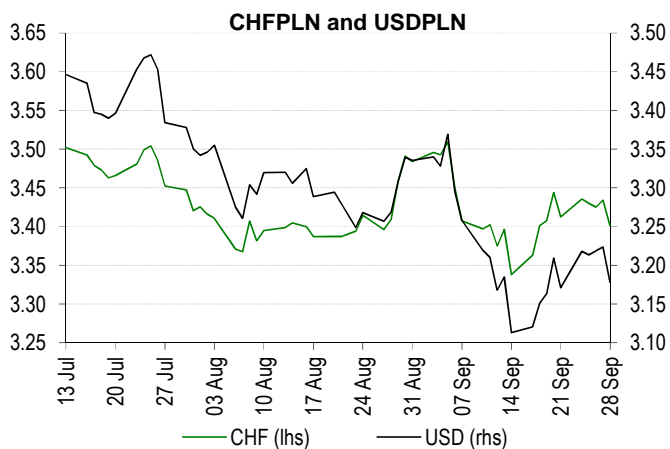
Zloty gained due to global mood improvement

▪ Zloty was under influence of negative investors' sentiment on the global market at the beginning of the week. Prospects of lower interest rates (especially after the NBP's governor statement, announcing monetary policy easing cycle) also negatively affected domestic currency. As a consequence EURPLN increased towards 4.16 (but that level effectively stopped zloty depreciation against the euro). In the following days, due to global mood improvement (after weaker than expected the US macro data), zloty has started strengthening, with the EURPLN declining to 4.10.

▪ As previously, changes of USDPLN were much higher than of EURPLN. The downward move of EURUSD towards 1.28 caused a sharp zloty depreciation to 3.234 against the US dollar (the highest level since the beginning of September). But after EURUSD increased above 1.29, the exchange rate came back to 3.17.

▪ The zloty is mainly staying under influence of global factors, but the MPC decision about interest rates may also be of importance for the domestic currency. The expected by us monetary policy easing can generate a move towards 4.16 per euro. However, the zloty weakening may be rather short-lived, as it will be limited by strong foreign demand for domestic debt.

▪ No important changes occurred on the EURPLN chart, probable oscillations range is still 4.05-4.20. Due to a high uncertainty we think that the rate may remain above 4.10.

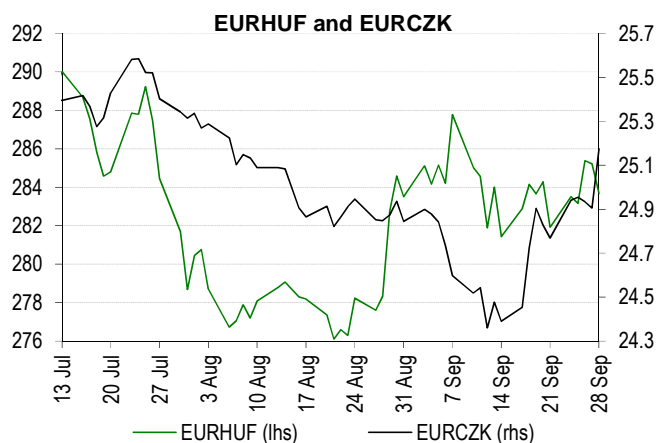
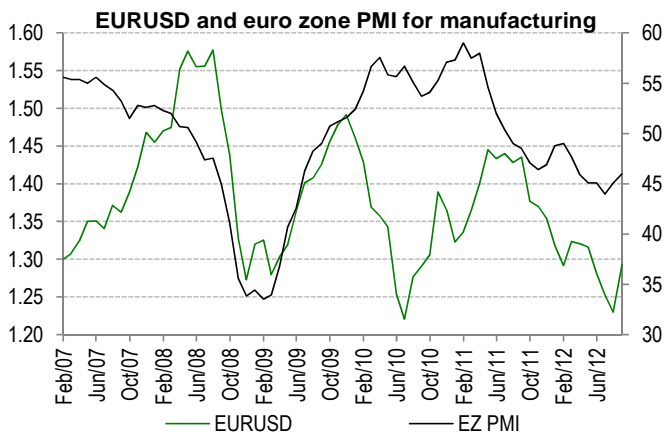


ECB decision and US labour data crucial for EUR

▪ First half of the week has brought a weakening of single currency, which was due to a release of weaker-than-expected Ifo index. Uncertainty about further developments of situation in Spain (expectations about releases of draft budget for 2013, stress-tests' results and Moody's decision) has also put a negative pressure on the euro. As a result, EURUSD fell to 1.284 in the first half of the week.

▪ The weaker-than-expected macro data from the USA (disappointing final GDP in Q2 and a deeper decline of durable goods orders) and positive market reaction to plan of reforms in Spain have supported the euro. Thanks to these developments, the EURUSD exchange rate climbed above 1.29 again.

▪ We have a very interesting week ahead, with ECB meeting, US labour market data and PMI for Germany and the euro zone. Resistance and support for this week are 1.284 and 1.300, respectively.



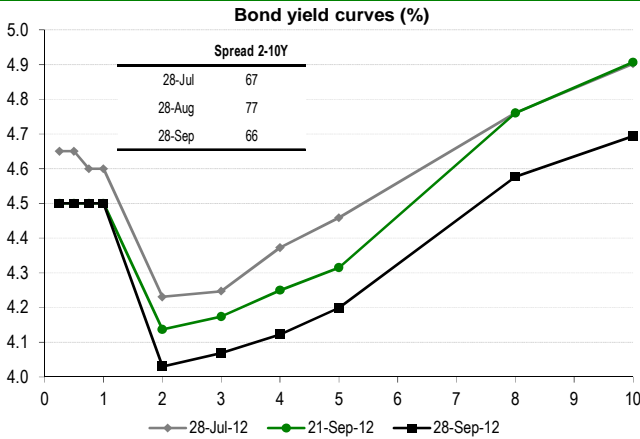
Central banks' decision weakened the CEE currencies

▪ The most important events of the past week on the CEE markets were central bank meeting in Hungary and in the Czech Republic. In both cases rates were cut (by 25bps, to 6.50% in Hungary and 0.25% in the Czech Republic (the lowest level in history).

▪ Decisions to reduce rates in Hungary and in the Czech Republic contributed to weakening of these countries' currencies. The EURCZK exchange rate climbed above 25 (with a peak at 25.18), while EURHUF rose above 285. However, the weakening of the Hungarian currency was limited by release of balance of payments data for Q2, showing a higher surplus than expected.

▪ As for this week, we expect EURHUF to oscillate in 280-286 range, while EURCZK may consolidate between 24.90 and 25.20.

Interest rate market – Attention focused on the MPC

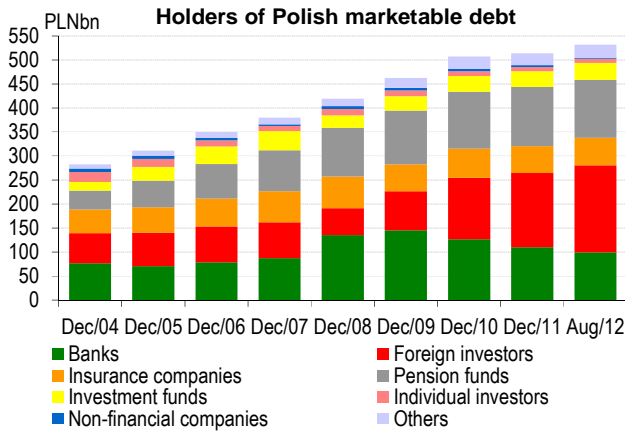


FRA bolder in pricing-in rate cuts

- Strengthening of expectations for rate cuts as soon as at the nearest MPC meeting dragged FRA rates down by 5-7bps. Still, lows established after disappointing GDP data for Q2 in late August were not reached.
- Consequently, after a few days of correction, the market does again price-in 100bps rate cut in next 9 months.

Mid- and long-term debt benefits thanks to Bunds

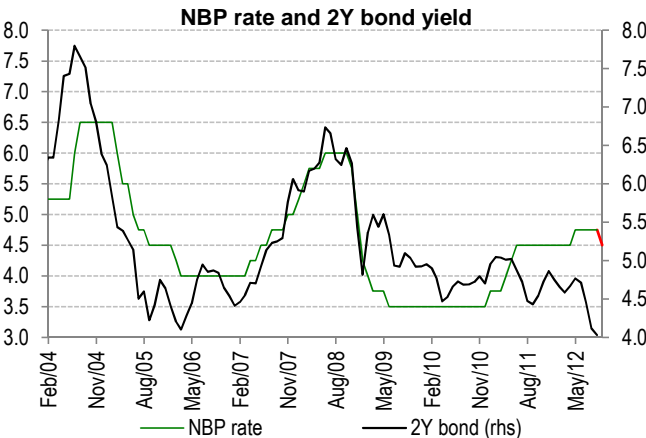
- Polish bond yield curve flattened during the past week due to clear strengthening of 5Y and 10Y debt. Downward trend of yields was fuelled by words of NBP governor and by visible gain of 10Y Bunds recorded last week. Additionally, the end-of-quarter effect mentioned by us last week also provided some support for Polish debt by investment funds. Consequently, yield of 10Y bond declined to lowest level since Q1 2006 (to 4.69%) and 5Y yield reached 4.17% (lowest in history).



- IRS also declined but at smaller scale than recorded on the bond market. As a result, the asset swap spread for 10Y sector broke the support at 40bps and at the end of the week was close to 34bps (vs. 46bps a week ago).

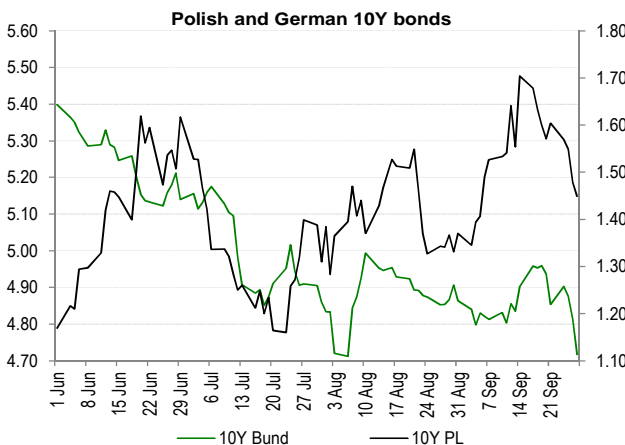
- The Finance Ministry informed that in Q4 it will offer bonds worth PLN10-18bn (but additional auctions are probable, depending on market situation). This week, investors will be able to buy WZ0117, WZ0121 and/or PS0417 worth PLN3-5bn. A new 10Y benchmark (DS1023) will be offered at the end of the month.

- The Finance Ministry data show that at the end of August foreign investors were holding marketable zloty-denominated securities worth PLN180.2bn, i.e. the most in history (as compared to PLN177.4bn in July). This means that they increased their share in marketable bonds to almost 34.5% (with pension funds taking the second place with 22.9%).



MPC decision in the spotlight

- This week MPC decision on interest rates will be crucial. We expect there will be a majority to cut NBP rates by 25bps.
- After disappointing data on GDP growth in Q2 the 3M WIBOR declined by 15bps in the following days. Currently, FRA market prices-in rate cuts by 50bps in 3 months. If the MPC cuts the interest rates and if 3M WIBOR declines by next ca. 10bps (in order to fully price a rate cut) then the scale of priced rate cuts falls. We expect the MPC to give a hint on possible further cuts – just like NBP governor suggested last week – and thus despite FRA market prices-in rate cuts pretty aggressively we see some room for a further decline of these rates, at least in the short-term.



- Similar situation may be observed on the short end of the bond curve. 2Y debt has already priced-in rate cuts for a couple of months. Even though (just like in case of the FRA market) expectations for easing of monetary policy are pretty aggressive and yields are not that attractive as earlier, we see some room for even lower yields of 2Y bond. On the other hand, last visible gains and no more support from end-of-quarter effect may encourage investors to take some profits.

- On the middle and long end of the curve decision of the MPC may have smaller effect. It is worth to notice that in the past week situation on the 10Y Bund market supported Polish long term debt. This relationship may continue to persist also this week.

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