Bank Zachodni WBK

Weekly economic update

15 – 21 November 2010

Amid increased risk appetite in the first part of the previous week, the zloty gained significantly. However, further part of the past week was marked by intensified concerns about debt problems of the euro zone's peripheries, especially Ireland, and stronger expectations for monetary tightening in China. This triggered rise in risk aversion, which corrected earlier positive market reaction to the Fed's decision on next round of quantitative easing. There was correction in the stock markets, clear weakening of the euro to the dollar and depreciation of the zloty against major currencies. The local debt market lost slightly. G20 summit had no visible impact on the markets.

This week will bring many important domestic macro figures, which may influence the zloty and Polish interest rate market. We expect that domestic CPI data due for release on Monday will be rather positive for bonds and negative for the zloty (our forecast is below the FinMin's estimate). Overall impact of other domestic data should be neutral. All in all, the zloty performance this week is likely to be determined mainly by changes in sentiment on the global market, which in turn will depend on important data from the US and developments regarding Ireland's debt problems. Markets will pay much attention to meeting of the euro zone's finance ministers on Tuesday-Wednesday.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (15 November)					
11:00	EZ	Trade balance	Sep	€bn	0.3	-	-4.3
14:00	**PL**	**CPI**	**Oct**	**%YoY**	**2.8**	**2.8**	**2.5**
14:30	US	NY Fed index	Nov	pts	14.0	-	15.73
14:30	US	Retail sales	Oct	%MoM	0.7	-	0.6
		TUESDAY (16 November)					
11:00	DE	ZEW index	Nov	pts	-7.0	-	-7.2
11:00	EZ	HICP	Oct	%YoY	1.9	-	1.8
14:30	US	PPI	Oct	%MoM	0.8	-	0.4
15:15	US	Capacity utilization rate	Oct	%	74.9	-	74.7
15:15	US	Industrial output	Oct	%MoM	0.3	-	-0.2
		WEDNESDAY (17 November)					
11:00	**PL**	**10Y bond auction DS1020 worth PLN1.5-3.0bn**					
14:30	US	Building permits	Oct	k	570	-	547
14:30	US	House starts	Oct	k	600	-	610
14:30	US	Core CPI	Oct	%MoM	0.1	-	0.0
		THURSDAY (18 November)					
10:00	EZ	Current account	Sep	€bn	-	-	-7.5
14:00	**PL**	**Wages**	**Oct**	**%YoY**	**3.8**	**3.9**	**3.7**
14:00	**PL**	**Employment**	**Oct**	**%YoY**	**2.0**	**2.0**	**1.8**
14:00	**PL**	**MPC minutes**					
14:30	US	Initiall jobless claims	week	k	440	-	435
16:00	US	Philly Fed index	Nov	pts	5.0	-	1.0
16:00	US	Leading indicators	Oct	%MoM	0.4	-	0.3
		FRIDAY (12 November)					
14:00	**PL**	**Industrial output**	**Oct**	**%YoY**	**9.7**	**9.3**	**11.8**
14:00	**PL**	**PPI**	**Oct**	**%YoY**	**4.0**	**4.1**	**4.3**

Source: BZ WBK, Reuters, Parkiet

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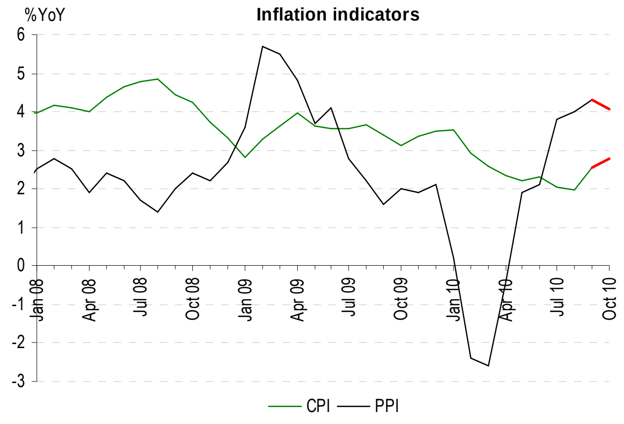
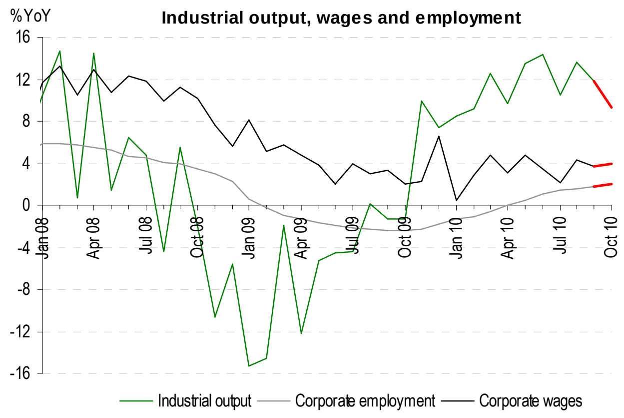
What's hot this week – Many data releases and developments in the European debt markets

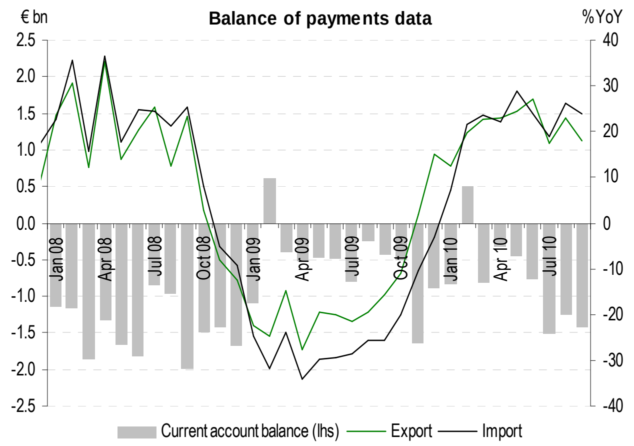


- The key events for the makets this week include data from the US (mainly inflation indicators amid Fed's concerns about deflationary pressures) and developments in the debt markets of peripheral countries of the euro zone.
- However, there will be also many important domestic data releases. The key focus of attention locally will be in particular CPI, wages and industrial output in the context of approaching MPC meeting in late November. Besides, the Thursday's minutes of MPC meeting in October may be important.
- FinMin estimates that CPI inflation in October accelerated to 2.9%YoY from 2.5%YoY in September after price rise of 0.6%MoM. Our forecast is at 2.8%YoY (consistent with market consensus). The key factor pushing the CPI inflation up is food prices (the FinMin assumed 1.4%MoM rise in this category, we assume 0.8%MoM rise) and rise in natural gas prices (2.5-3.0%MoM). Slight rise probably occurred also in fuel prices.



- Our forecast point to a slowdown in industrial output growth in October, partly due to one working day fewer than a year ago. However, surprising PMI rise in October suggest that we may see again double-digit growth of industrial output.
- The strong zloty probably led to weaker rise in producer prices in October. We forecast that PPI inflation slowed down to 4.1%YoY from 4.3%YoY in September.
- We predict that average wage growth in the enterprise sector in October accelerated slightly to 3.9%YoY. However even such growth rate would mean that wage pressure remains contained, especially given continued strong rise in labour demand. In line with market consensus, we predict that annual growth in average employment in the enterprise sector accelerated to 2.0% in October from 1.8% in September.

Economy last week – Weaker than expected balance of payments



- Balance of payments for September showed weaker than we expected results of the Polish foreign trade (although our estimates were above market expectations, in comparison to which the actual figures were only slightly lower). Slowdown in annual growth of exports and imports to some extent was related to the increasing base effect. In addition, exports was negatively affected by some slowdown in economic growth of Poland's major trading partners. Since the disappointment in relation to our forecasts for export was somewhat stronger than for imports, the trade deficit was higher than we forecasted (and amounted to €537m). The whole C/A gap was wider than expected and reached €1.42bn.
- On the capital and financial account, an improvement took place in inflow of EU funds and in inflow of FDIs. The inflow of portfolio capital was high again (over €1bn).

Quote of the week – FX interventions are not uncommon nowadays

Andrzej Bratkowski, MPC member, PAP, 9 Nov

There is a risk that the zloty appreciation will be too fast. Interest rate hikes will strengthen this process and clear gains of the zloty would not be desirable. (…) Limitation of short-term volatility, especially if the volatility is dangerous for the inflation target, is justified. Meanwhile, setting up some target for the exchange rate would be contradictory to the strategy of direct inflation targeting and with real possibility of the NBP to affect long-term of the zloty.

Ludwik Kotecki, deputy finance minister, PAP, 10 Nov

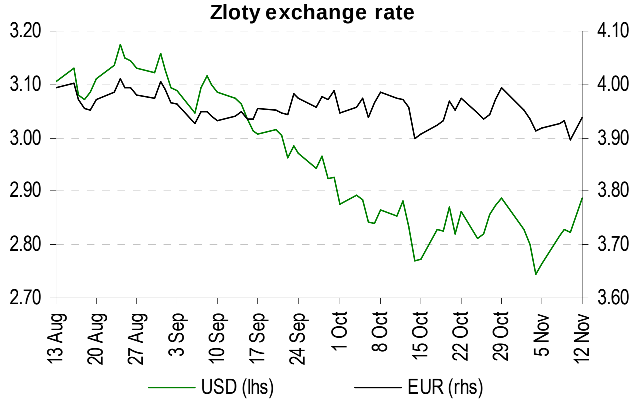
Excessive appreciation of the zloty would not be favourable for the prospects of the Polish economy.

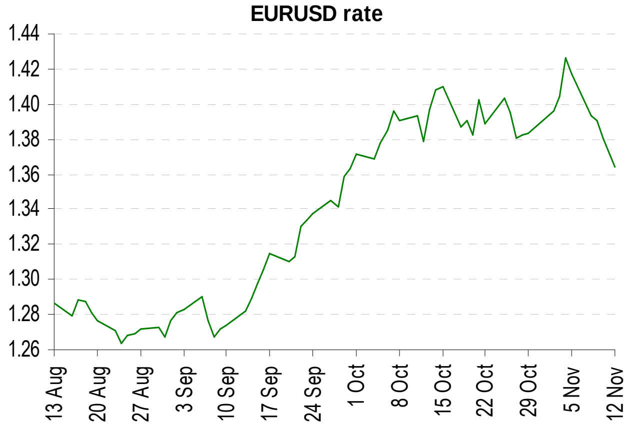
Witold Koziński, deputy NBP governor, PAP, 12 Nov

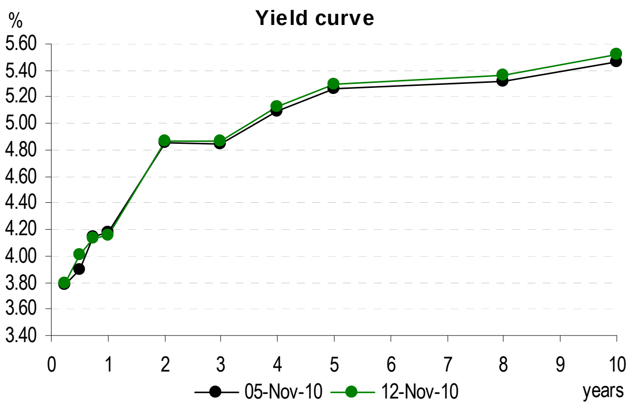
[Could the NBP intervene in the FX market?] Interventions of central banks in the FX markets are not uncommon nowadays.

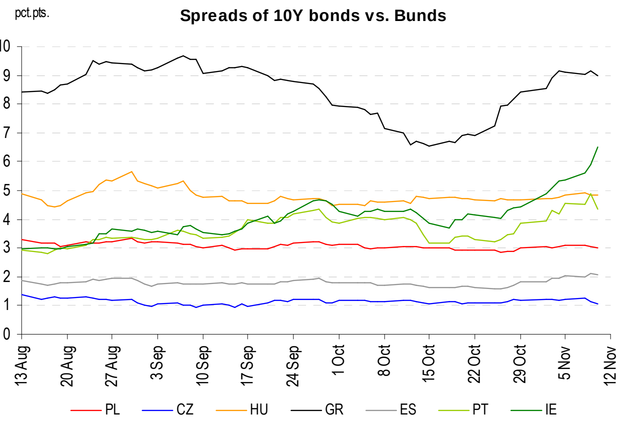
The last MPC statement showed that an important argument against beginning of interest rate hikes was concern about excessive zloty appreciation. The recent zloty appreciation intensified the concerns, which is indicated by fresh comments from central bankers and government's officials. The strong zloty is an argument for the MPC to delay interest rate hikes until the next year (which is consistent with our current view) and for the government this is a risk for economic growth, which could deteriorate fiscal situation. Possible further gains of the zloty would trigger next verbal interventions aimed at keeping the zloty at levels seen as comfortable from the point of view of both monetary and fiscal policy.

Market monitor









EURPLN highly volatile, euro under Irish pressure

▪ At the beginning of the past week the risk appetite and inflow of funds to emerging markets was prevailing, fuelling appreciation of the zloty. EURPLN dropped from ca. 3.94 to temporarily even below 3.88, breaking 3.90 and 3.89 on its way. However, the considerable zloty's appreciation was short-lived. The increase of worries over debt problems in Ireland and Chinese data pointing to the need of further monetary policy tightening led to higher risk aversion and zloty's depreciation. As the dollar was appreciating versus the euro, the USDPLN was rising for the whole week. Given our inflation forecast, the Monday's CPI will be negative for the zloty. Still, we do not expect a clear rise in EURPLN above 3.96. The domestic currency will be supported by anticipated by us weakening of concerns about Ireland. During the whole week, EURPLN should stay in the range of 3.89-3.96.

▪ Since the beginning of the past week the dollar was gaining versus the euro. The single currency was under the pressure related to Ireland's debt problems. Additionally, the decision of the Chinese central bank to raise the reserve requirement ratio by 50pbs and data showing stronger growth of inflation, pointing to a need of further cooling of the Chinese economy, caused increase in risk aversion and supported demand for the dollar. On Friday some correction occurred, as the European Commission officials reassured the EU have not received request from the Irish government for any financial support and no bailout plan had already been decided for Ireland. This week we expect that the situation regarding Ireland will calm down a bit and the euro will recover versus the greenback. The EURUSD should not decline below 1.36.

Domestic debt slightly weaker

▪ On the domestic fixed income market the yields increased slightly, though the investors' activity was limited due to perspective of long weekend. The long end of the curve was under the pressure due to this week's 10Y bond auction. This week, the key factor determining the domestic fixed income market would be the CPI data. We expect that the publication will trigger yields drop on the short end with FRA and IRS rates also lower. The reaction on the long end may be less clear due to swings of the global market sentiment.

▪ On the core fixed income markets the yields rose, despite deterioration of the market sentiment. The upward trend in the first part of the week was due to worries that the Fed's actions will initiate too high inflation in the US. Later in the week, pretty positive results of Portuguese and Italian bonds auctions and Greek T-bills tender, as well as Friday's weakening of worries over the situation in Ireland, pushed the yields of Bunds and Treasuries further up.

▪ The biggest increase of yields' spread versus 10Y Bunds was recorded in case of Irish bonds. Lack of majority to vote for the budget plan for 2011, increased margin deposit by one of the European clearing houses for Irish debt buyers pushed the spread to the all time high of 683pts. The Friday's statement of the European Commission denying that there was a request for financial support from Ireland calmed the situation. Tuesday's and Wednesday's meeting of euro zone's financial ministers may further reassure investors that the situation on the peripheral bond markets is under control.

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