Bank Zachodni WBK

Weekly economic update

29 November – 5 December 2010

Macroeconomic data released last week were overshadowed by mounting pressures on debt of euro area's peripheral countries. Agreed aid package for Ireland only briefly calmed investors, who quickly recognized that Portugal may be the next country in a queue for the financial assistance. In addition, risk aversion was boosted by the military incident on the Korean peninsula. In these circumstances, the zloty and Polish debt recorded a significant correction. The next week promises to be equally interesting. We believe that, despite a number of important economic data that are due for release, the main focus of attention will be still on the European debt market. Additional volatility in the currency market, especially for EURUSD, may by triggered by numerous public appearances of Fed members. In the shadow of the global market events, we will see publications of Polish GDP data for the third quarter, manufacturing PMI index for November, and Ministry of Finance's forecast of November inflation. Consequently, these data will have limited impact on the market.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (29 November)					
11:00	EZ	Economic climate	Nov	pts.	105.0	-	104.1
		TUESDAY (30 November)					
10:00	**PL**	**GDP**	**Q3**	**%YoY**	**3.8**	**3.8**	**3.5**
11:00	EZ	Unemployment rate	Oct	%	10.1	-	10.1
11:00	EZ	Flash HICP	Nov	%YoY	1.9	-	1.9
15:00	US	Home prices S&P/Case-Shiller	Sep	%MoM	-0.3	-	-0.3
15:45	US	Chicago PMI	Nov	pts.	60.0	-	60.6
16:00	US	Consumer confidence	Nov	pts.	52.0	-	50.2
		WEDNESDAY (1 December)					
3:30	CN	PMI manufacturing	Nov	pts.	55.4	-	54.8
9:00	**PL**	**PMI manufacturing**	**Nov**	**pts.**	**55.8**	**55.9**	**55.6**
9:53	DE	PMI manufacturing	Nov	pts.	58.9	-	55.9
9:58	EZ	PMI manufacturing	Nov	pts.	55.5	-	54.6
11:00	**PL**	**Auction of bonds OK0113 and PS0416**					
14:15	US	ADP report	Nov	k	75.0	-	43.0
16:00	US	ISM manufacturing	Nov	pts.	56.2	-	56.9
20:00	US	Fed's Beige Book					
		THURSDAY (2 December)					
11:00	EZ	GDP	Q3	%QoQ	0.4	-	0.4
11:00	EZ	PPI	Oct	%YoY	4.3	-	4.2
13:45	EZ	EBC decision		%	1.0	-	1.0
14:30	US	New jobless claims	w/e	k	428.0	-	407.0
16:00	US	Pending home sales	Oct	k	-1.0	-	-1.8
		FRIDAY (3 December)					
9:58	EZ	PMI services	Nov	pts.	55.2	-	53.3
11:00	EZ	Retail sales	Oct	%MoM	0.2	-	-0.2
14:30	US	Unemployment rate	Nov	%	9.6	-	9.6
14:30	US	Non-farm payrolls	Nov	k	138.0	-	151.0
16:00	US	ISM non-manufacturing	Nov	pts.	54.9	-	54.3
16:00	US	Factory orders	Oct	%MoM	-0.7	-	2.1

Source: BZ WBK, Reuters, Dow Jones

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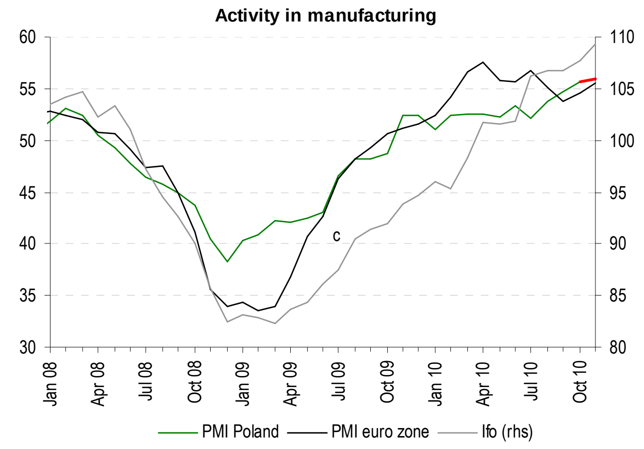
What's hot this week – Polish GDP, PMI, crucial still sentiment abroad



- This week we will see important domestic data, including GDP growth for Q3. One day later the PMI index will hint on the condition of Polish industrial sector in November, while the FinMin will show its inflation forecast.
- Our forecast of GDP growth in Q3 is at 3.8%YoY. We think that the main factor fuelling growth was domestic demand. We predict maintenance of moderately fact growth in individual consumption, and positive contribution of inventories' change. Data should also confirm a clear rebound in investment, and the first positive growth rate in this area for two quarters.
- Amid persisting positive business climate abroad (signalled by flash indicators of economic activity) we predict that PMI manufacturing index in Poland rose in November to 55.9, the highest level since mid-2004. We also expect to see a stabilisation of CPI growth in November at 2.8%YoY. Median market forecast is at 2.9%YoY.

Economy last week – Dovish statement, though MPC sees some risks

Selected fragments from the November MPC statement (marked significant changes versus the October statement)
In October 2010 the annual CPI inflation ~~increased~~ **rose** to ~~the level of the NBP inflation target set at~~ **2.8%. i.e. above the NBP's inflation target of 2.5%.** ~~This rise in CPI inflation was mainly driven by an increase in the growth of food prices and to a lesser degree of energy prices. Core inflation net of food and energy has not changed~~. **The inflation rise was primarily connected with a further increase in food and energy prices, while core inflation net of those prices remained unchanged.** At the same time, ~~other~~ **the remaining** core inflation ~~measures~~ **indices** ~~and PPI growth~~ increased. ~~The majority of inflation expectation measures are close to the NBP inflation target~~. In the ~~coming months a further rise in CPI inflation may be expected, which shall be driven by growing food and energy prices~~. **In the months to come, the growth of food and energy prices may be expected to continue, which will be conducive to higher CPI inflation**. ~~Moreover,~~ In 2011 the level of prices may be **additionally** slightly increased by the announced change in VAT rates.
In the Council's assessment, the **still** 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~~ **persistent risk of increased** 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.

- The MPC kept interest rates unchanged, what was in line with common expectations and should not be surprising in the context of the previous statement, and recent comments by Council members, even those with a hawkish attitude. There was no breakthrough in justification of the decision in the communiqué as regards signals suggesting that interest rate hikes are approaching.
- Marek Belka, when asked whether a rise in the headline inflation rate is not uncomfortable for the MPC, said that one should expect that CPI inflation will be above the target for some time and also stressed that the Council may be afraid of the second-round effects.
- As we have already indicated after the MPC meeting in October, NBP interest rates will most likely be kept on hold until the end of this year. We stick to our view that first hike of 25bps will be announced in Q1 2011.

- In October the retail sales increased by 9.0%YoY versus 8.6% in September. Interestingly, while the annual growth in main categories was still high (at double-digit level), in several sectors some slight deceleration may be observed. That is particularly visible in case of non-necessities and it was not due to base effect, but was a consequence of quite weak demand in the last month. The data of CSO on consumer confidence showed continuation of the downward trend.
- The unemployment rate remained flat at 11.5%. There was an increase in the number of registered unemployed by 0.3%MoM (6.0k), but that was not due to lower number of jobs, but the consequence of inflow of new people to the labour market. The unemployment rate, according to LFS methodology (without seasonal adjustment) declined in Q3 to 9.1%, the lowest level since the end of 2009.

Quote of the week – MPC members changing views

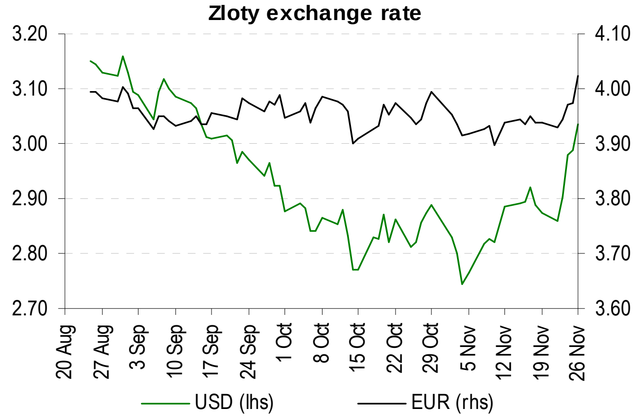
Marek Belka, NBP governor, press conference, 23 Nov
Zloty has great potential to appreciate. It is hard to quantify exactly how big, but by more than 10%. (...)The Council is discussing the prospect of responding to such a threat [the effect of the second round].

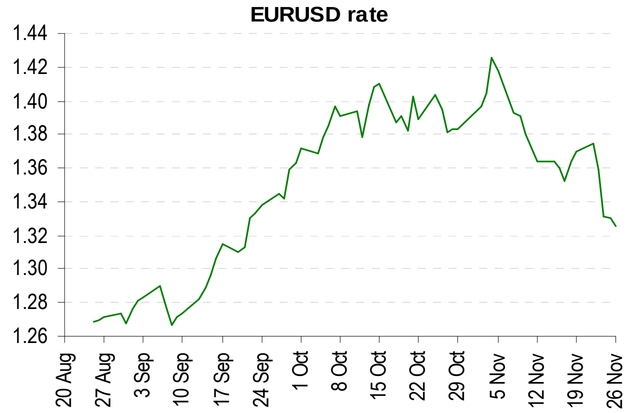
Adam Glapiński, MPC member, PAP, 26 Nov
A strong inflow of capital and a sudden jump in the zloty exchange rate (following a rate rise) would be a very unfavourable development, thus the MPC's intervention through interest rates does not seem to be advisable at the moment. (...) We are monitoring the situation and we will not let ourselves be surprised, we will not be late.

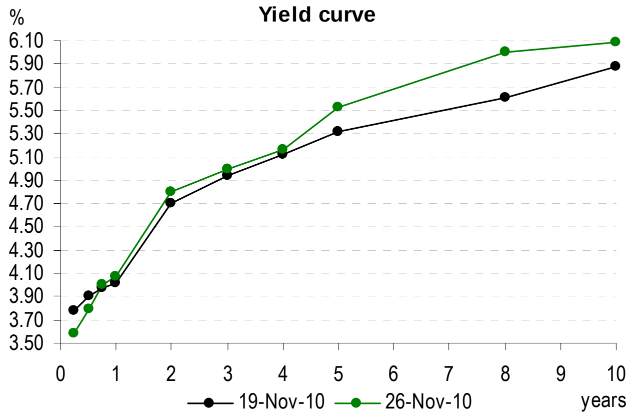
Zyta Gilowska, MPC member, Reuters, 26 Nov
The current level of Polish interest rates is appropriate for the needs of Polish economy and inflation is under control.

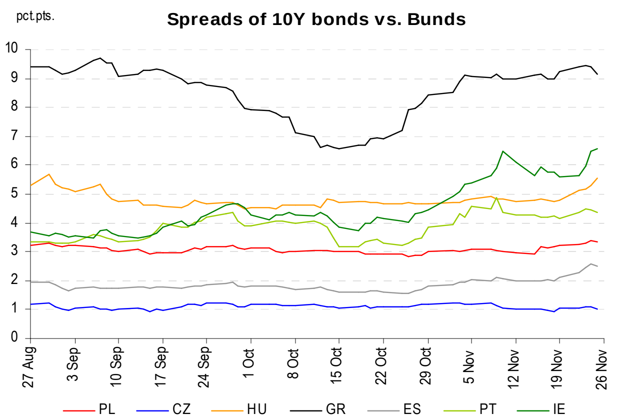
Marek Belka's comment regarding the zloty has been perceived by the market as verbal intervention, however market reaction was only temporary. The NBP president noticed that a risk factor for inflation is possibility of appearance of second-round effects. However, more important in the context of monetary policy prospects are comments of MPC members that appeared later in the week. Two members who used to vote in support of interest rate hike in August, now have signalled that in the current circumstances monetary tightening is not necessary. It is hard to imagine that in the near term a majority could be established that would pass a rate hike motion. It supports our forecast that monetary tightening cycle will start in the first quarter of 2011. It is really hard to say why those two changed their view so radically (and whether or not they will do it again).

Market monitor









Rising risk aversion hurts the zloty

- Despite the last weekend's announcement on a loan agreement for Ireland, the zloty was under pressure since the start of the week. After a drop to 3.92, the EURPLN broke through the top of the downtrend channel, broke resistance at 3.98, and at the end of the week has tested a resistance zone 4.04-4.05. The zloty also depreciated versus the dollar, and the rate rose from 2.84 to almost 3.05 at the end of the week. Uncertainty regarding the situation in the European debt market was boosted by a lack of majority to pass next year's budget in Ireland, a downgrade of the Ireland's credit rating by the S&P's, and investors' worries about the spread of the fiscal problems to other PIIGS countries. Failed attempt to break through the zone 4.04-4.05 on Friday may work in favour of the Polish currency in the coming days. We expect that this week EURPLN rate will remain within the limits of 3.98-4.05. In case of breaking through this zone, a potential range of zloty weakening is 4.14 per euro.
- Since the start of last week the dollar was clearly strengthening against the euro. EURUSD fell from 1.377 to 1.32 at the end of the week. Even better than expected flash PMI data in the euro area and Germany did not help the common currency too much. The focus of attention was on Ireland and other peripheral euro zone countries, and the North Korean attack on South Korea. To smaller extent, the dollar was supported by the lack of unanimity among the Fed members on the consequences of the second round of monetary stimulation, which was revealed by minutes of the November meeting. On Friday, the EURUSD was testing the support level at 1.33. Confirmed break of this limit may lead to further depreciation of the euro to 1.30. The euro is supported by the fact that the exchange rate reached the upward trend line drawn on weekly intervals, which may to some extent reduce the potential for the EURUSD decline.

Domestic debt affected by sentiment abroad

- High risk aversion associated with the uncertainty in the European debt market has triggered an increase in yields on the domestic debt market. The sale-off affected securities mainly in the middle and at the long end of the curve, and the largest part of the move took place in the second part of the week. Decline in expectations for interest rate hike this year after last week's MPC meeting and the subsequent comments of Council members has tamed a bit a sell-off at of short-term bond. We expect that this week the global market moods will continue to dominate, which will be reflected mainly in yields in the middle and at the long end of the curve.
- On the core debt markets, the two forces clashed. First, pushing yields down, was related to a widespread risk aversion in the global market. On the other hand, further pressure from Germany to include in the assumptions of the fiscal stability mechanism a statement forcing investors to bear the costs associated with a possible future bankruptcy of the country, favoured withdrawal from euro zone bonds. In addition, the auction of 10-year German bonds has attracted relatively weak demand. During the week the yields have not changed significantly.
- After a short break that occurred at the end of last week, spreads versus the 10-year Bunds continued their upward trend. Yields of Irish and Spanish bonds were rising consistently throughout the week. The Irish government still lacks majority to pass the next year's budget. Situation has not improved after the presentation of a 4-year savings plan, as investors assessed the assumptions on which it is based as too optimistic. Moreover, once again in the last two weeks one of European clearing houses raised the required margin for trading in Irish government bonds.

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