

# Weekly economic update

26 October – 1 November 2009

Last week in the global markets brought mixed data and earnings reports for Q3, but positive news were prevailing. As a result, risk appetite increased, which translated into increase in yields on the core debt markets and rise in EURUSD above 1.50. Such tendencies in the global markets were positive for the zloty and during the week EURPLN fell to 4.15, the lowest level in a month, although it was followed by a limited correction. Higher risk appetite and the zloty appreciation as well as generally lower than expected domestic macro data led to strengthening in the domestic interest rate market in the first part of the past week. However, later on there was profit-taking and the debt market stabilized at levels seen a week earlier. Although local macro figures were in most cases lower than expected, they were not disappointing enough to change our predictions for economic growth and assessment of monetary policy prospects. Meanwhile, fresh comments from the MPC suggest that a change in informal policy bias to neutral will probably be done by the new Council. Anyway, there probability of such a move this week has decreased considerably. However, this does not change much expectations regarding interest rate changes by the next MPC, although giving new central bankers a possibility to change bias to neutral may help them to build anti-inflationary credibility without swift rate hikes. Apart from the MPC meeting, there will be no important local events this week. As to events abroad, there will be many major data releases (focus on advanced US GDP figures for Q3) and numerous earnings reports.

## Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (26 October)</b>							
8:00	DE	Gfk index	Nov	pts	4.5	-	4.3
11:00	PL	<b>Auction PLN 0.4-0.5bn of 52-week Treasury Bills</b>					
<b>TUESDAY (27 October)</b>							
10:00	EZ	M3 money supply	Sep	%YoY	2.2	-	2.5
14:00	US	Case/Shiller house price index	Aug	%YoY	-11.8	-	-13.3
15:00	US	Consumer confidence	Oct	pts	53.1	-	53.1
15:00	US	Richmond Fed composite index	Oct	pts	-	-	14.0
<b>WEDNESDAY (28 October)</b>							
-	PL	<b>MPC decision</b>	-	%	<b>3.5</b>	<b>3.5</b>	<b>3.5</b>
13:30	US	Durable goods	Sep	%	1.3	-	-2.6
15:00	US	New home sales	Sep	m	0.44	-	0.429
<b>THURSDAY (29 October)</b>							
11:00	PL	<b>Switch auction of bonds</b>					
11:00	EZ	Business climate index	Oct	pts	84.0	-	82.8
13:30	US	Initial jobless claims	w/e	k	520.0	-	531.0
13:30	US	Preliminary PKB	Q3	%	3.3	-	-0.7
13:30	US	GDP deflator	Q3	%	1.2	-	0.0
13:30	US	Core PCE	Q3	%	1.8	-	2.0
<b>FRIDAY (30 October)</b>							
-	JP	Bank of Japan decision	-	%	0.1	-	0.1
11:00	EZ	Flash HICP	Oct	%YoY	-0.1	-	-0.3
13:30	US	Core PCE	Sep	%MoM	0.2	-	0.1
14:45	US	Chicago PMI	Oct	pts	48.5	-	46.1
14:55	US	Final Michigan index	Oct	pts	69.9	-	73.5

Source: BZ WBK, Reuters, Parkiet

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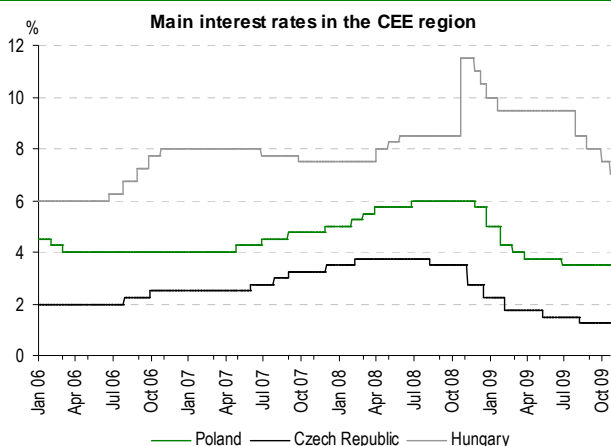
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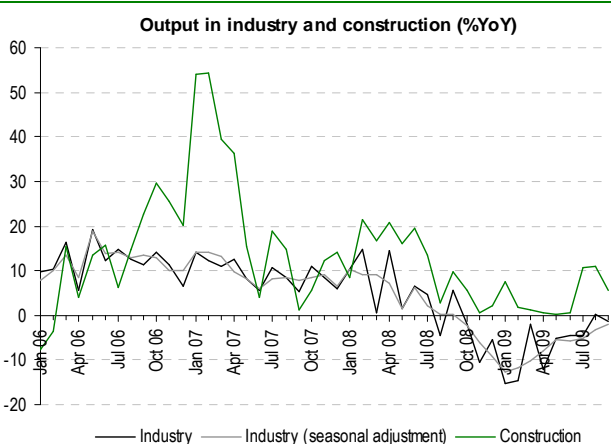
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## What's hot this week – MPC meeting with new NBP projection



- This week the key focus of attention in the Polish financial market will be the MPC meeting. It is widely expected that the interest rates will be kept on hold – not only this month, but until the end of term of the current Council. This way the Polish central bank stands out among other major central banks in the region, which continue monetary easing (50bps rate cut in Hungary last week and 25bps rate cut expected in the Czech Republic the next week). However, there is much uncertainty whether the current MPC will change informal policy bias to neutral (more details on this issue in *Quote of the week* section).
- Expectations regarding decisions of the current and new MPC may be influenced by results of the new NBP projection for inflation and GDP. Taking into account data released since since June, one may expect some upward move in the GDP path and slight changes in inflation path.

## Economy last week – Most of new local data below forecasts



- Output figures for September (in industry  $-1.3\%YoY$  vs. consensus of  $-2.4\%YoY$ , in construction  $5.6\%YoY$  up vs. consensus of  $9.2\%YoY$ ) are consistent with a scenario of gradual, slow recovery of the Polish economy.
- The deterioration of industrial output growth does not mean a change in tendency, but is connected with working days effect. Seasonally adjusted data (eliminating also the working days effect) showed continuation of improvement, to  $-2.1\%YoY$  from  $-3.1\%YoY$  in August.
- Despite deeper than expected slowdown to  $5.7\%YoY$  from  $11.0\%$  in August, construction output growth in September was still at solid level, probably thanks to rising scale of realisation of infrastructural projects. This is reflected by strong rise in production in entities for which the basic activity is civil engineering ( $28.8\%YoY$  after extraordinarily strong rise of above  $40\%$  in August).



- Retail sales growth clearly slowed down to  $2.5\%YoY$  in September after temporary revival in summer. Sales of durable consumption goods clearly weakened due to lowering growth rate of households' income and concerns about unemployment rise (further rise in declared lay-offs).
- PPI in September dropped the third straight month, this time by  $0.2\%MoM$  driving the annual producer price inflation down to  $1.6\%$ , lower than expected. The data indicate that weak demand and appreciation of the zloty lasting since March are effectively reducing pressure on prices at the producer level, which should eventually limit the growth in consumer prices.
- Almost all core inflation measures fell in September. CPI excluding food and energy prices stayed at  $2.9\%YoY$  seen in July and August. In our view it has already reached a peak and in the next months it is going to fall.

## Quote of the week – No change in bias until the end of the current MPC's term?

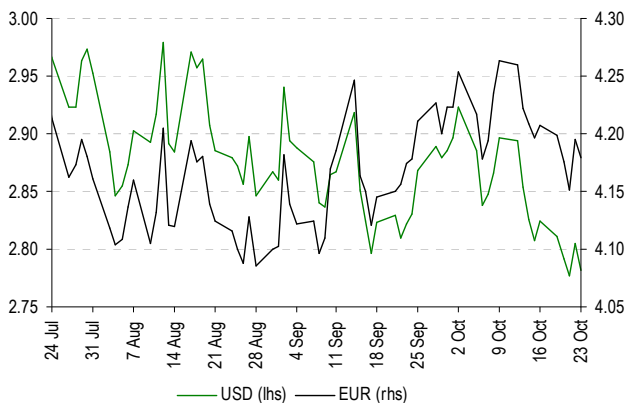
**Stanisław Owsiak, MPC member, Dziennik daily, 20 October**

[Q: What about the so-called informal bias in monetary policy? High inflation was the argument for the change from easing to neutral] (...) Today, we believe that it is more likely that inflation will fall to  $2.5\%$  in 6-7 quarters rather than it would return for the target later. Recent data confirm this prediction. Decline in inflation from  $3.7\%$  in August to  $3.4\%$ . September is substantial. Another assessment of the inflation outlook should be left to the next MPC. [Q: When will be the first interest rate hikes? Should the new Council start them next year?] I would recommend great caution. In the horizon of monetary policy transmission – i.e. 6-7 quarters – there will be no fundamental reason to raise rates. Economic growth will be still below potential. There is no reason to disturb the economy. Especially that inflation – which is shown by projections of the NBP, but not only – should fall. So I do not see the justification for interest rate hikes in the foreseeable future.

Next statements of MPC members indicate more clearly that there may be no majority for changing bias to neutral in October, and perhaps by the end of the current term of the Council. It is quite surprising in light of the statements of Council members made several weeks ago, and the contents of the communiqué released after the September meeting, which clearly suggested the possibility of changing bias in the near future. However, the latest comments of dovish Stanisław Owsiak underscored lack of justification for changing bias to neutral, which makes such decision less likely. Similar view was earlier expressed by a moderate Jan Czekaj, and also Sławomir Skrzypek, president of the NBP, who suggested that the Council remains in easing bias. Without the support of those central bankers a change in bias does not seem possible.

Market monitor

Zloty exchange rate

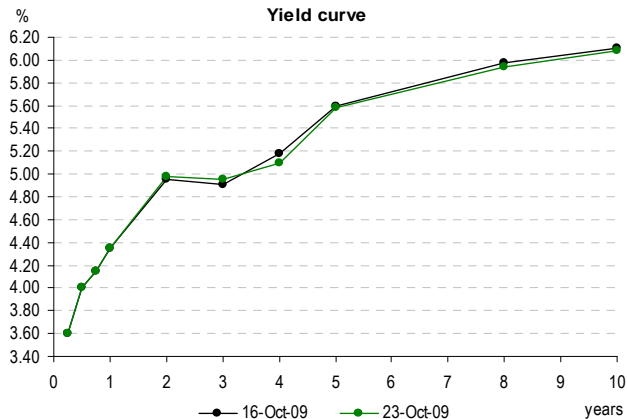


Zloty moderately stronger

As we expected, the past week was favourable for the zloty amid higher risk appetite in the world markets. The EURPLN rate broke important technical level of 4.18 and fell temporarily below 4.15. However, the improvement in the global sentiment was not strong enough to lower the EURPLN rate deeper, towards the 4.10. The zloty rate versus the euro performed better than the forint and Czech crown, which may be connected with among others more and more clear differences in the monetary policy prospects in Poland and these countries (next rate cuts, and in Czech Republic possible interventions aiming at crown weakening).

We expect that this week the EURPLN rate will be in range of 4.10-4.20. Nevertheless, next earnings reports for Q3 should support high level of risk appetite and in this situation the EURPLN rate may be closer to 4.10 than 4.20.

Yield curve

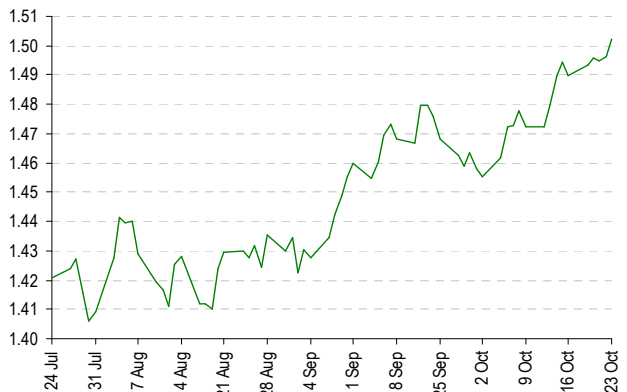


Stabilisation in the domestic debt market

In the first part of the past week the debt market strengthened along with the zloty appreciation, while at the end of the week there was a correction and stabilisation. The domestic data on industrial output and retail sales did not have visible influence on the Polish interest rate market. However, much lower than forecasted PPI inflation in September strengthened the effect of earlier published data on deeper than expected CPI drop that month, which improved expected inflation path in the short term and weakened expectations for fast rate hikes in Poland. The auction of BGK bonds was neutral for the market.

If the MPC does not change the bias to neutral and zloty slightly appreciates than the domestic interest rate market may slightly strengthen this week.

EURUSD rate

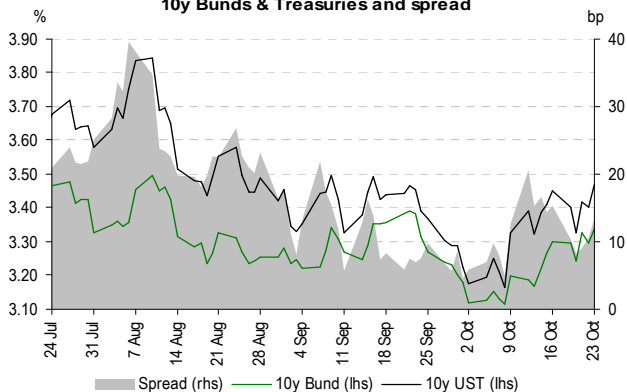


EURUSD breached 1.50

Publication of quite good financial results of companies for Q3 favoured the persistence of high risk appetite in global markets, despite the fact that part of the macro data from the US disappointed (in particular, data from the beginning of the week showing a surprise decline in house starts). In such a conditions the EURUSD continued march towards 1.50. This level was breached on Wednesday, and followed by a downward correction amid temporary fall in the equity markets. However, it did not last long and at the end of the week EURUSD was again above 1.50.

Further EURUSD movements will depend on changes in risk appetite under the influence of the new macro data and results of companies, but also an important issue may be the assessment of the relative strength of the euro zone and the US economies.

10y Bunds & Treasuries and spread



Weakening in the core debt markets

At the beginning of last week there was rise in interest in safe assets under influence of weak macro figures in the US and yields of bonds in the core debt markets fell. However, the rising risk appetite seen later in the week had negative impact on the core debt markets leading to rise in yields. At the end of the week yields of 10Y Treasuries and Bunds reached 3.47% and 3.34%, respectively, against 3.45% and 3.30% a week earlier.

This week the core debt markets will still be driven mainly by changes in risk appetite and prospects for implementation of exit strategies from monetary easing by major central banks in the world. From this point of view, important factor will be advanced GDP figures for Q3 from the US due for release on Thursday.

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