

# Weekly economic update

3 – 9 October 2011

Over the last week the debt crisis was still the most important concern among investors. This time, however, the market turned a bit more optimistic, hoping that the criticism, which fell on the top euro zone policymakers after the summit in Wrocław, had invigorated them to take more decisive steps. Expectations for faster actions were also supported by the decisions of national parliaments (including Germany and Finland) to increase the EFSF. Data from the US, released last week, had a positive impact on investors' sentiment. However, after the publication of data indicating a contraction of Chinese industry in September, for the third month in a row, the sentiment deteriorated slightly. The zloty did not benefit from calm moods and recorded a slight weakening over the week against the euro, despite another NBP intervention on Friday, while domestic bonds gained as a result of increased demand for risky assets.

Although the data from the US have surprised on the upside, they did not change the outlook the global economic growth substantially. The indices on activity in manufacturing for the US, Germany and the euro zone, which will be released next week, are likely to confirm that September was another month of contracting activity in this sector. At the end of the week, investors will pay attention to the monthly data from the US labour market, which tends to disappoint recently. Also the consecutive votes over EFSF and even their positive results (this week Malta is likely to vote) will not change substantially the markets' assessment of prospects for solving the debt crisis in the euro zone, as it seems apparent that further enhancement the EFSF will be needed, some additional actions securing the banking system. On Monday the Ecofin will begin its meeting and the market will remain sensitive to their comments. The investors will pay particular attention to suggestions of increase in the participation of private investors and the possibility of renegotiating the second package for Greece, which was suggested by the German chancellor last week. Focus will be also on the EBC statement (particularly in the context of higher than expected inflation in September), while the communique of the Polish MPC is unlikely to impact the market. We predict the EURPLN will stay in range 4,36-4,50 as uncertain situation in world markets will constrain potential for decline.

## Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (3 October)</b>							
9:00	PL	PMI – manufacturing	Sep	pts	51.0	51.4	51.8
9:28	DE	PMI – manufacturing	Sep	pts	50.0	-	50.9
9:58	EZ	PMI – manufacturing	Sep	pts	48.7	-	49.0
16:00	US	ISM – manufacturing	Sep	pts	50.3	-	50.6
<b>TUESDAY (4 October)</b>							
11:00	EZ	PPI	Aug	%YoY	5.8	-	6.1
16:00	US	Industrial orders	Aug	%MoM	0.0	-	2.4
<b>WEDNESDAY (5 October)</b>							
	PL	MPC decision		%	4.50	4.50	4.50
9:58	EZ	PMI – services	Sep	pts	49.1	-	51.5
11:00	EZ	GDP revision	Q2	%YoY	1.7	-	2.4
11:00	EZ	Retail sales	Aug	%YoY	-0.7	-	-0.2
14:15	US	ADP report	Sep	k	75	-	91
16:00	US	ISM – services	Sep	pts	53.0	-	53.3
<b>THURSDAY (6 October)</b>							
13:00	GB	BoE decision		%	0.50	-	0.50
13:45	EZ	EBC decision		%	1.50	-	1.50
14:30	US	Initial jobless claims	week	k	410	-	391
<b>FRIDAY (7 October)</b>							
12:00	DE	Industrial production	Aug	%MoM	-1.9	-	4.0
14:30	US	Non-farm payrolls	Sep	k	60	-	0
14:30	US	Unemployment rate	Sep	%	9.1	-	9.1

Source: BZ WBK, Reuters, Parkiet

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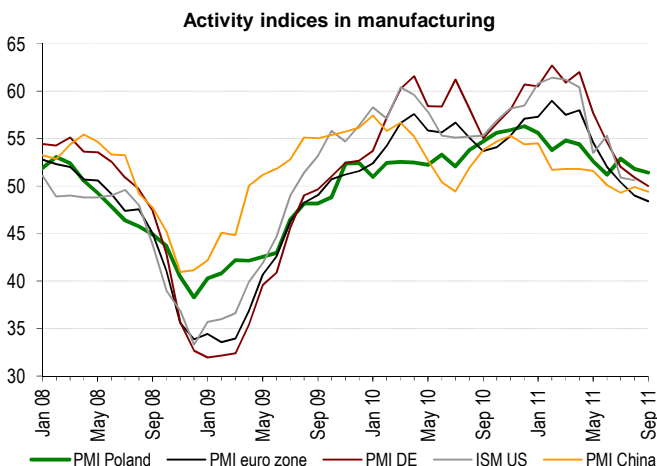
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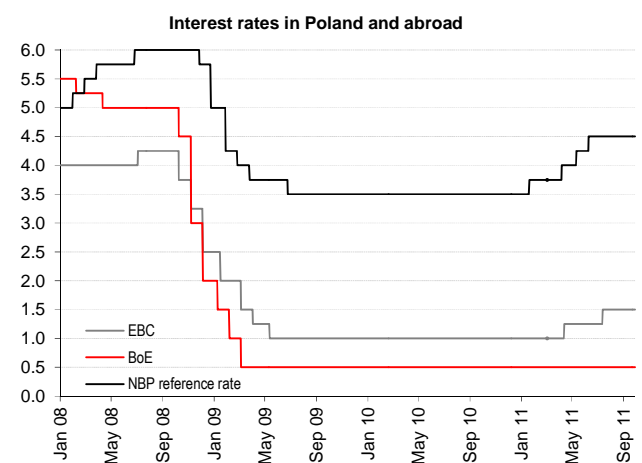
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**What's hot this week – Central bank decisions and manufacturing activity indicators**



- Flash PMI indices for the euro zone and Germany have shown continuation of activity drop in manufacturing sector. We expect that the PMI index for Polish industry will show a similar conclusion. The main source of decline will be most likely falling export orders, employment, and possibly production.
- The latest ECB communique has confirmed that the cycle of interest rate hikes in the euro zone has come to an end, amid expected economic slowdown. Amid little chance for cuts before the end of Trichet's tenure, investors will be awaiting the announcement of other measures that could stabilise the financial markets. The decision about renewal of one- or two-year refinancing operations may be announced, decreasing market concern about banks' liquidity problems.



- The MPC decision on interest rates is due for release on Wednesday. Recently, the MPC members presented rather hawkish bias and they did not suggest a possibility of cut, which supported our expectations for flat NBP interest rate at 4.50% until end of 2011.
- In our view, the MPC can underline in the post-meeting communiqué not only the persisting uncertainty about outlook for global growth but also the significant zloty weakening which took place in the last weeks. It can be stressed that this weakening can have a considerable impact on the "outlook of inflation returning to target".
- The FRA market is currently pricing-in one 25-bp rate cut in 6-9 months and we anticipate that the Wednesday's communiqué will not alter these expectations markedly due to persisting uncertainty about the economic growth in 2012.

**Last week in the economy – Clear drop in inflation expectations**



- NBP's measure of households' inflation expectations decreased clearly in September to 3.8% from 4.2 in August (CPI known at the time of the survey was July's 4.1%). The ratio of respondents expecting that in the next 12 months prices will be growing faster or at the same pace as currently, was the lowest since December 2010. Also, the share of people expecting a drop of prices or their slower growth has increased. The data supported our forecast of leaving interest rates unchanged in 2011.
- The quarterly balance of payments figures for 2011Q2 have shown a current account deficit at €3.4bn, i.e. by €1.0bn higher than it resulted from the monthly data. This discrepancy was visible mostly in the income balance, which has shown a deficit deeper by €1.0bn. The exports and imports for Q2 were not revised considerably.

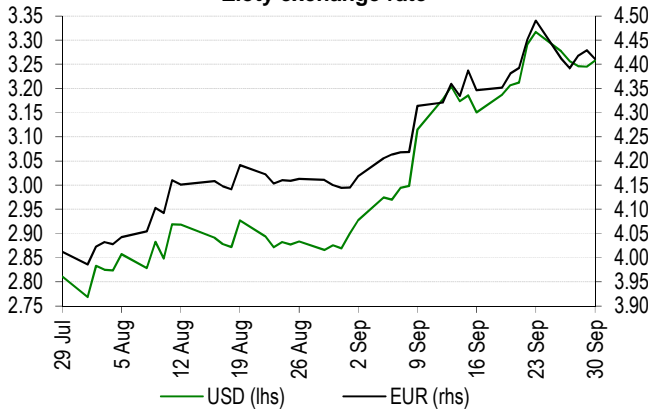
**Quote of the week – Budget safe even with GDP growth at 3%?**

**Jacek Rostowski, Finance Minister, Reuters, 27 September**  
 I see no ground for doing that [lowering the GDP forecast for 2012] (...) First, 4% GDP growth is very probable in this year (...) Budget is secure even by a 3% growth, which is not even expected. If there is a need, we will be ready to change these forecasts.

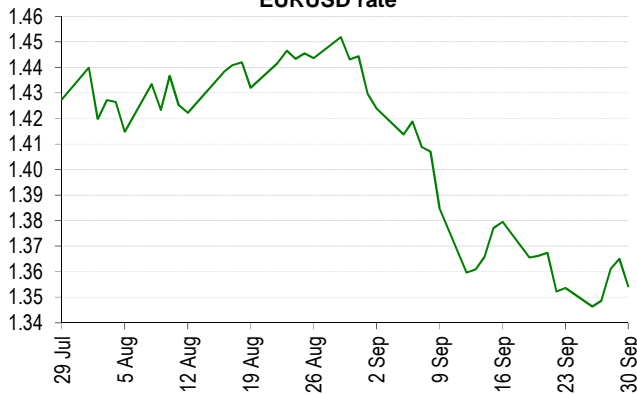
Last week, the government approved budget draft for 2012. It maintained earlier assumptions of budget deficit at PLN35bn, GDP growth at 4% and average inflation at 2.8%. Though our forecasts regarding the EURPLN rate are close to those presented by the government (4.35 at year-end), we are clearly less optimistic as regards GDP growth. We expect the economy will expand by 2.7% in 2012, which will have negative impact on tax income plan presented by the government. It is very likely that that the budget will be adjusted after the October's parliamentary elections.

**Market monitor**

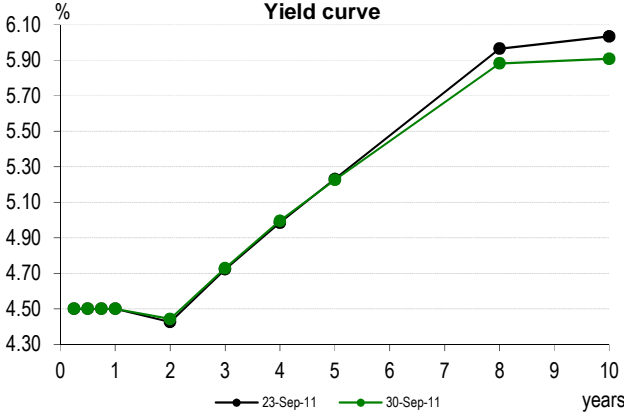
**Zloty exchange rate**



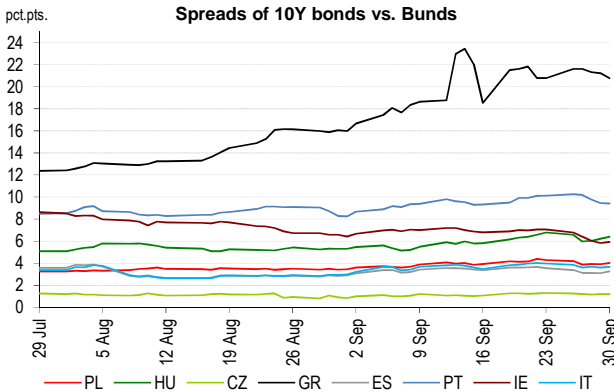
**EURUSD rate**



**Yield curve**



**Spreads of 10Y bonds vs. Bunds**



**Uncertainty limiting downward potential for EURPLN**

▪ After a sharp decline of EURPLN, which was sparked by the NBP's intervention on previous Friday, the rate rebounded slightly during last week. Although the global markets were in a relatively good mood, zloty did not benefit much from a rise in demand for risk, and EURPLN declines during the week were only temporary. At the end of the week, there was information about BGK selling dollars, and on Friday NBP re-entered the market. The sale of foreign currencies by the central bank had smaller impact on the market, than the morning information about NBP's interest in bid and ask prices of the euro. In our opinion the EURPLN will remain within the range of 4.36-4.50 as the uncertainty in the global market is constraining potential of a decline.

▪ Czech koruna and Hungarian forint also depreciated against the euro during past week.

▪ EURUSD rate grew from the beginning of the week supported by hopes for a more decisive action to resolve debt crisis in the euro zone. Besides, there was a negative pressure on the dollar after the Fed chief said that further stimulus in the US economy is possible if inflation forecasts decline. In the middle of the week the momentum of the euro appreciation was destroyed, and when the market began to worry about global economic growth, EURUSD began to fall and returned to Monday's level. Overall, the rate ranged during the week between 1.34 and 1.37 and in a broader perspective there was no groundbreaking changes. This week the rate will be under the influence of news from the Ecofin group. Later on, the trend will be determined by information from the ECB and Friday's data from the US.

**MPC decision unlikely to rock the debt market**

▪ In the last week the domestic yield curve flattened due to a strengthening in the middle and at the longer end. The Polish bonds gained thanks to increasing demand for risky assets, but the turnover was lower than during the previous sell-off. 10Y IRS rate fell in a similar scale to yields of bonds, so the asset swap spread has remained virtually unchanged. FRA rates remain stable and we do not expect the MPC communiqué to cause considerable volatility. The prices of bonds will depend mostly on sentiment abroad. In our view, the potential for weakening at the shorter end (provided that risk aversion rises) is limited as compared to other segments of the curve, as the short-term bonds are supported by expectations for interest rates cuts. On the other hand, the market is still predominated by unstable moods, while optimism is provided only by hopes for decisive actions of the euro zone policymakers. This means that a potential for strengthening on the middle and at the longer end of the yield curve is still limited.

▪ On the core debt markets, the yields have recorded considerable increases due to dropping demand for safe assets. At the end of the week the yields of 10Y Bunds and Treasuries amounted to 1.89% and 1.91%, respectively.

▪ On the euro zone peripheries the spreads to 10Y Bunds have narrowed in most cases. The Greek spreads did not decrease, due to persisting concerns about resolution of its problems.

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