Bank Zachodni WBK

Weekly economic update

10 – 16 October 2011

The start of the new week and the new quarter passed under the sign of concerns about possible spillover of the debt crisis to other euro zone countries. At the Eurogroup's summit the decision was made to postpone disbursement of next aid tranche for Greece (possibly even until mid-November). Also, the policymakers signalled the need to increase the scale of private sector engagement in the bailout programme. Moreover, at the start of the week the risk aversion was supported by data pointing to further fall in economic activity. Clear improvement in global moods took place only in the middle of the week, after information that euro zone leaders are working on recapitalisation of banking sector. Optimism was also boosted by the IMF's declaration that it may more actively join the fight with debt crisis in the euro zone. The Polish MPC kept interest rates on hold and retained quite hawkish tone of the official statement, which had slightly negative impact on the debt market. NBP President said that more FX interventions are possible, which supported the zloty. The ECB keep kept interest rates unchanged and decided to launch covered bonds purchase programme and run two long-term liquidity operations.

One should keep in mind that the optimism that appeared in recent days was triggered, similarly as two weeks ago, by hopes for more decisive actions to contain the European debt crisis. The anonymous source from the EC informed that already before the EU summit the Commission will present proposals to support the European banks. The time is crucial, as if the European leaders will not coin their proposals into a consistent plan, the risk aversion may return quite soon. As regards macro data, particularly interesting will be the end of the week, then important data from the US will be released. A set of interesting data will also appear in Poland (CPI, balance of payments), but we do not expect that it will have a significant impact on the market. We believe that at the start of the week the result of general election in Poland will impact the FX and FI markets, in particular the market will try to evaluate how quickly the new government may be established. Thanks to Fridays' better than predicted data from the US labour market, the EURPLN was testing the support at 4.36 and if the election results are positively perceived by investors, the rate may drop again below this level. We see a supportive environment for the domestic debt market.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (10 October)					
8:00	DE	Exports	Aug	%MoM	0.5	-	-1.8
10:30	EZ	Sentix index	Oct	pts	-18.3	-	-15.4
		TUESDAY (11 October)					
20:00	US	Fed Minutes					
		WEDNESDAY (12 October)					
11:00	**PL**	**Bonds switching auction**					
11:00	EZ	Industrial output	Aug	%MoM	-0.7	-	1.0
		THURSDAY (13 October)					
3:00	CN	Trade balance	Sep	$bn	16.0	-	17.76
14:00	**PL**	**CPI**	**Sep**	**%YoY**	**4.1**	**4.1**	**4.3**
14:00	**PL**	**Current account balance**	**Aug**	**€m**	**-1273**	**-1376**	**-1611**
14:00	**PL**	**Exports**	**Aug**	**€m**	**10 832**	**11 106**	**10 721**
14:00	**PL**	**Imports**	**Aug**	**€m**	**11 805**	**12 168**	**11 921**
14:30	US	Trade balance	Aug	$bn	-46.0	-	-44.8
14:30	US	Initial jobless claims	week	k	405	-	401
		FRIDAY (14 October)					
3:30	CN	CPI	Sep	%YoY	6.0	-	6.2
11:00	EZ	HICP	Sep	%YoY	3.0	-	2.5
14:00	**PL**	**Money supply**	**Sep**	**%YoY**	**9.2**	**9.4**	**8.5**
14:30	US	Import prices	Sep	%MoM	-0.3	-	-0.4
14:30	US	Retail sales excluding autos	Sep	%MoM	0.2	-	0.1
15:55	US	Flash Michigan index	Oct	pts	60.2	-	54.9

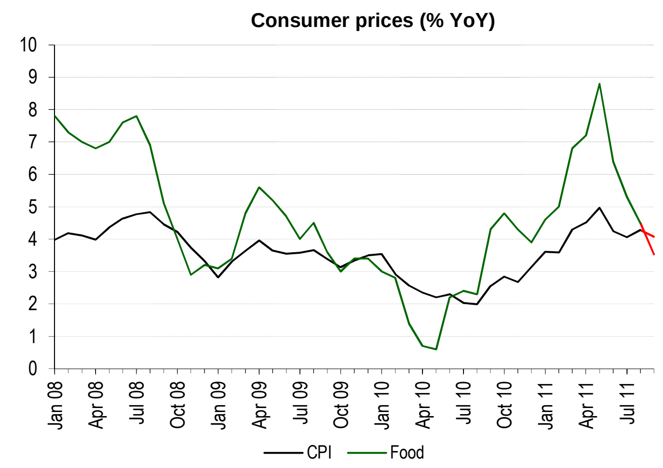
Source: BZ WBK, Reuters, Parkiet

Maciej Reluga Chief economist +48 22 586 8363 e-mail: ekonomia@bzwbk.pl

Piotr Bielski +48 22 586 8333 **Marcin Sulewski** +48 22 586 8342

Agnieszka Decewicz +48 22 586 8341 **Marcin Luziński** +48 22 586 8362

What's hot this week – Domestic inflation and balance of payments

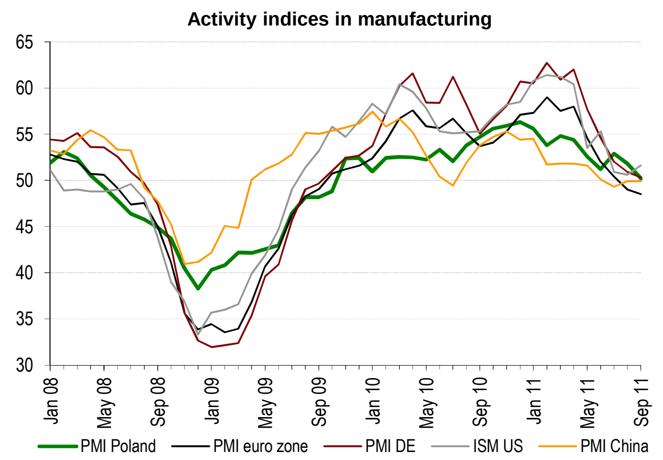


▪ We expect that the annual CPI inflation slowed down in September. According to our estimates, in September the food prices have increased only slightly against August, which is untypical for this month. This means that the annual growth of food prices decreased significantly.

▪ In our view the balance of payments figures will show that in August the current account deficit narrowed. We think that this was due to a smaller trade deficit, an improvement of income balance and greater inflow of current transfers. A rebound of industrial output in August supports our forecast of acceleration of imports and exports.

▪ The M3 money supply figures will show if the corporate loans are still expanding. This can be an important hint about fixed investments in Q3.

Last week in the economy – Industry slows down, MPC communiqué still hawkish



▪ Polish PMI manufacturing index fell in September in a larger scale than indicated by forecasts. The reading at 50.2pts was the lowest since October 2009.

▪ As one could have expected, this was driven mostly by lower orders, especially as regards foreign demand. Also, slower increase in employment and significant slowdown in production contributed to the deterioration in sentiment. Subindex for industrial production fell to the lowest level in 25 months. It is quite clear that recent weakening of the Polish currency has not offset lower export orders. However, depreciation of the zloty has had an impact on producer prices, which accelerated as compared to August.

▪ As PMI figure was significantly below our forecast, we revised down our estimate of September's industrial output (from around 5% to 3.8%YoY).

Fragment of the October's MPC communiqué
In the coming months, annual CPI inflation will continue to run at an elevated level, primarily due to the previously observed sharp rise in global commodity prices.
In the medium term, inflation will be curbed by the anticipated decline in domestic economic growth amidst fiscal tightening, including reduced public investment spending, and interest rate increases implemented in the first half of 2011, as well as a likely global economic slowdown. On the other hand, the impact of the situation in the global financial markets on the zloty exchange rate constitutes an upside risk factor to domestic price developments.
In the opinion of the Council, the significant monetary policy tightening implemented since the beginning of 2011 should enable inflation to return to the target in the medium term. Given the above, the Council decided to keep the NBP interest rates unchanged. The Council does not rule out the possibility of further monetary policy adjustments, should the outlook for inflation returning to the target deteriorate.
In the recent period the National Bank of Poland sold some amount of foreign currencies in exchange for zlotys. Such transactions were consistent with the pursued monetary policy strategy defined in the *Monetary Policy Guidelines*.

▪ MPC kept interest rates unchanged. In line with our expectations, the Council's rhetoric did not change significantly compared with the previous month, in spite of signals of a global and domestic slowdown.

▪ The result of today's MPC meeting confirms that the Council does not see a necessity of prompt loosening of monetary policy. Inflation at still elevated level and weak zloty (that may deteriorate outlook of CPI's return to the target) work against soon rate cuts.

▪ Poor economic outlook may finally push the MPC towards rate cuts. We assume that in a few months' time (at the beginning of 2012), when the inflation starts to decelerate, situation on the currency market is stable and the ECB begins to cut rates, the Council will change its bias towards more dovish and will cut rates. There will probably be two cuts by 25bps.

Quote of the week – More interventions possible

Marek Belka, NBP's governor, press conference after the MPC's meeting, 5.10.2011, PAP

Yes, such actions are possible [NBP's interventions].

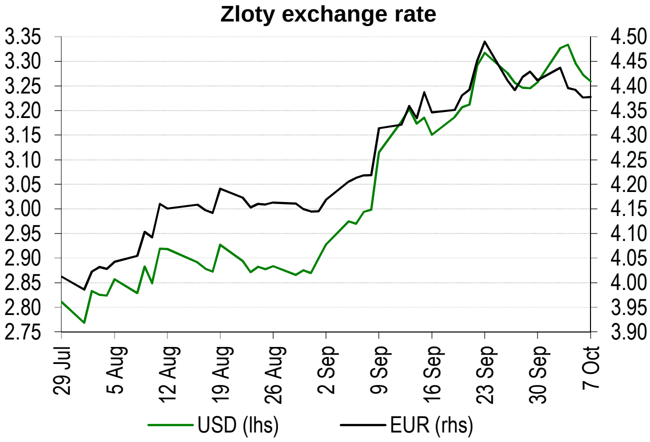
We wanted to calm the markets. It is a signal for investors that they must be aware because the NBP could intervene.

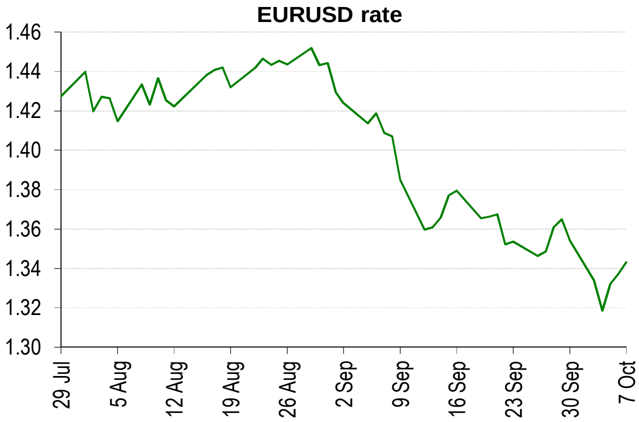
Yes, I believe that as a result of external factors, the zloty is detached from fundamentals and the equilibrium exchange rate.

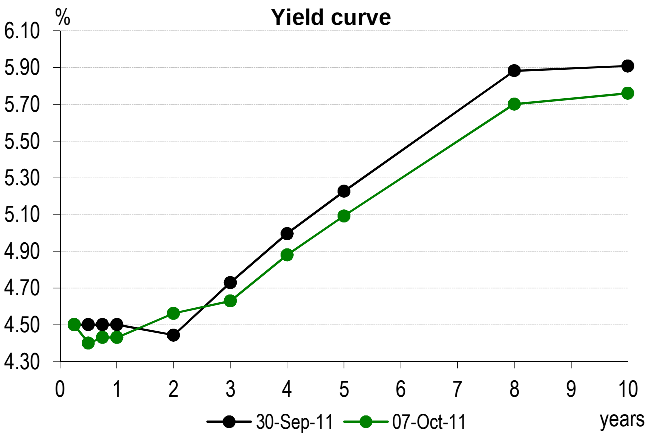
We will not allow this, so exchange of sales [for zloty] acted in the opposite direction as the basic tools of monetary policy.

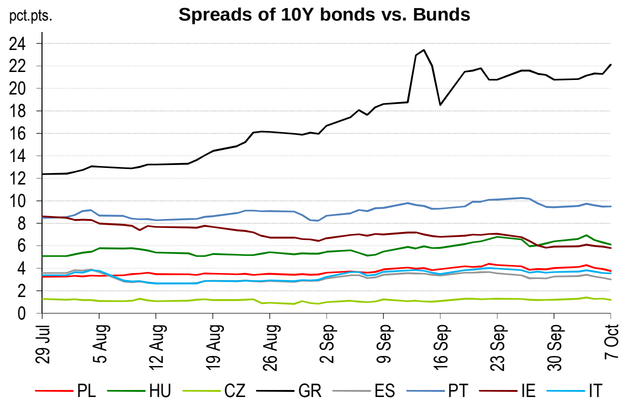
Poland's MPC among others is analyzing not only the impact of the PLN weakening on inflation, but also taking into account the possible effects of exchange rate fluctuations for the overall stability of the financial system. This approach was supported by the NBP's governor statement. The announcement of possible further intervention supports our stance that the Council will maintain interest rates unchanged till year-end. Running currency interventions by the NBP accompanied by rate cuts would have been obviously incoherent.

Market monitor









Zloty under influence of elections

▪ Over the last week, the zloty strengthened against the main currencies. On Monday the NBP has entered the market and sold "some amount of foreign currencies" for the third time in two weeks, thus protecting the domestic currency against potential depreciation due to a substantial rise in risk aversion. In the following days the zloty was under positive impact of sanguine market sentiment. Especially the Friday's monthly data on US labour market have strongly contributed to the strengthening of domestic currency. In our view, the crucial factor for the zloty at the beginning of the week will be the results of parliamentary elections. If the vote brings a possibility of quick establishment of government similar to current one, the EURPLN may slide below support at 4.36 provided that the global market sentiment is good enough.

▪ The Hungarian forint gained over the week, but on Friday gave away a better part of its gains due to rumours about possible downgrade in response to a Hungarian government's bill to allow a repayment of currency loans at a preferential exchange rate.

▪ EURUSD had begun the week below the Friday's close, but the following days brought a strengthening against the dollar. The single currency was supported by plans of recapitalizing the European banks and the Friday's US labour market data. A disappointment about lack of interest rate cut by the ECB (which caused a downward correction) was only temporary. In due course, EURUSD retreated from the lowest level since February (1.3144) and ended the day close to 1.35. At the start of the new week, the positive effect of US data may persist and the euro may extend its gains. The issue of the debt crisis still remains in focus. Support is at 1.31, resistance at 1.37.

Environment supports T-bonds

▪ Last week yield curve flattened as a result of the stabilization on short end and significant strengthening of mid- and long-term bonds. A further decline in yields of 5- and 10-year sectors came from reducing the concerns about the banking system in Europe, which supported the demand for risky assets. The MPC's decision to keep interest rates unchanged was neutral for the market, but a relatively hawkish communique caused a slight increase in yields. The IRS rates also decreased, following the ongoing trend on the bond market. The FRA market is currently pricing-in that in 9 months horizon there will be interest rate cut by 25bps and there is some chance for another one. We predict two cuts by 25 bps in the first half of 2012. We believe that the parliamentary election results could affect the debt market similarly as the exchange rate market. We also believe that the recent improvement in sentiment on the global market creates good conditions to further purchase of bonds from mid and long-end of yield curve after previous weakening. The risk factor for this scenario is the possible quick profit taking. This week switch auction will take place, and the MinFin will offer, for the first time since August, 2-year bond (OK0114).

▪ At the core debt markets yields were relatively stable, and only on Friday clearly increased after better than expected US labour market data. At the end of the week, yields on 10-year Bunds and Treasuries were 1.99% and 2.07% respectively.

▪ At the periphery of the euro zone spreads to 10-year Bunds were relatively stable over the week.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl