Bank Zachodni WBK

# Weekly economic update

## 13 March – 19 March 2006

**With no economic data releases the last week was expected to be relatively calm, however the outflow of capital from emerging markets brought a significant weakening on the foreign exchange, fixed income and equity markets. At the end of the week there was some stabilisation on the political scene as it seems the conflict between PiS, Self-Defence and LPR was head off (possibly temporary). However this was not an event for the market as the zloty reached a week maximum on Friday. Further outflow of capital from emerging markets is possible, especially after strong non-farm payrolls data, after which worries about inflation may rise.**

**The upcoming week will bring a couple of important information for monetary policy perspective, and thus crucial for financial markets. We expect a moderate increase in CPI (above market consensus) and PPI, but they should remain at low level of ca. 1%YoY. However, the medium-term perspective should be more important for the MPC and this shows a gradual return of inflation into the target. We maintain our view that the MPC will keep rates on hold for some time and will wait for effects of already adopted changes. The scenario of economic growth acceleration in Q1 2006 should be confirmed this week by industrial output data.**

### Economic calendar

| TIME GMT | REGION | INDICATOR (importance level*) | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **TUESDAY (14 March)** | | | | | |
| **13:00** | **POL** | **Money supply (M)** | **Feb** | **%** | **10,2** | **10,2** | **10,2** |
| **13:00** | **POL** | **Current account (M)** | **Jan** | **€ m** | **-291** | **-136** | **-410** |
| **13:00** | **POL** | **Trade balance (M)** | **Jan** | **€ m** | **114** | **-20** | **-339** |
| 10:00 | GER | ZEW index (H) | Mar | pts | 70,0 | - | 69,8 |
| 13:30 | US | Retail sales (M) | Feb | %MoM | -0,4 | - | 2,3 |
| | | **WEDNESDAY (15 March)** | | | | | |
| **10:00** | **POL** | **Auction of 10Y PLN1.8-2.8bn DS1015 bonds (H)** | | | | | |
| **13:00** | **POL** | **Wages (H)** | **Feb** | **%YoY** | **3,8** | **4,0** | **3,6** |
| **13:00** | **POL** | **Employment (H)** | **Feb** | **%YoY** | **2,6** | **2,6** | **2,6** |
| **13:00** | **POL** | **CPI (H)** | **Feb** | **%YoY** | **0,8** | **0,9** | **0,7** |
| 14:00 | US | Capital net flows (H) | Jan | USD bn | 62,4 | - | 56,6 |
| 13:30 | US | Import prices (M) | Feb | % | -0,35 | - | 1,3 |
| | | **THURSDAY (16 March)** | | | | | |
| 10:00 | EMU | Final HICP (H) | Feb | %YoY | 2,3 | - | 2,4 |
| 13:30 | US | CPI (H) | Feb | %MoM | 0,2 | - | 0,7 |
| 13:30 | US | Build permits (M) | Feb | m | 2,05 | - | 2,276 |
| | | **FRIDAY (17 March)** | | | | | |
| **13:00** | **POL** | **PPI (H)** | **Feb** | **%YoY** | **1,0** | **1,0** | **0,5** |
| **13:00** | **POL** | **Industrial production (H)** | **Feb** | **%YoY** | **9,6** | **7,9** | **9,5** |
| 10:00 | EMU | Industrial production (M) | Jan | %YoY | 2,6 | - | 2,5 |
| 14:15 | US | Capacity use (H) | Feb | % | 81,3 | - | 80,9 |
| 14:15 | US | Industrial production (H) | Feb | %MoM | 0,6 | - | -0,2 |
| 14:15 | US | Preliminary Michigan index (H) | Mar | pts | 88,0 | - | 86,7 |

* Importance level: (H)igh, (M)oderate; Source: Parkiet Reuters, BZ WBK

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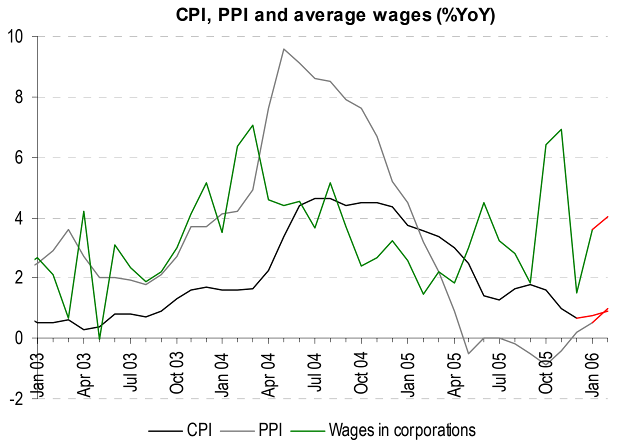
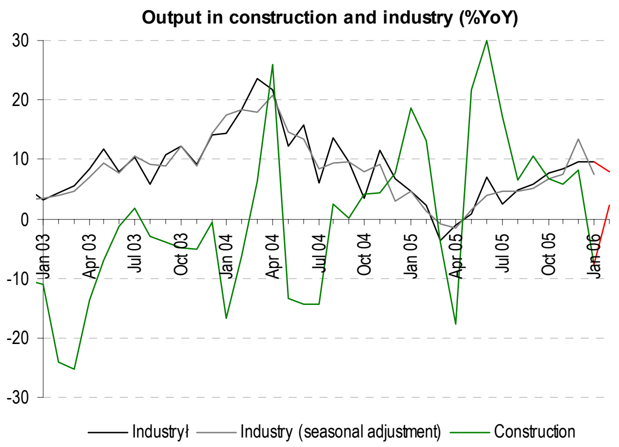
## **What's hot this week** – What inflation at the beginning of 2006? What about labour market?




▪ The key figures for the market will be released on Wednesday, when we get to know CPI inflation for January and February, as well as labour market data, carefully watched by the MPC.

▪ In connection with the fact the CSO is likely to take into account mobile phone services in the new CPI basket, it has been expected that the data may be revised downwards. Meanwhile, Eurostat's data showed that HICP in Poland increased to 0.9%YoY in January from 0.8% and it is worth to remember that Eurostat's data were quite a good hint on a scale and direction of revision in CSO data last year. In sum, we tend to believe in CSO president's words that revision would not be major.

▪ We expect some acceleration in wage growth and a stabilisation in employment growth at quite high level, which may be an argument for keeping rates on hold.

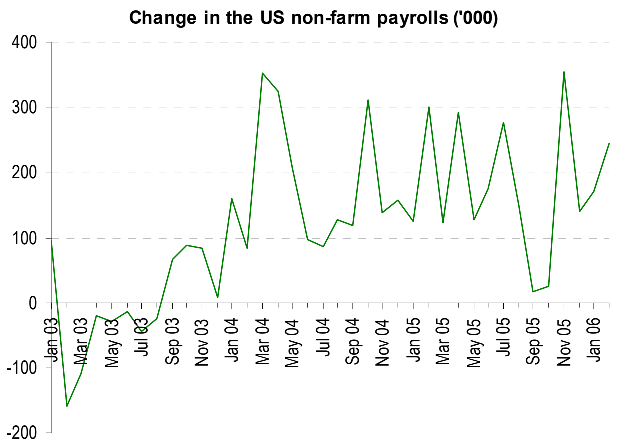



▪ Another portion of important data will be shown on Friday. As a matter of fact the NBP will release money supply and balance of payments data already on Monday, but they should be of lower importance than other figures.

▪ We expect produce prices were flat in February as a result of stabilisation of oil prices and on the foreign exchange market. In annual terms this would mean a rise to 1% from 0.5% in January, as PPI fell by 0.5%MoM in February 2005.

▪ We forecast industrial production growth of close to 8%, which would be a result in line with the scenario of faster GDP growth in Q1. However, this would be below the ministry of finance's forecast (11-12%) and market consensus (slightly below 10%). Construction output should see a recovery from very poor January's result, which was connected with bad weather conditions.

## **Economy last week** – No domestic data, but interesting week




▪ Last week, positive economic perspectives were confirmed by business climate indicators, however in the face of lack of domestic data the market weakened as a result of changes on international markets.

▪ Domestic politics could have added fuel to the flames as another turmoil was caused by a threat of self-dissolution of the parliament and early election. The situation stabilised at the end of the week, but you never know when and how the same story will be back. Additionally, we see strong conflict between the government and the central bank.

▪ US labour market data were awaited by investors the most this week and they showed higher than expect non-farm payroll figure (243k). The unemployment rate rose in January to 4.8% from 4.7%.

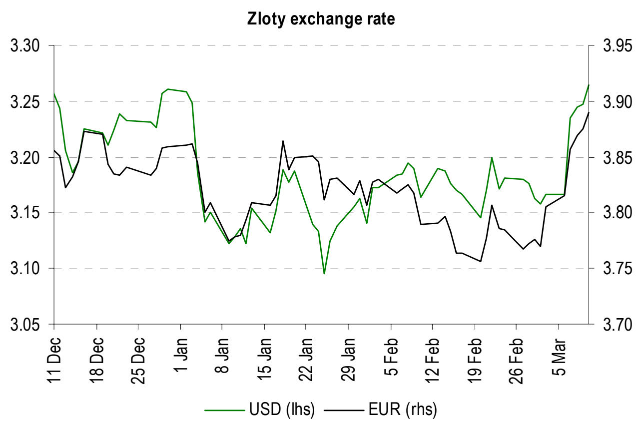
## **Quote of the week** – Rates close to neutral level

**Andrzej Sławiński**; Bloomberg, 7-8 March

*If the future scenario, events, will reflect the recent inflationary scenario, this would mean that interest rates are close to neutral levels. A neutral level of interest rates provides economic growth that is close to its potential. What we are seeing is economic growth close to potential and inflation steadily approaching our target in the medium term.*

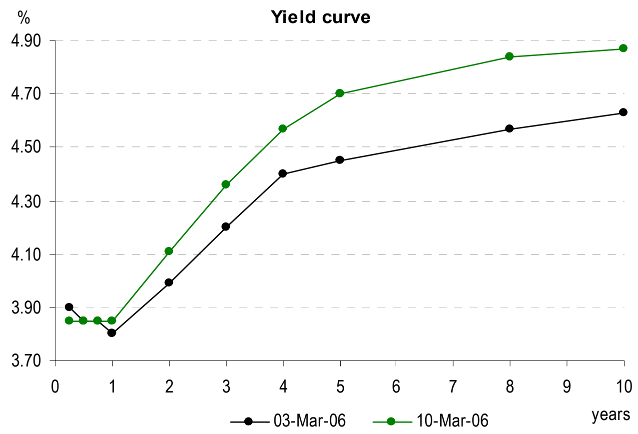
It seems that opinions expressed by prof. Sławiński in interview with Bloomberg confirm our view that Polish official rates will be on hold for some time. While we do not expect rate cut in March, April's decision remains a big question mark as this will be dependant on the new inflation projection of the central bank. However, it seems that even if we see a cut in April, this should be treated as a fine-tuning rather than first cut from another easing series, unless economic scenario changes completely.

## Market monitor



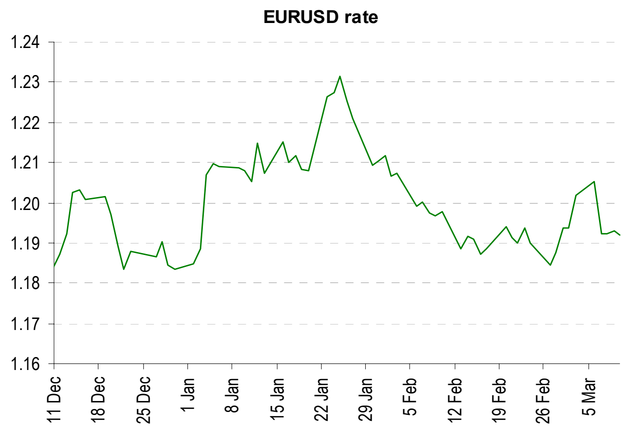

### Significant zloty sell-off

- Last week there was a strong sell-off of assets on the emerging markets, which was connected with higher interest rates expectations in the U.S. as well as in the euro zone. The zloty weakening went in line with significant drop of indices on the Warsaw bourse as well as treasuries sell-off. Since the start of the week. Zloty, forint, Czech and Slovak crown fell against the euro by 2.3%, 1.7%, 1.0%, 1.2%.
- The emerging markets sell-off may be a parallel to the situation from March and April last year. In our opinion zloty will stay at the weaker level than in the previous weeks and EURPLN will fluctuate a in range of 3.95-3.85 while USDPLN rate between 3.20 and 3.30. An important support level for EURPLN rate will be 3.92.



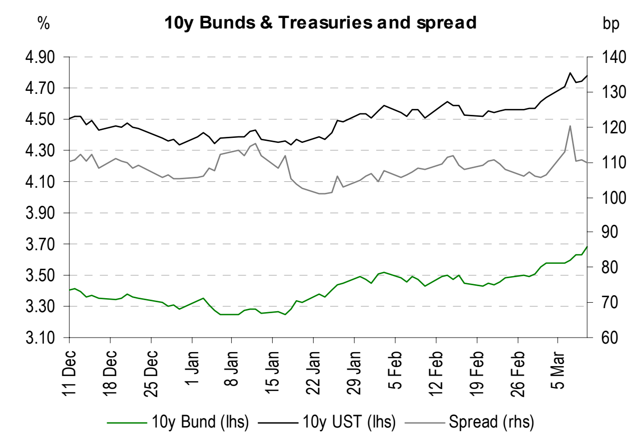

### Bonds weakened and yield curve steepened

- Polish debt did not manage to escape from the emerging markets sell-off. Bonds yields rose by ca. 10-23 bp, while the yield curve strongly steepened. This was influenced by the situation on the core bond markets, as well as uncertain political situation and negative sentiment toward Poland. FRA market slightly lost ground and currently no further official interest rate cuts are priced in.
- It seems that the interest rate market should gradually stabilize near the current levels, although further retreat from the region and other emerging economies may take place. In our opinion CPI as well as wages data will be slightly above consensus, which will additionally work against market strengthening, although softer industrial production data may give some support.




### Rate hikes expectations strengthen the dollar

- Despite the previous week's rate hike in the euro zone as well as hawkish comments from the ECB representatives, the dollar appreciated against the euro by ca. 0.7% as a result of increased expectations of higher rate hikes in the U.S. and after statements of Fed's central bankers.
- Next week's data, which influence the expectations towards the future level of interest rates will have again the biggest impact on the relation of euro to the greenback. Despite the record high trade deficit net capital flows may be of lesser importance. It seems that figures from the U.S. economy should be much stronger so as the EURUSD rate broke 1.18. We assume it should stay in recent range 1.18-1.21.




### Inflation fears negatively affect core markets

- There was a substantial weakening on the core bond market with regards to increased expectations towards higher interest rates in U.S. amid higher inflation fears as well as after Fed's and ECB's representatives. U.S. Treasuries yields amounted to 4.81%, the highest level since 21 months, although later on they dropped to 4.78%, while Bund yields rose by 6 bp to 3.63%
- Next week ZEW index will show, whether improvement of euro zone economy is stable. HICP inflation will be quite essential as well amid increased forecasts of inflation by the EBC. In Unites States CPI inflation may influence the market as well as capacity use data which, if hold at high levels may inflict an inflation pressure in the U.S. economy.

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