

Weekly economic update

1 – 7 November 2010

The Monetary Policy Council decided to leave main interest rates unchanged in October, but at the same time it decided to raise reserve requirement rate from 3.0% to 3.5%, effectively since 31 December. According to the NBP Governor, raising the reserve requirement was a signal in the direction of monetary policy tightening. However, the tone of the MPC statement was more dovish than a month before, which reduces the likelihood of interest rate hikes this year. The market interpretation was similar, which was reflected in decrease in yields and weaker zloty. Meanwhile, in the statement concluding mission in Poland the IMF advised the MPC should be cautious and ready to respond to inflationary pressure amid ongoing economic revival. In the opinion to 2011 budget draft, the MPC wrote the government plan is a step in a right direction, although insufficient.

This week will be full of important decisions and data publication. The key event is the Fed's decision, due on Wednesday's evening, which (hopefully) will dispel investors' uncertainty about the scale of second round of quantitative easing in the US. Before that, many indicators of activity in world's biggest economies will start appearing since Monday. The domestic data (PMI and MinFin's inflation forecast) will be released just after the long weekend. However, the sentiment in the domestic market will be driven by news from abroad.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (1 November)							
	PL	All Saints Day					
3:30	CN	PMI – manufacturing	Oct	pts	53.8	-	52.9
13:30	US	Consumption	Sep	%MoM	0.4	-	0.4
13:30	US	Personal consumption	Sep	%MoM	0.3	-	0.5
13:30	US	Core PCE	Sep	%MoM	0.1	-	0.1
15:00	US	ISM – manufacturing	Oct	pts	53.8	-	54.4
TUESDAY (2 November)							
9:00	PL	PMI – manufacturing	Oct	pts	54.2	54.5	54.7
9:53	DE	PMI - manufacturing	Oct	pts	56.1	-	55.1
9:58	EZ	PMI - manufacturing	Sep	pts	54.1	-	53.7
WEDNESDAY (3 November)							
13:15	US	ADP raport	Oct	k	20.0	-	-39.0
15:00	US	ISM – services	Oct	pts	53.3	-	53.2
15:00	US	Industrial orders	Sep	%MoM	1.5	-	-0.5
19:15	US	Fed decision		%	0.0-0.25	-	0.0-0.25
THURSDAY (4 November)							
9:58	EZ	PMI – services	Oct	pts	53.2	-	54.1
11:00	EZ	PPI	Sep	%YoY	4.2	-	3.6
13:45	EZ	EBC decision		%	1.0	-	1.0
14:30	US	Initial unemployment claims	week	k	440.0	-	434.0
FRIDAY (5 November)							
11:00	EZ	Retail sales	Sep	%YoY	1.3	-	0.6
13:30	US	Non-farm payrolls	Oct	k	55.0	-	-95.0
13:30	US	Unemployment rate	Oct	%	9.6	-	9.6
15:00	US	Pending home sales	Sep	%MoM	3.0	-	4.3

Source: BZ WBK, Reuters, Parkiet

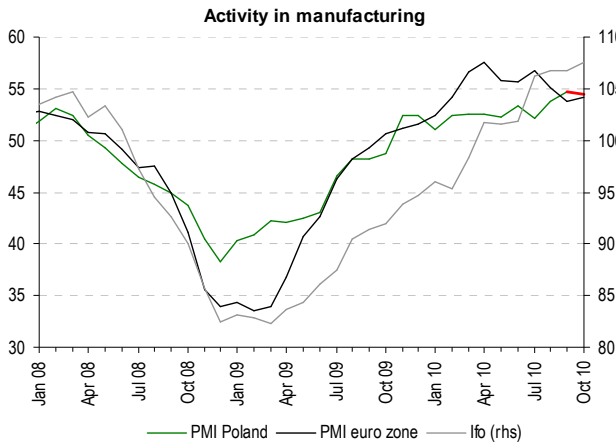
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What's hot this week – Domestic events overshadowed by Fed and foreign data releases

▪ This week, a list of domestic events is quite short. On Tuesday we will know the PMI index for Polish industry in October. We expect a slight correction compared to the previous month. Also on Tuesday the FinMin will publish its CPI forecast for October. We expect a further rise in inflation to 2.8%YoY.

▪ Abroad, the week will start with publication of Chinese manufacturing PMI index on Monday in the early morning. Any clear deviation from forecasts may have a significant impact on the global market moods. Investors will also look forward to see the statement after Wednesday's Fed meeting, in which the US central bank may announce a scale of quantitative policy easing. On Friday there will be publication of very important monthly data from the US labour market.

Economy last week – Robust consumer demand

▪ Retail sales rose in September by 1.2%MoM and 8.6%YoY, exceeding expectations. What is important, robust growth of sales occurred – just like in the previous months – in majority of branches, including durable goods (consumer electronics: 33.3%YoY, motor vehicles: 21.2%YoY). This confirms the solid foundation of consumer demand, which is additionally supported by expected tax hikes in 2011. Sales data fit well into our expected scenario assuming a gradual increase in the importance of domestic demand in economic growth.

▪ The registered unemployment rate rose in September to 11.5%, and the data for previous months were revised up slightly (August from 11.3% to 11.4%). Data after the revision indicate that after a marked increase in the number of economically active population at the beginning of the year, in recent months the trend has extinguished. According to Eurostat, seasonally adjusted unemployment rate in Poland rose in September to 9.6% (in euro zone to 10.1%).

Inflation and GDP projections in the next Inflation reports

	GDP growth			
	Oct 09	Feb 10	Jun 10	Oct 10
2010	0.8-2.8	2.1-4.1	2.5-3.9	3.3-3.7
2011	2.2-4.2	1.8-4.0	3.3-5.9	3.3-5.5
2012	-	1.9-4.3	2.2-5.0	2.8-5.5
	CPI inflation			
	Oct 09	Feb 10	Jun 10	Oct 10
2010	0.8-2.2	1.3-2.2	2.3-2.9	2.4-2.6
2011	1.1-3.2	1.7-3.1	2.1-3.3	2.5-3.5
2012	-	2.6-4.6	2.2-3.7	2.4-3.7

▪ In the new inflation projection the central path of the CPI was raised quite clearly for 2011, although in the entire forecast horizon it remains below 3.5%, i.e. the upper limit of the fluctuations. According to the authors of the projection, the risks for inflation are balanced, however in the MPC's view the risk of lower inflation is apparently higher, as the model had ignored "possibility of growing capital inflows to the emerging economies, including to Poland, amidst the extended period of expansionary monetary policy of major central banks".

▪ October *Inflation report* shows that the motion to raise the reserve requirement in August was supported by "presidential" MPC members: Gilowska, Glapiński and Kazmierczak. A hike in key interest rates was backed by: Gilowska, Glapiński, Bratkowski and Rzońca. Four votes for rate hike means that they do not need much more for majority, but in November, just like in October, quite hawkish data may be not enough to neutralize the MPC's fears about the appreciation of the zloty.

Quote of the week – MPC afraid of possible zloty appreciation**Marek Belka, NBP governor, post-MPC conference, 27 Aug**

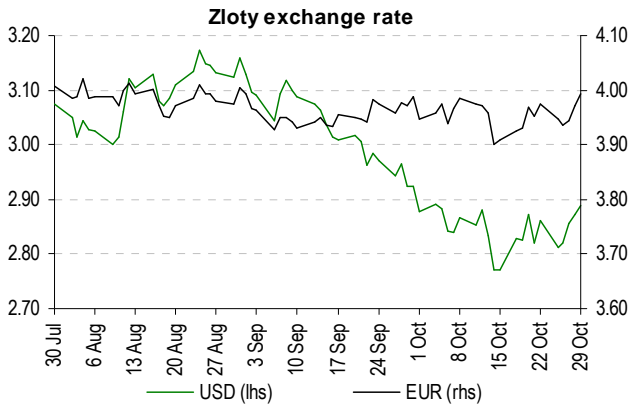
Raising the reserve requirement rate is a gentle signal of tightening monetary policy.

Fragment of MPC statement after the meeting, 27 Aug

In the Council's assessment, the currently limited inflationary and wage pressure in the Polish economy and – not accounted for in the baseline scenario of the October inflation and GDP projection – the possibility of growing capital inflows to the emerging economies, including to Poland, amidst the extended period of expansionary monetary policy of major central banks, combined with the risk of further weakening of the global economic growth justify keeping the NBP interest rates unchanged.

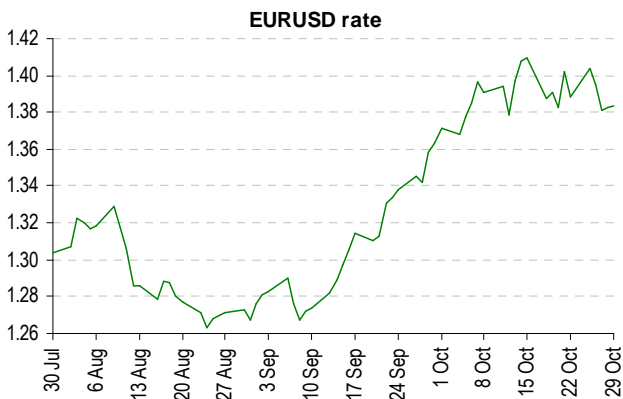
MPC statement and comments from the NBP President Marek Belka at the press conference did not necessarily confirm that the increase in reserve requirement was a substitute for interest rate hike. However, the overtone of the post-meeting statement was more dovish than a month ago, which reduces in our view the chances of interest rate hikes this year. Fragments emphasizing importance of inflation expectations for future MPC decisions have disappeared almost completely. Key issues for the council are the concerns about the zloty appreciation and potential slowdown abroad. While the latter will be probably reduced under the influence of good data coming recently from abroad, the exchange rate risk factor may not disappear quickly.

Market monitor

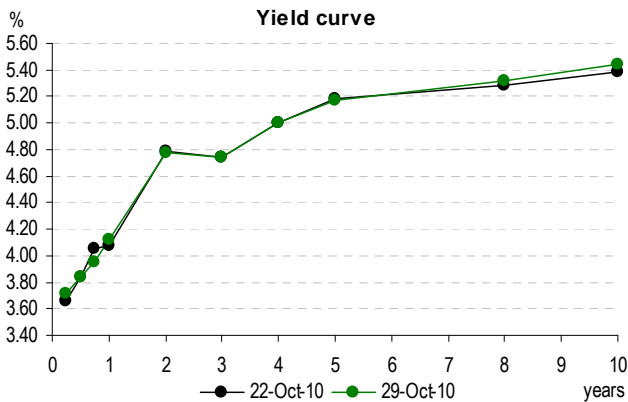


Lack of interest rate hike weakened the zloty

▪ During first days of the past week the EURPLN was declining just as we expected. This was supported by the market expectations for the interest rate hike. The EURPLN dropped to 3.92, but as the MPC’s decision to keep the interest rates unchanged disappointed some market participants, the zloty depreciated considerably, to almost 4.0. At the end of the past week the changes in the EURPLN rate were clearly detached from the other CEE currencies (forint, lei), which appreciated clearly, what may indicate that domestic factors were mainly affecting the zloty. Only on Friday the zloty regained, and EURPLN fell to 3.96. We expect, that in coming days the zloty will be more sensitive to the changes in global market sentiment, and the EURUSD should remain in a range 3.92-3.98.

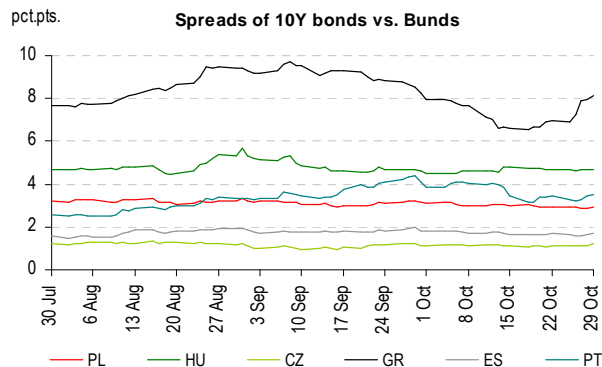


▪ The EURUSD clearly departed from the area 1.40-1.41 indicated in our previous report. That was mainly due to rising uncertainty regarding the scale of next round of quantitative easing in the US that is expected to be announced by the Fed on Wednesday. The vague comments of the Fed members on planned purchase of Treasuries supported the correction of latest dollar depreciation (triggered by expectations for aggressive bonds purchases by the Fed). Although important economic data will be released already at the start of the week, in our view they may only temporarily increase volatility in EURUSD, and until the release of Fed statement the rate will move in 1.38-1.42 range. Announcement of smaller scale of easing than expected may strengthen the dollar (even to 1.35), while decision in line with expectations is probably already priced-in and should not push euro much higher.



Yields decline after the MPC decision

▪ Before the MPC meeting the yields on the domestic fixed income market were rising as some part of investors expected the interest rate hike. The initial reaction to the higher reserve requirement ratio was ambiguous, yields declined, but only temporarily. Finally, after the publication of dovish communiqué the expectations for swift monetary policy tightening in a form of higher official interest rates abated which was followed by yields decrease. Later in the week the yields continued the downward trend initiated on Wednesday, yet did not managed to erase earlier increase.



▪ On the core fixed markets the main drivers were the same factors that influenced the EURUSD. The yields of 10Y Bunds and Treasuries surged, and in case of German securities crucial technical level at 2.50% was broken. The macro data published during the week did not influence the market much.

▪ Considering peripheral bond market, the biggest decline of prices was recorded in case of Greek, Portugal and Irish securities. The sell-out of Irish debt was due to worries over its fiscal situation connected with costs of saving the banking sector. In case of Portugal, the main event that triggered the deterioration of investors confidence was the breakdown of negotiations between the government and opposition on budget plan for 2011. The underperformance of Greek bonds was due to the comment of the PIMCO’s officials (the biggest debt investment fund). He said that Greece may default on its debt during coming three years.

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