Bank Zachodni WBK

Weekly economic update

17 – 23 October 2011

Last week, the sentiment on the global market continued to remain volatile. Still, the optimism that the euro zone debt crisis would be solved has been prevailing. The optimism was supported by declaration made by German chancellor and French president, who announced that prior to G20 summit (scheduled for 3 November) they will present a comprehensive package, concerning the European banking sector recapitalization and long term rescue plan for Greece. The Slovak parliament has finally voted "yes" to the EFSF, at the second attempt. On the other hand, the pessimistic view on the inter-bank market presented by Jean-Claude Trichet and warnings from the ECB that too high participation of the private sector in the rescue package for Greece can prove dangerous for the stability of the financial system influenced the market mood in short-run. Thanks to market optimism, the zloty strengthened in relation to the main currencies, while the EURUSD exchange rate increased.

This week, the calendar is heavy of important macroeconomic data releases in the US and China. In case of domestic macro data, this week's publications should show how global economic activity slowdown influences the Polish industry sector (and consequently also the labour market). The key event, however, will be the EU summit, when the decision on the sixth tranche of bailout for Greece should be made. It seems that this fact is already priced-in by the market, therefore crucial will be comments or proposals addressing the recapitalization of the banking sector and containing the crisis in the euro area. The EURPLN is slightly is slightly above the important support; its fluctuations in the nearest days will be determined mainly by sentiment in the international markets.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (17 October)					
14:30	US	NY Fed index	Oct	pts	-4.0	-	-8.82
15:15	US	Industrial output	Sep	%MoM	0.2	-	0.2
15:15	US	Capacity utilization rate	Sep	%MoM	77.5	-	77.4
		TUESDAY (18 October)					
4:00	CN	GDP	Q3	%YoY	9.2	-	9.5
4:00	CN	Industrial output	Sep	%YoY	13.3	-	13.5
11:00	DE	ZEW index	Oct	pts	-45	-	-43.3
14:00	**PL**	**Wages in enterprise sector**	**Sep**	**%YoY**	**5.4**	**5.6**	**5.4**
14:00	**PL**	**Employment in enterprise sector**	**Sep**	**%YoY**	**2.9**	**2.9**	**3.1**
		WEDNESDAY (19 October)					
11:00	**PL**	**Auction of a new 5Y benchmark PS1016 worth of PLN1.0-3.5bn**					
14:00	**PL**	**Industrial output**	**Sep**	**%YoY**	**5.1**	**3.8**	**8.1**
14:00	**PL**	**Construction output**	**Sep**	**%YoY**	**10.3**	**13.8**	**10.8**
14:00	**PL**	**PPI**	**Sep**	**%YoY**	**7.2**	**8.0**	**6.6**
14:30	US	Core CPI	Sep	%MoM	0.2	-	0.2
14:30	US	House starts	Sep	k	590	-	571
14:30	US	Building permits	Sep	k	610	-	625
20:00	US	Fed's Beige Book					
		THURSDAY (20 October)					
14:00	**PL**	**MPC minutes**					
14:00	**PL**	**Core CPI**	**Sep**	**%YoY**	**2.8**	**2.6***	**2.7**
14:30	US	Initial jobless claims	week	k	405	-	404
16:00	US	Home sales	Sep	m	4.91	-	5.03
16:00	US	Philly Fed index	Oct	pts	-9.0	-	-17.5
16:00	US	Leading indicators	Sep	%MoM	0.2	-	0.3
		FRIDAY (21 October)					
10:00	DE	Ifo index	Oct	pts	106.6	-	107.5

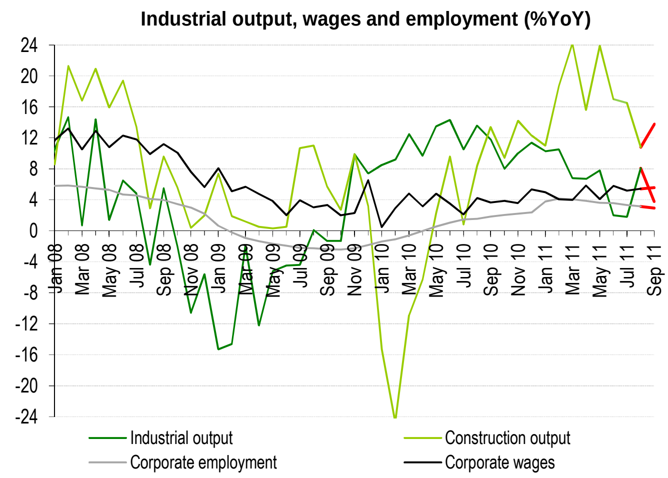
Source: BZ WBK, Reuters, Parkiet   *forecast after Polish CPI data

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

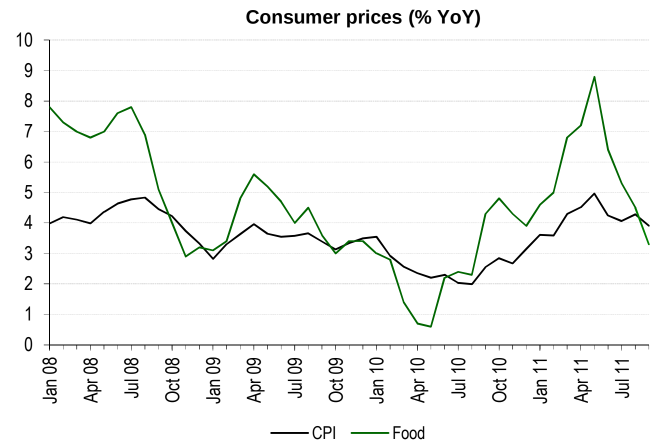
Agnieszka Decewicz +48 22 586 8341   **Marcin Luziński** +48 22 586 8362

What's hot this week – Data from the Polish manufacturing sector and labour market

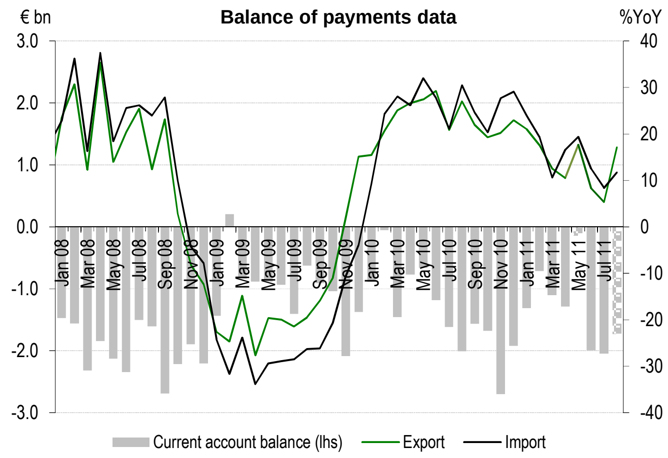


- We predict that wages in enterprise sector kept rising at above 5%YoY in September. However, this time it is mainly statistical effect – in our opinion wages were stable in monthly terms. Employment data should confirm recent trend on the market, showing further slowdown in job growth in corporate sector.
- We revised downward our September's industrial output forecast to 3.8%YoY from 5.1%YoY after PMI reading. In our opinion the data will reflect a slowdown in economic activity abroad.
- We are more pessimistic than market in case of PPI inflation, seeing growth by 8%YoY in September. In our opinion PPI acceleration resulted from higher production costs and export prices due to sharp zloty weakening.
- To sum up, this week's macroeconomic data releases should confirm weaker economic activity in forthcoming months.

Last week in the economy – Lower inflation, while exports higher than forecast



- CPI inflation decreased in September to 3.9%YoY, down from 4.3% in August. In monthly terms consumer prices increased by 0.1%. This outcome proved to be substantially lower than our forecast and market consensus (both at 4.1%).
- The surprise came mainly from lower than expected growth in three categories: food and non-alcoholic beverages, fuels as well as clothing and footwear.
- Our estimates indicate that these three categories that moved CPI down in September will rebound in October and that will push inflation to slightly above 4%YoY. We expect CPI to stay close to that level till year-end and more visible deceleration will start in January 2012.
- After September's CPI data release we estimate core inflation excluding food and energy prices to decrease to 2.6%YoY.



- Current account deficit reached the level of €1.73bn, well above our and market expectations.
- Higher than expected data resulted from high income deficit, which increased to €1.67bn (from €1.53bn in previous month) due to negative income balance of investment (€1.78bn).
- Trade data surprised on the positive side, with deficit significantly narrowing to only €750m (from a deficit of €1178m in July), mainly due to strong exports growth
- Last week NBP's balance of payment revision confirmed significant slowdown in both exports and imports growth in July (to 5.4%YoY and 8.4% YoY, respectively), while in August we again noted two-digit growth. Exports was growing faster than imports, for the first time since March 2011.

Quote of the week – Stability, observation and wait-and-see

Elżbieta Chojna-Duch, MPC's member, 13.10.2011, Reuters

The decisions on my side...will be: stability, observation and wait-and-see

Anna Zielińska Głębocka, MPC's member, 13.10.2011, Reuters

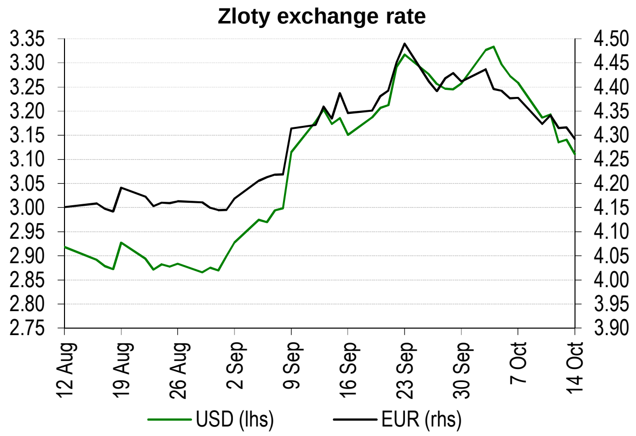
In my opinion monthly data are not enough to judge balance of risk for inflation; I think that inflationary pressure remains still high

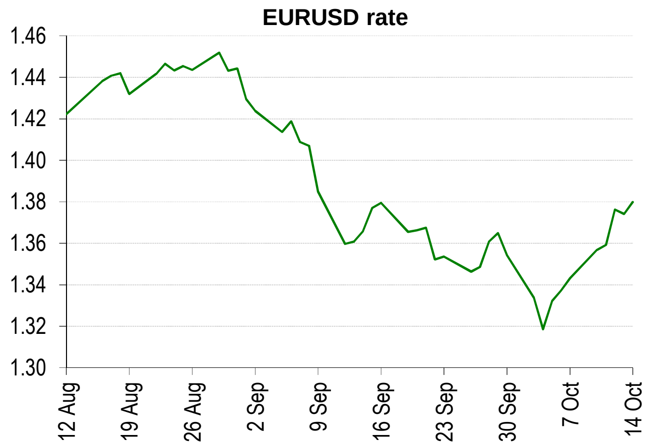
Andrzej Bratkowski, MPC's member, 13.10.2011, Reuters

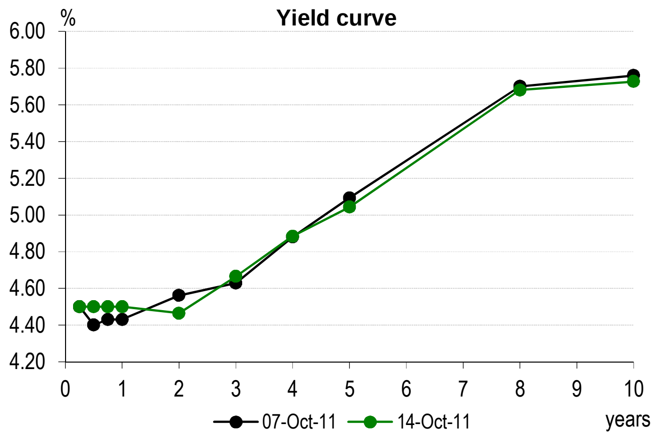
Generally, I'm optimistic, I think (economic growth in 2012) should be no lower than 3 percent and, under this scenario, interest rates may remain stable next year

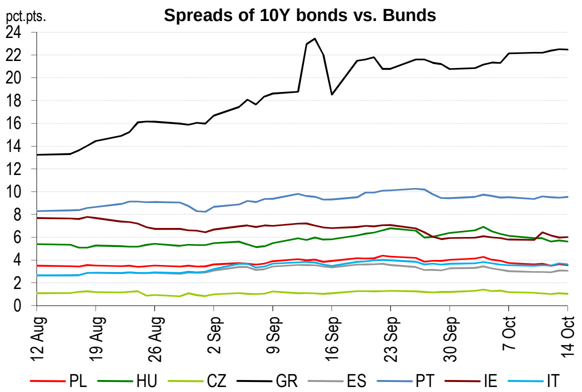
The MPC's members, commenting October's inflation data, agreed that official interest rates should remain stable till year-end, confirming "wait-and-see" stance of the MPC. In our opinion Bratkowski presented more "hawkish" view, expecting stable interest rates in whole 2012. We uphold our baseline scenario that the MPC will decide to cut rates in H1 2012 as a consequence of financial market stabilization, inflation fall and interest rates cuts by the ECB. Additionally, next year monetary policy easing is supportive by expected deeper slowdown of the Polish economy.

Market monitor









EURPLN close to an important support

▪ The good market sentiment at the beginning of the week and a positive market's reception of the parliamentary election results dragged EURPLN again below support 4.36. In the following days the volatility was lower and the zloty continued to gain. In due course, EURPLN fell to another support at 4.28. Thanks to increasing EURUSD, the zloty recorded even more considerable gains against the dollar. In the upcoming week, the domestic data should not provide a substantial support for the zloty, provided that they are in line with our forecasts. The global sentiment is still a crucial factor for the FX market. Both the G20 Finance Ministers summit over the weekend, and Eurogroup meeting one week later can come up with information, which can affect the investors assessment of chances for surmounting the euro zone debt crisis. We expect that EURPLN will stay in the horizontal channel 4.28-4.315.

▪ The Hungarian forint and Czech koruna gained as well over the week, due to improved market sentiment.

▪ The EURUSD exchange rate climbed at the beginning of the week from 1.34 to 1.37 due to declarations of German and French policymakers. The following days brought a further appreciation of single currency, although it was not that strong. The downward corrections (due to ECB warning about the financial system stability) proved to be only temporary and limited. As a result, EURUSD was testing an important resistance at 1.385 (it is the mid-point of the recent downward move from 1.455 to 1.310, recorded two weeks ago) and finally managed to breach it on Friday. The direction of trading in the coming days will depend mainly upon the anti-crisis actions in the euro zone.

Domestic yields under impact of foreign news

▪ Last week yields on Polish government bonds were volatile, however, the week ended with yield curve near the previous week's close. Deputy minister of finance Dominik Radziwiłł's statement that the ministry does not rule out 10Y bonds issue this year (due to market sentiment improvement and yields fall in 10Y sector) affected the FI market only in short-run, and so did the better than expected CPI reading for September. In our opinion this week debt market will be still under pressure of global news flow, i.e. macroeconomic data releases on core markets, rhetoric of both the EU officials' and world politicians' statements, while domestic macro data will be in the shadow of these. The key event on the FI market will be auction of a new 5Y benchmark PS1016 (worth of PLN1.0-3.5bn). We expect good results – market liquidity is supportive factor for auction, especially taking into account that the settlement date is fixed to the same date as coupon payments from DS and PP series (25.10.11).

▪ Bunds and the US Treasuries were slightly weaker, however, upward movements were observed mainly in the first part of the week. Next yields have volatile in horizontal trend, followed changes in investors' sentiment. Last week ended with 10Y Bund yield at 2.18% and 10Y US Treasuries at 2.23%.

▪ On the euro zone peripheries the spreads to 10Y Bunds have widened in most cases, despite Bunds yields increase. It shows that despite hopes to stop debt crisis in euro zone, fiscal risk in countries with huge general government debt level is recognized as a still high.