Bank Zachodni WBK

Weekly economic update

22 – 28 November 2010

Last week saw many events important in Poland and abroad. The start of the week brought a deterioration of sentiment amid persisting uncertainty regarding Ireland's problems and fears about monetary tightening in China. Hence, in the first part of the week the zloty has weakened, which was supported also by dovish comments of MPC hawks. The rest of the week saw an increase of hope for a quick solution to the problems of Ireland and the increase in risk appetite, and consequently a rebound of domestic currency. On the debt market the yield curve became steeper – falling yields at the short end amid weakening expectations for interest rate hikes after the dovish signal sent from the MPC, and rise in yields at the long end following behaviour of core markets. This week the focus of attention will remain on Ireland, but we expect to see more good news (announcement of aid package in some form is very likely), which will be positive for the zloty and domestic bonds (the most attractive seems to be the middle segment of the curve). In Poland, the focus will be on the MPC, although after the recent statements of the Council members there are little doubts that this time again the rates will remain on hold.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 November)					
14:00	**PL**	**Core CPI**	**Oct**	**%YoY**	**1.2**	**1.2**	**1.2**
14:00	**PL**	**Business climate**	**Nov**	**pts**		**-**	
16:00	EZ	Consumer confidence	Nov	pts	-11.0	-	-11.0
		TUESDAY (23 November)					
	PL	**MPC decision**		**%**	**3.50**	**3.50**	**3.50**
8:00	DE	GfK index	Dec	pts	5.0	-	4.9
9:28	DE	Flash PMI – manufacturing	Nov	pts	56.8	-	56.6
9:58	EZ	Flash PMI – manufacturing	Nov	pts	54.4	-	54.6
14:30	US	Core PCE	Q3	QoQ	0.8	-	0.8
14:30	US	Preliminary GDP	Q3	QoQ	2.4	-	1.7
16:00	US	Home sales	Oct	m	4.5	-	4.53
20:00	US	Fed minutes					
		WEDNESDAY (24 November)					
10:00	DE	Ifo index	Nov	pts	107.4	-	107,6
11:00	EZ	Industrial orders	Sep	%YoY	14.7	-	24,4
14:30	US	Personal income	Oct	%MoM	0.4	-	-0,1
14:30	US	Consumer spending	Oct	%MoM	0.5	-	0,2
14:30	US	Core PCE	Oct	%MoM	0.1	-	0,0
14:30	US	Durable goods orders	Oct	%MoM	-0.4	-	3,5
14:30	US	Initial jobless claims	week	k	435.0	-	439.0
15:55	US	Michigan index	Nov	pts	69.4	-	67,7
16:00	US	New home sales	Oct	k	310.0		307,0
		THURSDAY (25 November)					
10:00	**PL**	**Unemployment rate**	**Oct**	**%**	**-**	**11.5**	**11.5**
10:00	**PL**	**Retail sales**	**Oct**	**%YoY**	**7.9**	**8.9**	**8.6**
	US	Market holiday					
		FRIDAY (26 November)					
10:00	EZ	Money supply	Oct	%YoY	1.3	-	1.0

Source: BZ WBK, Reuters, Parkiet

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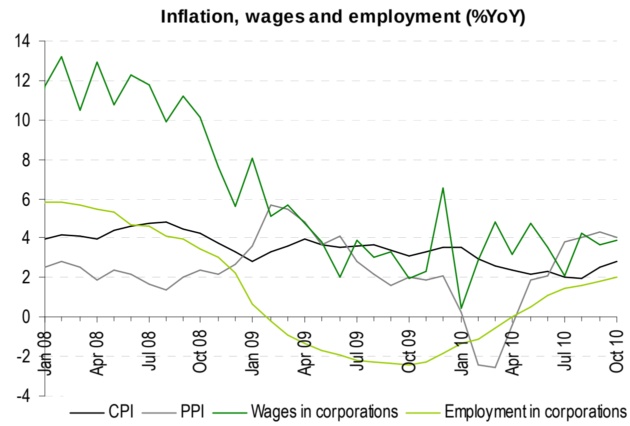
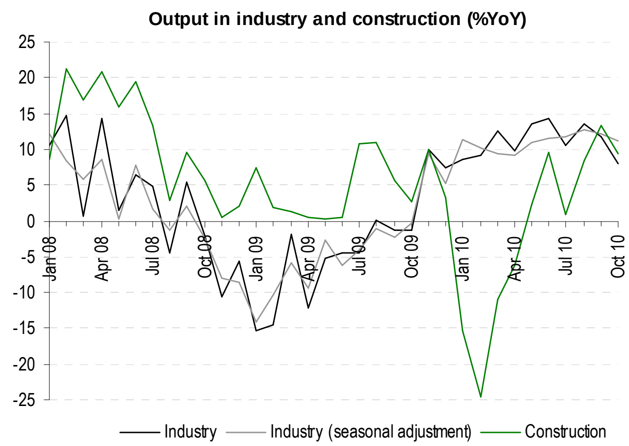
What's hot this week – MPC decision, important data and Irish deal

- This week the key event for the Polish financial market is the MPC meeting. This time the Council will not have the full set of monthly indicators as some figures (in particular the retail sales) will be revealed only on Friday. Our optimism on retail sales is connected among other with the fact that we assume shopping spree before the VAT hike in 2011.
- Core inflation measures as for now do not indicate so that reviving consumption translates into stronger underlying inflationary pressures. We estimate that key core inflation measure (CPI less food and energy) remained stable.
- The Statistical Bulletin due for release on Friday will include data on investment outlays of biggest firms after Q3, which will be some hint before GDP numbers for Q3 to be published the next week.
- There will be many crucial events abroad. Apart from talks between Ireland and IMF/EU, the markets will be focused on important data from major economies.

Economy last week – Output not as bad as looks at the first sight



- CPI inflation continued upward trend in October (as we expected rising to 2.8% from 2.5% versus the FinMin's estimate of 2.9%) and this was driven – similar as in September – mostly by increase in prices of food and clothing and footwear.
- Slight acceleration of annual growth in average wage in the enterprise sector (to 3.9% in October from 3.7% in September) amid firmer employment growth (2.1% vs. 1.8% in September) confirm that so far the increased labour demand is not accompanied by stronger wage pressure. From the MPC's point of view, such a situation is conducive to delay rate hikes. Despite average wage growth remains moderate, the clear employment growth led to acceleration in wage bills growth.
- PPI inflation slightly decelerated to 4.0%YoY in October from 4.3% in September. We predict that despite the strong zloty may constrain rise in producer prices in the next months, PPI inflation will remain high due to rising commodities prices in the global markets.



- The data showing deceleration of industrial output growth in October to 8.0%YoY from 11.8%YoY in September are not as bad as they look at the first glance, due to one-off impact of fewer working days and a short production downtime in Fiat factory at the end of month. The nearest months should be slightly better, yet later on some slowdown seems quite likely, due to weakening foreign demand. The data did not change our view on economic prospects, though for the market they were a confirmation that the MPC will not get many strong arguments this month in favour of faster monetary policy tightening.
- Construction output growth also decelerated in October (to 9.4%YoY from 13.4% in the previous month), however we think that slowdown in this sector was also transitory and next months should see return to double-digit growth rate, along with strengthening investment activity.

Quote of the week – Strong zloty is a substitute for rate hikes

Andrzej Bratkowski, MPC member, Reuters, 16 Nov

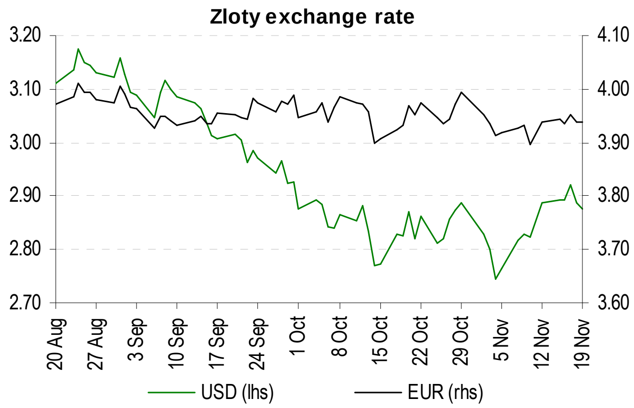
I said that one should start interest rate cycle soon, but this does not necessarily mean that at the nearest meeting. This [the strong zloty] is a substitute for rate hikes in the short term. (...) If someone keeps asking whether [there should be a rate hike] at the nearest meeting, I would reply that in my opinion rather not, but whether at the next one – probably not, but I am not convinced.

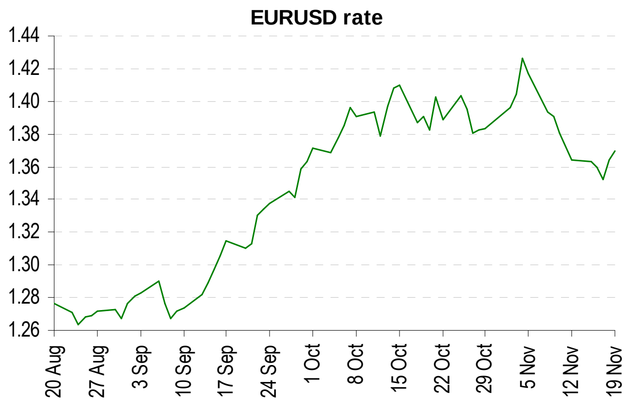
Anna Zielińska-Głębocka, MPC member, Reuters, 16 Nov

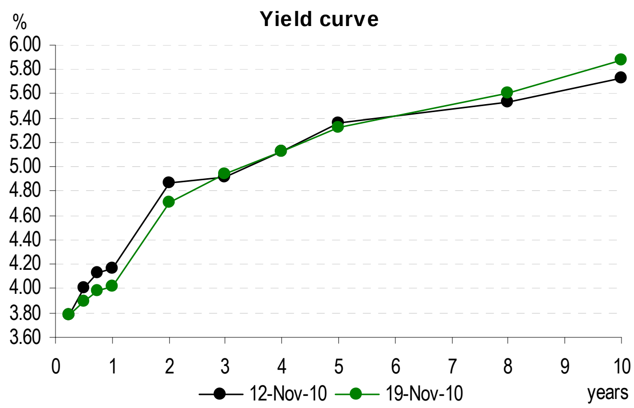
Assuming that this should be a corrective move, i.e. hike by 50bps – then one could decide for the move earlier. If the tightening is to be gradual – one may decide for rate hikes only in the next year.

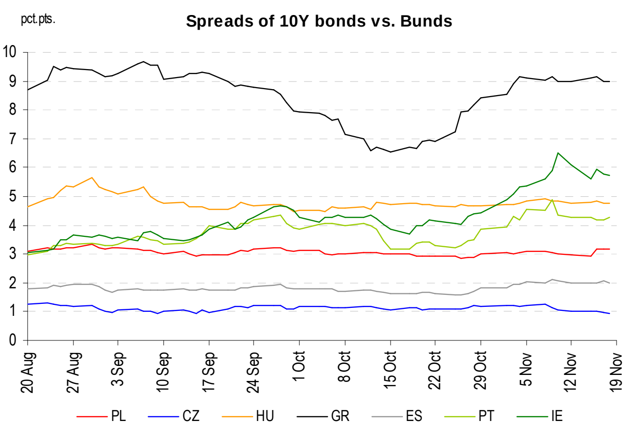
Fresh comments from A. Bratkowski and A. Zielińska-Głębocka, i.e. rate-setter seen by the market as hawks, weakened expectations for swift rate hikes. It seems that even such central bankers as Bratkowski, who already in August voted for 50bps rate hike, now are not going to swiftly start cycle interest rate hikes by 25bps. Such comments from MPC members support our current view that interest rates will remain unchanged. The importance of exchange rate behaviour for interest rate decisions emphasized in Bratkowski's comments confirms his high sensitivity to the possible zloty appreciation. A week ago we wrote about opinions of Bartkowski and NBP deputy president Witold Koziński that the central bank should be more active in the FX market. Koziński repeated such opinion in recent days.

Market monitor









Zloty and euro pared loses due to Ireland

▪ During first days of the past week the zloty was under the influence of solving problems in Ireland and dovish comments of the MPC members. Lower expectations for the interest rate hike on the Tuesday's meeting and high risk aversion pushed the EURPLN up from 3.92 to nearly 3.97. Later on worries over Ireland were abating. Considerable decline of risk aversion supported the zloty, the EURPLN rebounded from the upper band of the downward trend and plunged to 3.93 at the end of the week. As the euro was recovering versus the dollar in the second part of the week, the USDPLN retreated from the peak at 2.94 reached earlier in the week and closed at 2.87. We expect that at the beginning of the week the zloty will be backed by improving market sentiment due to Irish agreement to accept help. Leaving the interest rate unchanged by the MPC shall not surprise the market, while the communiqué may be important factor influencing the exchange rate. We expect that the EURPLN will stay in the range of 3.89-3.96, rather closer to the lower band.

▪ First trading days on the EURUSD market were influenced by the uncertainty regarding the way of solving case of Ireland. Criticism from economists that the QE 2.0 will not support US economy provided additional support for the dollar. Possibility that the program launched lately may not be expanded if the US economy will deteriorate dragged the EURUSD down below 1.35. At the end of the week the euro recovered as Ireland, after several days of talks, decided to accept external help to stabilize fiscal situation. Consequently, the EURUSD ended the week at ca. 1.37. We expect that latest downward correction of the EURUSD ended, and we predict continuation of euro's appreciation towards 1.39 per dollar.

Domestic yield curve steeper

▪ Dovish comments of MPC members, mainly traditionally "hawkish" Andrzej Bratkowski, triggered visible decline of yields, particularly on the short end of the curve. The reaction at the long end was constrained as bigger impact was put by changes on the core fixed income markets. Before Tuesday's MPC meeting some stabilization of short term bonds will probably occur. It seems to us that after latest dovish comments of MPC members, leaving the interest rate unchanged shall not surprise the market participants. Consequently, it is the communiqué that may influence yields. Lower risk aversion on the global market may support mid-term bonds.

▪ On the core fixed income market yields of the Treasuries were rising all week long, due to worries over continuation of the bonds purchases by Fed. In case of Bunds, the worries over Ireland constrained the upward trend. All in all, yields of Bunds increased less than Treasuries.

▪ During the past week it was again Ireland that attracted investors' attention. In first days the uncertainty over the Irish problems remained elevated, the impatience of investors was high as there were no vital decisions taken. Information emerging later in the week suggesting that the agreement is becoming more probable were gradually improving market sentiment. Finally, Ireland agreed to accept external help, although it is still not certain whether it will be for banks of for the state budget. The IMF, ECB and EC officials are still examining the situation of Irish banks and details on the deal are due to be revealed in coming days. Spain benefited from market sentiment improvement and sold on relatively good conditions its 10Y and 30Y bonds.

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