

Weekly economic update

14 - 20 September 2009

The past week in the Polish financial market was marked by negative news about the 2010 budget, which led to clear depreciation of the zloty (EURPLN close to 4.20) and substantial rise in bond yields. This took place despite higher risk appetite in the global markets, reflected in EURUSD rise to the highest level this year (above 1.46) and fall in prices in the core debt markets. On Friday, the zloty was negatively affected by NBP data, which showed C/A gap of ca. €0.5bn in July instead of an expected surplus of over €0.2bn. This was due to trade gap of around €0.5bn, high deficit on the income account (mainly as a result of dividend payments) and low surplus in the current transfers (not much flows from the EU). Exports fell deeper than expected while imports level was higher than in previous months. This week the zloty may still weaken due to fiscal news (EURPLN likely above 4.20), although continuation of increased risk appetite may prevent it. Yields of local bonds should rise further, but they may be supported by weaker than expected (in case of most variables our forecasts are below consensus) domestic macro figures.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST VALUE
				MARKET	BZWBK		
MONDAY (14 September)							
11:00	PL	Auction PLN 0.8-1.0bn of 52-week Treasury Bills					
11:00	EZ	Industrial output	Jul	%YoY	-16.6	-	-17.0
14:00	PL	Money supply M3	Aug	%YoY	10.1	10.2	11.7
TUESDAY (15 September)							
11:00	DE	ZEW index	Sep	pts	60.0	-	56.1
14:00	PL	CPI	Aug	%YoY	3.6	3.6	3.6
14:30	US	PPI	Aug	%YoY	-5.3	-	-6.8
14:30	US	Retail sales	Aug	%MoM	1.9	-	-0.1
14:30	US	NY Fed index	Sep	pts	15.0	-	12.08
WEDNESDAY (16 September)							
11:00	EZ	Final HICP	Aug	%YoY	-0.2	-	-0.7
14:00	PL	Average wage in the corporate sector	Aug	%YoY	3.2	2.9	3.9
14:00	PL	Average wage in the corporate sector	Aug	%YoY	-2.3	-2.3	-2.2
14:30	US	CPI	Aug	%YoY	-1.7	-	-2.1
15:00	US	TICS capital flows	Jul	\$bn	-	-	90.7
15:15	US	Capacity utilisation	Aug	%	69.0	-	68.5
15:15	US	Industrial output	Aug	%MoM	0.6	-	0.5
THURSDAY (17 September)							
-	JP	BoJ decision	-	%	0.1	-	0.1
14:00	PL	Industrial output	Aug	%YoY	0.3	-1.9	-4.6
14:00	PL	Construction output	Aug	%YoY	9.6	6.3	10.7
14:00	PL	PPI	Aug	%YoY	2.7	2.1	3.0
14:00	CH	SNB decision	-	%	0.25	0.25	0.25
14:30	US	Initial jobless claims	w/e	k	545.0	-	550.0
14:30	US	House starts	Aug	m	0.60	-	0.581
14:30	US	Building permits	Aug	m	0.58	-	0.564
16:00	US	Philly Fed index	Sep	pts	8.0	-	4.2

Source: BZ WBK, Parkiet daily, Reuters

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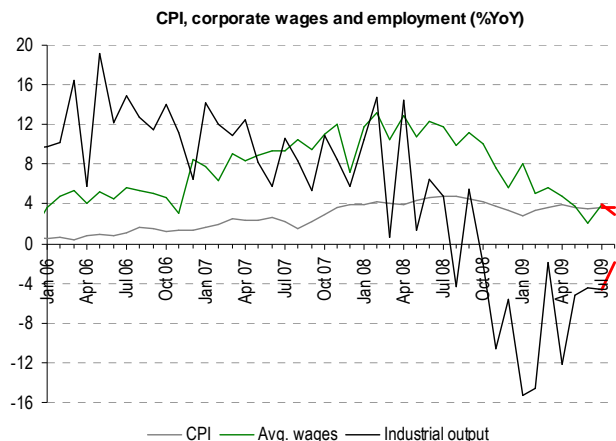
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What's hot this week – Large dose of important data locally and abroad



- The CPI inflation stabilization at 3.6%YoY in August that we forecast should be neutral for the market (market consensus at the same level), which currently prices in rate hikes in early 2010. Whether we will actually see rate hikes next year will depend on pace of inflation drop starting from the beginning of 2010. In this context some hint will be data on wages for August.
- However, the key factor for assessment of monetary policy prospects are expectations regarding strength of economic recovery and thus data from the real economy. Our forecast points to annual fall in industrial output in August, although we see slight upward risk to it after a bit better than expected domestic PMI for August.
- As to events abroad there will be many major data - both inflation figures and economic activity indicators as well as fresh data from the US housing market.

Economy last week – Planned 2010 budget deficit much higher than expected

Main macroeconomic assumptions for 2009-2013 according to the 2010 budget draft

Annual average	2009	2010	2011	2012	2013
GDP growth	0.9	1.2	2.8	3.0	3.4
Private consumption	2.2	0.9	2.2	3.5	3.5
Fixed investment	-2.5	0.3	4.6	4.1	7.0
Exports	-8.0	2.8	6.2	8.5	4.5
Imports	-11.9	3.2	6.7	9.1	5.4
EURPLN	4.37	4.08	3.85	3.61	3.50
CPI inflation	3.6	1.0	1.8	2.3	2.5
NBP reference rate	3.8	3.5	4.1	4.3	4.5

- Domestic budget deficit in 2010 was set at PLN52.2bn. Additionally, deficit of the separated budget of EU funds will be PLN15.2bn. Thus, in comparable terms, the central budget deficit in 2010 will reach PLN67.5bn, i.e. three times the PLN22.5bn assumed for this year.
- Macro assumptions of the 2010 budget are conservative, especially for inflation. Higher than assumed GDP growth and/or inflation could lead to lower deficit. The same effect may be related to a possible transfer of NBP profit and possible higher than assumed income from dividends.
- On the other hand, assumptions regarding tax income seem overly optimistic. However, given all the risks we think there is a chance that the 2010 budget deficit will be lower than planned.
- The public finance sector in 2010 is estimated by the government at 7% of GDP vs. 6% this year.

Planned income and spending of the domestic budget (without budget of EU funds) – selected elements

Item	2009 PLNbn	2010 PLNbn	2010 %YoY
Tax and non-tax income	235.86	245.50	4.1
Tax income	210.60	223.14	6.0
VAT	97.50	106.20	8.9
excise tax	52.70	53.07	0.7
CIT	24.00	26.30	9.6
PIT	34.86	36.00	3.3
Non-tax income	25.26	22.36	-11.5
Dividends	7.65	4.22	-44.8
Spending	273.5	297.7	8.9

- Negative feature of the state's financial plan for 2010 is lack of major changes on the spending side as well as the planned transfer of PLN7.5bn from the Demographic Reserve Fund to the Social Security Fund.
- Net borrowing needs will rise from PLN52bn this year to PLN82bn in 2010, out of which PLN61bn will be covered by domestic financing and PLN21bn by foreign financing. Gross borrowing needs next year will grow to ca. PLN203bn against PLN163bn this year. From the market's point of view it is important that issue of market treasury bills and bonds domestically will reach PLN169bn vs. PLN137bn in 2009) This means that average monthly issuance in 2010 will be ca. PLN14bn. Such a large amount of gross borrowing needs puts a pressure on the Polish debt market. In such situation, realisation of the privatisation plan becomes a key focus of attention.

Quote of the week – October is a good moment for change in bias?

Mirosław Pietrewicz, MPC member, PAP, 8 September

In October we will have the new inflation projection. This will be a moment for a possible correction of bias [informal easing bias], if there are grounds for that. If the projection changes the medium-term outlook strongly enough, one will be able to state that shift from easing to neutral bias is justified.

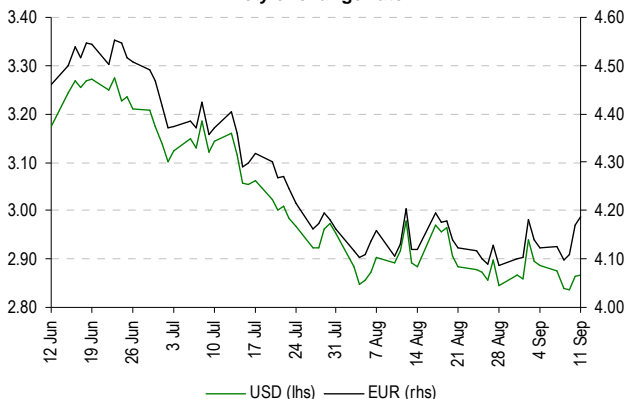
Sławomir Skrzypek, NBP governor, PAP, 8 September

Such assessment [regarding impact of budgetary news on monetary policy] are ahead of us. However, I do not agree with the opinion that such shape of fiscal policy is entirely neutral for monetary policy.

The past week brought next comments from MPC members indicating that rate cuts cycle has ended and one should expect swift change in monetary policy bias from easing to neutral. Statement from usually clearly dovish Mirosław Pietrewicz suggests that a good moment for a change in informal policy bias is October when the NBP projection of inflation and GDP will be known. Comment from NBP governor Sławomir Skrzypek on impact of prospects for fiscal policy on monetary policy suggests that he probably supports the idea of a change in policy bias to neutral in the near time. Other MPC members also suggested recently that policy bias should be changed soon, so majority of the Council may decide there is no need to change with change in policy bias until October.

Market monitor

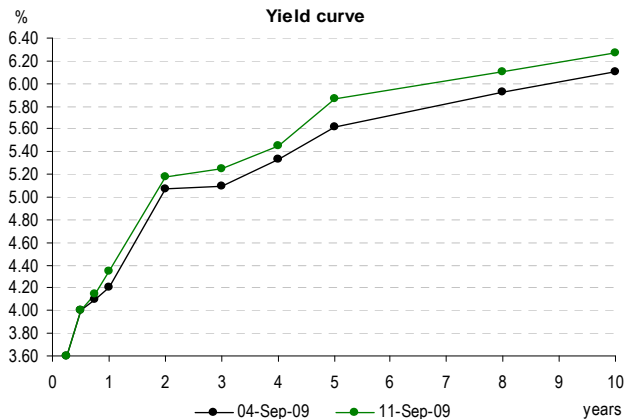
Zloty exchange rate



Zloty depreciation despite higher global risk appetite

- The zloty significantly depreciated last week in reaction to negative budgetary information and this was additionally driven by higher than expected C/A deficit figure for July. On Friday EURPLN exceeded 4.19. The scale of zloty weakening could have been even higher if not the increase in global risk appetite last week - higher equity indices, sharp increase in EURUSD. The negative reaction of the zloty to fiscal information is well reflected by the fact that during the week it weakened against the euro by ca. 2%, while Hungarian forint was unchanged and the Czech crown gained 0.1%.
- This week the zloty will be still under pressure of negative budgetary information and this may lead to EURPLN level above 4.20 if global moods deteriorate. If appetite for risky assets maintains, 4.20 may remain strong resistance level.

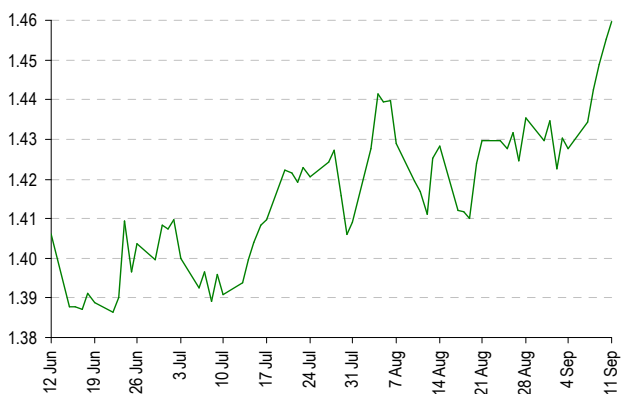
Yield curve



Yields much higher due to high budget deficit

- Budgetary information caused significant increase in yields of Polish government bonds, as well as widening of asset swap spread. Rise in FRA and IRS rates, though less significant than in the case of bonds, was connected with another comments by central bankers, who suggested a swift change in monetary policy bias to neutral from easing.
- This week we expect the upward trend in yields to continue. Expectations of high financing needs in 2010 will remain to be the most important factor. Data publications, if consistent with our forecasts, which are slightly more dovish than market consensus, should be supportive for the market, at least at the short end of the curve. If production and/or wages surprise to the downside, this may increase worries about condition of public finances, leading to further widening in asset swap spread.

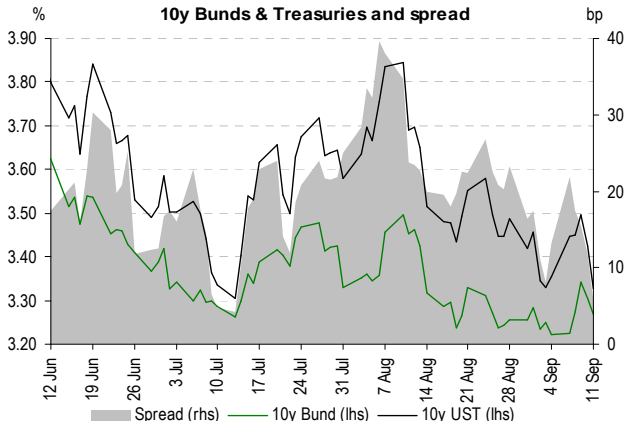
EURUSD rate



Significant rise in EURUSD

- The US dollar weakened sharply during the past week. The EURUSD rate reached the highest level this year (above 1.46), which was driven by higher risk appetite on global markets. This was connected with better than expected data from the labour market in the US, higher than consensus industrial production figure in China, successful bond auction of Treasuries and optimistic forecasts of financial results of companies in the US.
- We think this week may bring a downward correction in the EURUSD rate. The dollar should be supported by the expected increase in risk aversion internationally. In our opinion, macroeconomic data from the euro zone and the US will not be strong enough to support rising trend in risky assets and EURUSD in the short-term.

10y Bunds & Treasuries and spread



Weaker core bond markets

- Higher risk appetite led to the weakening in core bond markets. However, the rise in yields has been limited by successful auctions of government's papers in the US. This was very important signal for the market leading to fall in yields after Thursday's 30-year bonds offer, despite the fact that risk appetite continued to rise. Still, the losses recorded earlier during the week were not entirely erased. On Friday yields of 10Y Treasuries and Bunds were at 3.34% and 3.28% against 3.32% and 3.22% a week ago.
- This week the core debt markets may see some strengthening together with a possible fall in appetite for risky assets and with weaker worries about financing needs of the US government after successful auctions last week.

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