Bank Zachodni WBK

Weekly economic update

30 August – 5 September 2010

The MPC meeting in August, after 2 months holiday break, has not brought significant change in monetary policy prospects. At the same time the new local macro figures has not changed much picture of economic situation. Global markets were nervous about the extent of the economic slowdown (among others after record weak data from the US housing market), but the Polish market proved to be quite resistant to that. The zloty lost only slightly and temporarily while rise in yields of local bonds was limited.

This week there will be a few important domestic factors: GDP for Q2 as well as PMI and FinMin's inflation estimate for August. However, the zloty and local bonds should remain mainly under impact of changes in sentiment on the global markets. This in turn will depend on plethora of crucial data due for release in the euro zone and the US this week.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (30 August)					
10:00	**PL**	**GDP**	**Q2**	**%YoY**	**3.2**	**3.1**	**3.0**
10:00	**PL**	**Investments**	**Q2**	**%YoY**	**0.4**	**1.0**	**-12.4**
10:00	**Pl**	**Consumption**	**Q2**	**%YoY**	**2.1**	**2.2**	**2.2**
11:00	**PL**	**Tender of 52-week T-bills worth PLN0.5-0.7bn**					
11:00	EZ	Business climate	Aug	pts	101.7	-	101.3
14:30	US	Personal income	Jul	%MoM	0.3	-	0.0
14:30	US	Personal spending	Jul	%MoM	0.3	-	0.0
		TUESDAY (31 August)					
11:00	EZ	Flash HICP	Aug	%YoY	1.6	-	1.7
15:00	US	S&P/Case-Shiller index	Jun	%MoM	0.0	-	0.5
15:45	US	Chicago PMI	Aug	pts	57.0	-	62.3
16:00	US	Consumer confidence	Aug	pts	51.0	-	50.4
		WEDNESDAY (1 September)					
9:00	**PL**	**PMI manufacturing**	**Aug**	**pts**	**52.2**	**52.1**	**52.1**
9:58	EZ	PMI manufacturing	Aug	pts	**55.0**	**-**	**55.0**
11:00	**PL**	**Auction of 2Y bonds**					
14:15	US	ADP report	Aug	tys.	18.0	-	42.0
16:00	US	ISM – industry	Aug	pkt.	53.0	-	55.5
		THURSDAY (2 September)					
11:00	EZ	GDP	Q2	%QoQ	1.0	-	1.0
13:45	EZ	ECB decision		%	1.0	-	1.0
14:30	US	Job efficiency	Q2	%QoQ	-1.8	-	-0.9
14:30	US	Jobless claims	week	k	473.0	-	473.0
14:30	US	Factory orders	Jul	%MoM	0.4	-	-1.2
16:00	US	Pending home sales	Jul	%MoM	0.2	-	-2.6
		FRIDAY (3 September)					
9:58	EZ	PMI services	Aug	pts	55.6	-	55.6
14:30	US	Non-farm payrolls	Aug	k	-100.0	-	-131.0
14:30	US	Unemployment rate	Aug	%	9.6	-	9.5
16:00	US	ISM – services	Aug	pts	53.5	-	54.3

Source: BZ WBK, Dow Jones, Parkiet, Reuters

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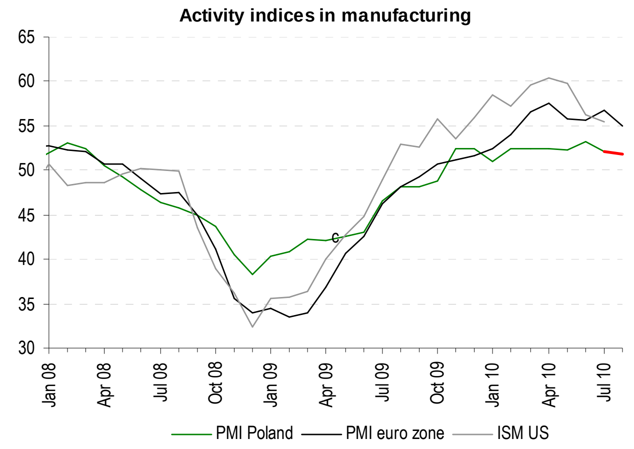
What's hot this week – GDP, PMI, FinMin's inflation estimate and a lot of crucial events abroad

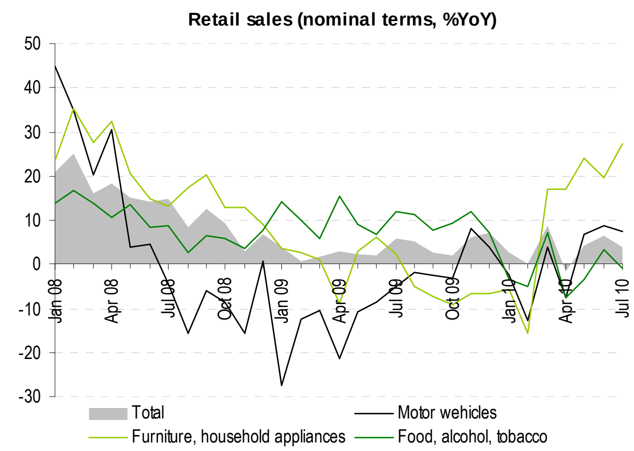


- We predict that annual GDP growth slightly accelerated in Q2 with stabilisation of private consumption growth and rebound of fixed investment growth rate from negative territory in Q1. Net export's contribution should change from positive to negative. A risk factor for reading of fixed investment in Q2 are the stats office data on investments in big companies, which showed a pronounced decline in H1, which was deeper than a drop in fixed investment in the Q1. However, if fixed investment prove to have been weaker in Q2, it would be most likely offset by better net exports and total effect for GDP should be neutral.
- An important hint on performance of the Polish economy in Q3 will be PMI and FinMin's estimate of CPI. For assessment of prospects for the Polish economy it will be also crucial what a large number of macro figures abroad will show. The ECB meeting will be important as well.

Economy last week – No major change in MPC rhetoric after holidays

Selected fragments from the August MPC statement (marked significant changes to the June statement)
~~Disruptions in the international financial markets, connected with the uncertainty as to the reduction of fiscal imbalances in some of euro-area countries, continued. The scale of those disruptions has nevertheless decreased recently, which has contributed to halting the fall in prices of some financial assets.~~ **In the recent period the price of some agricultural commodities have increased markedly in the global markets. At the same time, the observed alleviation of tensions in the financial markets have favoured the inflow of capital to emerging economies and the appreciation of those countries' currencies, including the strengthening of the zloty.**
~~This decline in CPI inflation was mainly connected with a decrease in core inflation. In the coming period, inflation will be further lowered by negative base effects stemming from a strong increase in the prices of excise goods in 2009.~~ **In subsequent months, inflation may be gradually increased by food and energy price growth. In the first months of 2011 the level of prices may be raised by the announced change of VAT rates. The impact of this change on inflation should nevertheless be minor.**
The Council has discussed factors that may fuel inflationary pressures in the medium term.

- MPC met after 2-months holiday break and did not introduced significant changes to the official statement after the meeting. Above all, the key sentence about "discussion on factors that may fuel inflationary pressures in the medium term" was kept, which indicates direction of changes in monetary policy in the following months.
- In addition, the Council noticed: uncertainty regarding the global economy, improved market sentiment, rise in agricultural commodity prices and lack of wage pressure.
- The Council expects a rise in inflation in the coming months, but only the new inflation projection in October will help to assess to what extent this increase (in our opinion, even to 3%) may be permanent. Earlier, we may learn more about views within the MPC from the *Monetary Policy Guidelines for 2011*. We keep our view that rates will rise by 25bps in 4Q 2010 and by 100bps totally by



- Annual growth of retail sales slowed down to 3.9% in July from 6.4% in June, but this was due to high base effect while the high demand for durable goods suggests that the consumption demand is pretty robust.
- The gradual improvement of labour market conditions is continued (the registered unemployment rate fell to 10.4% in July from 10.6% in June), though there are no signs of stronger wage pressure. The detailed data from the statistical office indicated that the slowdown of wage growth in July affected nearly all sections of the industry.
- Results of CSO consumer climate survey showed further improvement in households' evaluation of possibility for purchases and save money, but also worsened outlook of economic situation, future income and unemployment. All in all, the consumer climate indicators fell in August, but remained well above levels

Quote of the week – Will October be critical?

Adam Glapiński, MPC member, PAP, 27 August

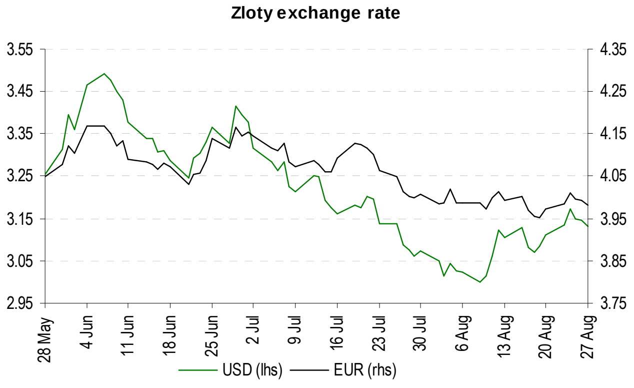
Moje poglądy pozostają aktualne, ulegają nawet wzmocnieniu, a nie osłabieniu. Uważam, że jeśli chodzi o reakcję ze strony RPP, trzeba działać w sposób znaczący, zdecydowany, z wyprzedzeniem, a nie w momencie, jak już coś się dzieje. Sygnał musi być silny, większy, niż 25pb. Później powinna nastąpić stabilizacja stóp na dłużej. Konkretnej daty bym nie wyznaczał. Nie przywiązywałbym się do października.

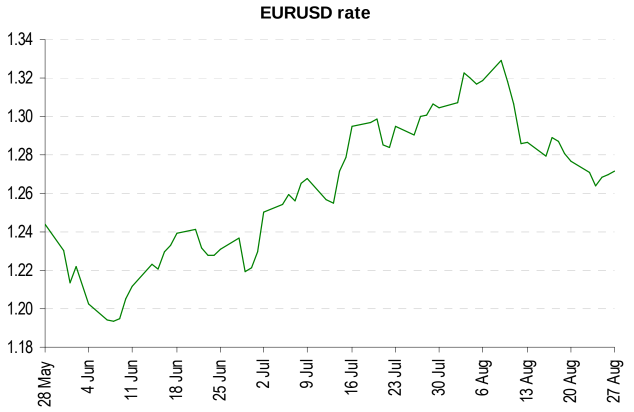
Anna Zielińska Głębocka, MPC member, PAP, 27 August

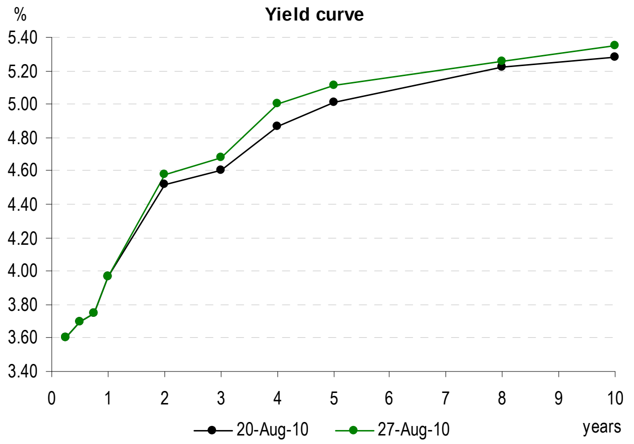
I think that October will be critical. There will be new projection, we will knot the 2011 budget. We will see what is happening after the holiday period in Europe – whether strong growth in Germany is maintained. What will be [in Poland] with industrial output and also with producer prices – high PPI inflation in July was an alarming factor for us.

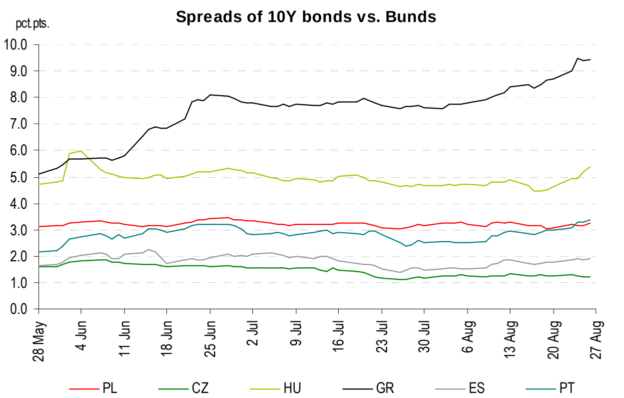
Freshest comments from MPC member has not changed our view that the first rate hike expected by us in Q4 will most likely take place in October. Quite hawkish Adam Glapiński maintained (or rather strengthened) his earlier opinion that the Council should react to expected inflation rise in a decisive way (with the first hike larger than 25bps, although later on there could be long pause until the next move) and in a pre-emptive manner (in this context Glapiński is not attached to October and may submit a motion for a hike in September). Anna Zielińska-Głębocka quite clearly suggested that a proper moment for a change in monetary policy parameters will be October. Elżbieta Chojna-Duch did not suggest any month, but did not exclude a rate hike this year.

Market monitor









Zloty resistant to increased risk aversion

▪ At the beginning of the week, the zloty weakened to just above 4.02 to the euro (maximum indicated by us in the last report), but it was a temporary move. Next days saw a gradual appreciation of the domestic currency, despite the worst ever data from the US real estate market and a substantial increase in global risk aversion. The past week confirmed resistance of the zloty to a decline in sentiment in global markets, which may also imply that as long as the yields in the core debt markets remain low, the EURPLN rate should not go up under the influence of high risk aversion. We believe that this week will be – similarly as the previous ones – quite volatile, which eventually will result in stronger zloty. The resistance is at 4.01, support at 3.96.

▪ The beginning of the week on the EURUSD market was in line with our expectations, the dollar was appreciating. The downward trend of the EURUSD was the continuation of the past week's deterioration of market sentiment and lower-than-expected data on manufacturing index for the euro zone and Germany. But two sets of the worst in all history data from the US real estate market (the data on home sales is collected since 1993 and on new home sales since 1963) constrained the euro's depreciation just below 1.26 (the level of support indicated in the previous report). Next few days brought some recovery, as the good data from the euro zone (the Ifo index) and the US (the jobless claims) supported the euro, that managed to pare some loses. The data on revised GDP growth in the US did not influence the exchange rate. During this week we expect the upward trend of the EURUSD with the support level at 1.26 and resistance levels as 1.28 and 1.30.

Stable debt, core markets vulnerable to data

▪ Correction after recent declines in yields on the domestic debt market could be noticed at the beginning of the last week. Expectations for the Wednesday's switch auction strengthened this movement. MPC comment after the meeting on Tuesday, and quite hawkish comments from MPC members on Friday did not affect the market. Over the whole week, yields grew, particularly in the middle and at the long end of the curve, but the supply did not come from abroad. The correlation between 10Y Polish bonds and 10Y Bunds was sustained. In the following days foreign investors, after a week's break, may again affect the Polish debt market.

▪ On the core debt markets yields decreased further with 10Y Bunds at new historical lows (2.09%). Decreases in yields of German and US bonds were driven by very poor data from the US housing market. After better than expected US data on GDP released on Friday (1.6% growth against 1.4% expected) yields of 10Y Treasuries and Bunds increased sharply.

▪ Last week the investors' attention in the debt markets was focused on Ireland, which after the downgrade of the rating by the S&P's planned a sale of T-bills. Finally the auction was successful (sizeable demand and yields lower than at the previous tender). Hungary was less successful, as after announcement that the government does not plan to return to talks with the IMF it had to offer higher yields for 3Y, 5Y and 10Y bonds.

▪ Further declines in yields of 10-year Bunds triggered an increase in the spreads versus bonds of the peripheral countries of the euro area.

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