Bank Zachodni WBK

Weekly economic update

26 September – 2 October 2011

The previous week was predominated by high risk aversion. Even though Greece has paid bond coupons in line with schedule and G20 has declared readiness to take coordinated actions if necessary, the market sentiment has not improved. The market was dominated by fears of recession due to pessimistic Fed's assessment of US economic outlook and weak PMIs, as well as concerns about crisis in the euro zone and worries about European banking system after downgrade of Italy and Italian, Greek and US banks. Amid rapid rise in risk aversion, EURPLN temporarily broke 4.50, while the domestic yields were under pressure. On Friday the NBP intervened by selling foreign currencies on the market. Moreover, there were rumours that BGK was selling euro and purchasing domestic bonds. In due course, the ERUPLN exchange rate slid below 4.40. Domestic data on industrial output and retail sales proved to be better than expected, but this does not change our forecasts indicating an imminent slowdown in domestic industry and consumers' demand.

It seems that in the week ahead, the most important issues will be still uncertainty related to euro zone debt crisis and depth of slowdown in global economy. Over the weekend, some important news can emerge, as central bankers and finance ministers are meeting in the IMF. After the weekend the IMF, EC and ECB mission returns to Greece. Investors will also focus on the data from Germany and the USA. These releases will help in assessment of business climate in the key economies. We stick to our opinion that the rebounds on the market have to be seen as temporary, as the key problems of the European economy and banking sector still remain unresolved. The domestic data and the government meeting on Tuesday on the budget for 2012 and strategy of debt management will be of secondary importance.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (26 September)					
10:00	DE	Ifo index	Sep	pts	106.5	-	108.7
16:00	US	New home sales	Aug	%YoY	295	-	298
		TUESDAY (27 September)					
08:00	DE	Gfk Index	Oct	pts	5.0	-	5.2
10:00	EZ	Money supply	Aug	%YoY	1.9	-	2.0
15:00	US	S&P/Case-Shiller index	Jul	%MoM	0.1	-	-0.1
16:00	US	Consumer confidence	Sep	pts	46.0	-	44.5
		WEDNESDAY (28 September)					
14:30	US	Durable goods	Aug	%MoM	0.0	-	4.1
		THURSDAY (29 September)					
11:00	EZ	Consumer confidence	Sep	pts	96.0	-	98.3
14:00	**PL**	**Balance of payments**	**Q2**	**€m**	**-**	**-2552**	**-3364**
14:30	US	GDP - third estimate	Q2	%QoQ	1.2	-	0.4
14:30	US	Initial jobless claims	week	k	420	-	423
16:00	US	Pending home sales	Aug	%MoM	-1.3	-	-1.3
		FRIDAY (30 September)					
4:30	CN	PMI - manufacturing	Sep	pts	-	-	49.9
11:00	EZ	Flash HICP	Sep	% YoY	2.5	-	2.5
14:00	**PL**	**Inflation expectations**	**Sep**	**%YoY**	**-**	**-**	**4.2**
14:30	US	Consumer spending	Aug	%MoM	-	-	0.5
14:30	US	Personal income	Aug	%MoM	0.1	-	0.3
14:30	US	Core PCE	Aug	%MoM	0.2	-	0.2
15:45	US	Chicago PMI	Sep	pts	55.3	-	56.5
15:55	US	Michigan index	Sep	pts	58.0	-	57.8

Source: BZ WBK, Reuters, Parkiet *forecast after inflation figure for August

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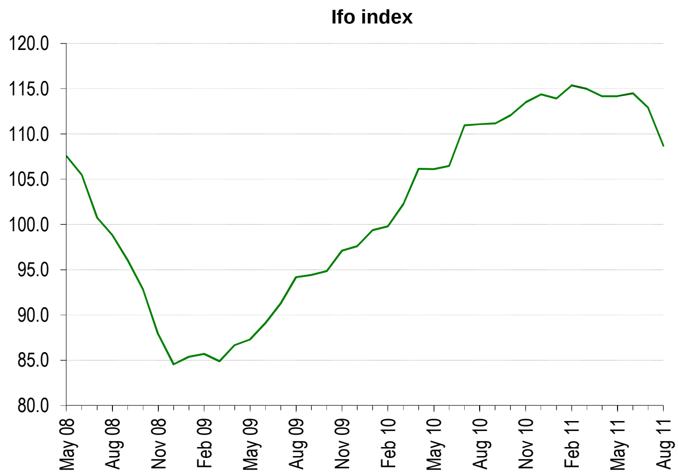
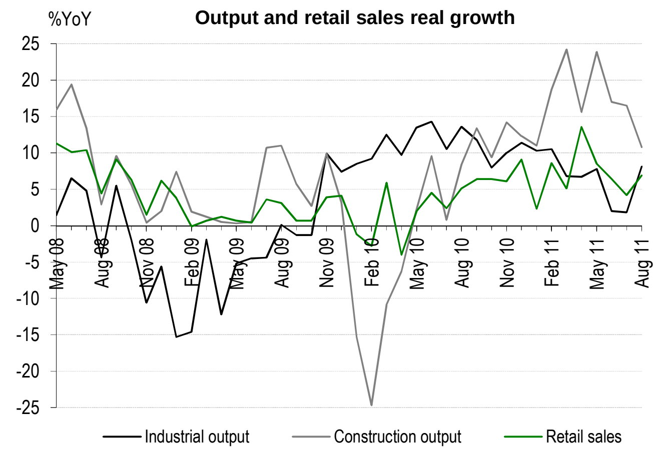
What's hot this week – Another bunch of important data from abroad

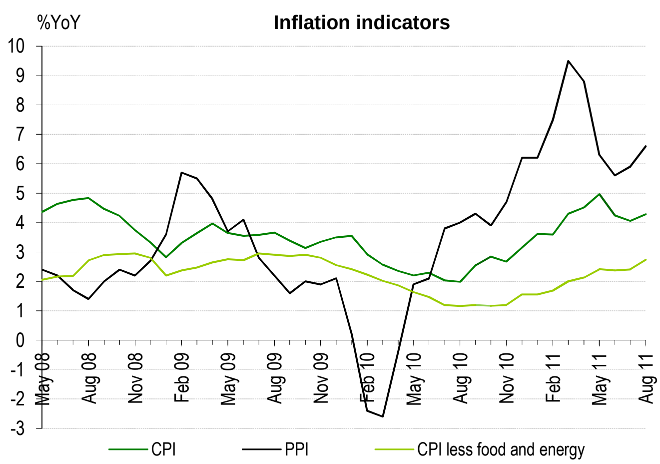


- This week the market will remain focused on events and data releases abroad. On Monday we will see German Ifo index for September and on Tuesday GfK for October. In the following days the market will focus on important data from the USA, reflecting the housing market condition and situation as well as optimism of US consumers. Figures from Germany and the USA will show the depth of slowdown of economic activity. Market will also be sensitive to news about Greece. The IMF, EC and ECB mission is returning to Athens to finish talks on disbursement of next aid tranche. Important news may appear already during the weekend, from the officials' meeting at the IMF.
- On Tuesday the government will work on 2012 budget draft and strategy of debt management. Domestic data (quarterly balance of payments and inflation expectations) will be of secondary importance.

Last week in the economy – Industrial output and retail sales surprise on the upside



- Industrial output rose in August by 8.1%YoY and construction and assembly output rose by 10.8%YoY. The largest increase occurred in manufacturing (9.3%YoY), especially in the production of motor vehicles (23.2%YoY) - which was suggested several days ago by SAMAR report on car production in August. Solid results were also recorded in other sectors with traditionally high share of production for export
- This suggests that the impact of slowdown in economic activity abroad has not yet affected Polish manufacturing as severely as it was previously judged, especially after the results of rather weak production and low PMI index in recent months. It doesn't change the general view that in the coming quarters we should expect a slower growth in industry, because of weaker inflow of orders from major EU economies.



- PPI rose by 6.6%YoY, mainly due to the weaker zloty. Core inflation excluding food and energy prices in August rose to 2.7%YoY from 2.4%. Other measures of core inflation also increased, and it would be an argument for the MPC to hike interest rates if there was no looming economic slowdown in Poland and abroad.
- Retail sales accelerated in August to 11.3%YoY, clearly exceeding expectations. A significant slowdown in furniture, electronics and appliances is worth attention, since it can indicate a growing consumers' uncertainty about major purchases.
- Visible slowdown of the positive trends in the labour market and rising concerns about prospects for the economy in coming quarters will probably deteriorate the consumer confidence and reduce the sales growth. At year-end, the unemployment may also increase after falling to 11.6% in August, in line with expectations.

Quote of the week – Another balanced comments

Andrzej Kaźmierczak, MPC member, 20 September, Reuters

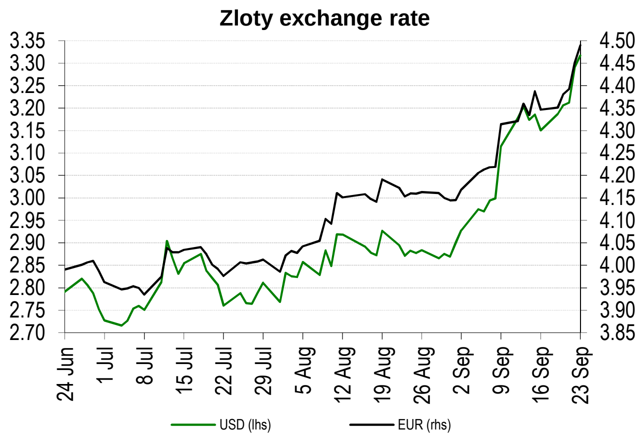
Restrictive bias should be maintained. The situation is uncertain and it poses a risk to inflationary processes. There is no issue of changing bias until this situation is going to clear out and calm.

Anna Zielińska-Głębocka, MPC member, 19 September, Reuters

These data [on industrial output] do not justify the need for changes in monetary policy, including possible cuts in interest rates. In a situation where we are facing an economic slowdown at the end-year, I can see no room for rate hikes, unless there would be a dramatic collapse in the FX market.

Another comments of MPC members weakening expectations for rate cuts appeared last week. Perhaps the majority of MPC members do not want to suggest a monetary easing when the zloty is under a clear negative pressure. Minutes from the last meeting MPC showed that its members were unanimous about keeping the interest rates at the current level. These publications and the comments of MPC members support our expectations about leaving interest rates unchanged in this and next year.

Market monitor

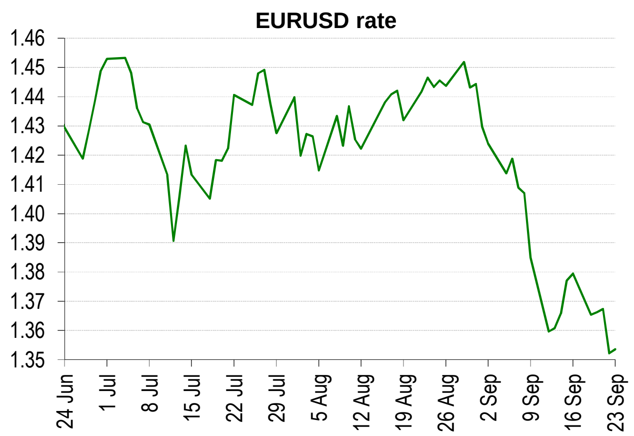


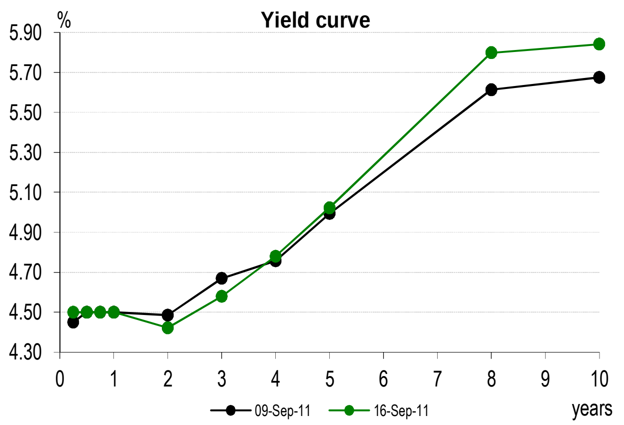
EURPLN close to an important level

▪ Last week was the third one in a row, marked by substantial losses of the zloty against the euro. The persisting high risk aversion has pushed EURPLN to the highest level since June 2009. EURPLN has even temporarily climbed above 4.50, but the Friday's NBP intervention has dragged it down to ca. 4.40. However, in longer term, the effectiveness of such intervention will depend on the global sentiment. For the upcoming days, we see a resistance area at 4.50. The scenario that the exchange rate will move down is supported by the divergence between price of the zloty and RSI oscillator (exchange rate is setting new peaks, while RSI is not). Support is at 4.28. On the other hand, the current situation is highly volatile, so nothing can actually be ruled out. If the rate breaks through 4.50 for good, it may climb further, up to psychological levels of 4.60 and 4.70. However, we see a chance that at the end of the month EURPLN will be close to 4.44

▪ The Czech koruna has also lost throughout the week, EURCZK has broken the upward border of horizontal trend, in which the rate moved since March. A negative pressure on the koruna, apart from weak global sentiment, was exerted by a dovish communiqué from the Czech MPC meeting.

▪ EURUSD has dropped considerably due to market's disappointment about the Fed statement and concerns about the euro zone. The rate has hit the lowest level since February. The current market conditions leave the door open for further drops.



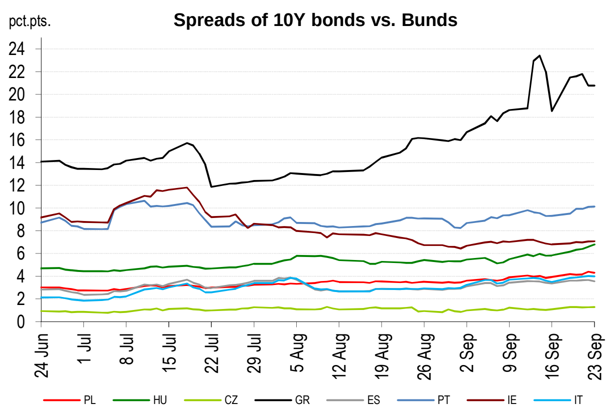


No conditions for persistent stabilisation of yields

▪ Domestic bonds were hit by lower demand for risky assets. Securities from the short end resisted the sell off for some time but finally we saw rising yields also in that segment of the curve. Still, the biggest weakening was seen on the middle and long end of the curve. The move of same scale (ca. 20bps) was also seen in case of IRS rates. On Friday bonds pared some loses after it was rumoured that BGK was buying domestic treasuries. The behaviour of the market during past few days has shown that the risk aversion broke the level below which Polish bonds were perceived by investors as relatively safe and paying adequate interest. Recently, there were signs of herding behaviour in the market, close to a panic. The sources of uncertainty that generate risk aversion are still alive so we do not expect the situation on the domestic debt market to change in the nearest future.

▪ On the core debt market yields plunged due to high demand for safe assets amid persisting very high risk aversion. Yields of 10Y Bunds and Treasuries reached all-time lows at 1.636% and 1.674%, respectively.

▪ On the peripheries of the euro zone's debt market spreads versus 10Y Bunds widened. That was due to weakening of bonds issued by countries with uncertain fiscal situation but also due to falling yields of Bunds.



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