

# Weekly economic update

21 – 27 April 2008

As we expected, the series of domestic macro data published last week supported our view assuming weakening in market expectations of another interest rate hike at MPC meeting in April and strengthened the interest rate market. Data on inflation, labour market statistics and industrial output growth proved lower than predicted.

An important event last week was resignation of deputy finance minister Stanisław Gomułka. He said that the reasons for his decision are based on merits and not on personal issues. According to him, proposals of reforms from the finance ministry get stuck at the level of Prime Minister. Already before the resignation, we believed that the updated version of the convergence program is doubtful. Gomułka's resignation seem to confirm that realization of the program will be difficult. This may negatively affect the longer end of the yield curve and the zloty.

This week we expect further slight strengthening in the local debt market, especially in the short end of the yield curve following much weaker than expected data on industrial output and given our forecasts of retail sales (below consensus). We also predict a correction of the zloty amid weaker data from the economy and possible weakening of expectations regarding another interest rate hike by the MPC already in April. Apart from data on retail sales, the stats office will also release data on registered unemployment. Core inflation measures to be revealed by the central bank will show increase of the net inflation, but it should be lower than estimated before the CPI data release. This week we will also see more earnings results of the large US companies, including major banks. This will shape appetite for risk in the global markets and thus indirectly also the Polish financial market.

## Economic calendar

| Time GMT                    | COUNTRY | INDICATOR                              | PERIOD | FORECAST |       | LAST VALUE |       |
|-----------------------------|---------|--|--------|----------|-------|------------|-------|
|                             |         |  |        | MARKET   | BZWBK |            |       |
| <b>TUESDAY (22 April)</b>   |         |  |        |          |       |            |       |
| 12:00                       | PL      | Net inflation                          | Mar    | %YoY     | 2.7   | 2.7        | 2.5   |
| 12:00                       | PL      | Retail sales                           | Mar    | %YoY     | 21.0  | 19.0       | 23.8  |
| 12:00                       | PL      | Rate of unemployment                   | Mar    | %        | 11.1* | 11.0       | 11.5  |
| 14:00                       | US      | New home sales                         | Mar    | m        | 4.9   | -          | 5.03  |
| <b>WEDNESDAY (23 April)</b> |         |  |        |          |       |            |       |
| 12:00                       | PL      | Business climate indicators            | Apr    | pts      | -     | -          | -     |
| 8:00                        | EZ      | Preliminary PMI – manufacturing sector | Apr    | pts      | 51.6  | -          | 52.0  |
| 8:00                        | EZ      | Preliminary PMI – services sector      | Apr    | pts      | 51.4  | -          | 51.6  |
| 11:00                       | US      | Mortgage index                         | weekly | pts      | -     | -          | 743.4 |
| <b>THURSDAY (24 April)</b>  |         |  |        |          |       |            |       |
| 12:00                       | PL      | MPC minutes                            | Mar    | -        | -     | -          | -     |
| 8:00                        | DE      | Ifo index                              | Apr    | pts      | 104.3 | -          | 104.8 |
| 12:30                       | US      | Initial jobless claims                 | Mar    | '000     | 380.0 | -          | 372   |
| 12:30                       | US      | Durable goods orders                   | Mar    | %        | 0.0   | -          | -1.1  |
| 14:00                       | US      | New home sales                         | Mar    | m        | 0.58  | -          | 0.58  |
| <b>FRIDAY (25 April)</b>    |         |  |        |          |       |            |       |
| 8:00                        | EZ      | Money supply                           | Mar    | %YoY     | 10.8  | -          | 11.3  |
| 13:55                       | US      | Final Michigan index                   | Apr    | pts      | 63.2  | -          | 69.5  |

Source: BZ WBK, Parkiet, Reuters \* preliminary estimate of the Ministry of Labour and Social Policy

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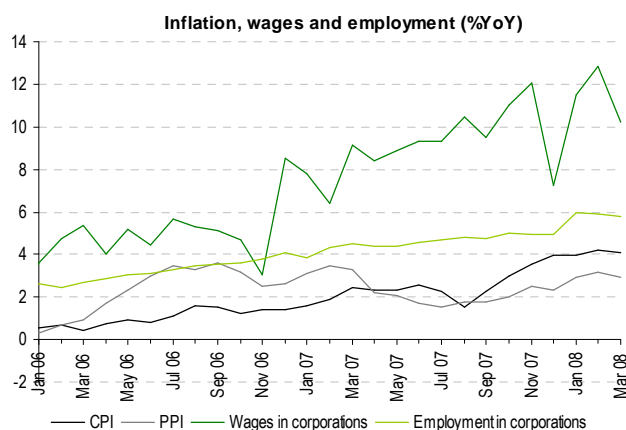
e-mail: ekonomia@bzwbk.pl

## What's hot this week – Next domestic data

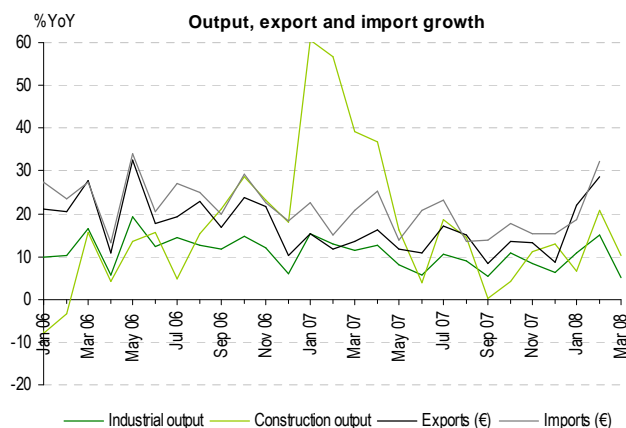


- This week we will get more domestic data.
- Our estimates of net inflation based on the CPI data release are slightly lower than estimates based on CPI forecast. We currently estimate that the net inflation in March was 2.7%, instead of 2.8% earlier.
- As regards retail sales we predict it rose 19%YoY. The high growth of sales results from strong rise in wages and employment, although our forecast is below market consensus.
- We also expect a fall of the registered unemployment rate to 11% at the end of March from 11.5% in February.
- The Statistical Bulletin to be released by the CSO will also include detailed statistics on wages in the corporate sector.
- Apart from the data, we will also see the MPC *minutes* due for release on Thursday.

## Economy last week – CPI, wages and production lower than expected



- CPI inflation in March fell in line with our forecast to 4.1%YoY instead of stabilisation at 4.2% seen in February expected by the market. The annual food and fuel prices growth appeared higher than we forecasted and reached 7% and 10.1%, respectively. Overall growth in other categories of prices appeared lower than expected.
- The average wage in the corporate sector increased by 3.7%MoM and 10.2%YoY in March against expected slowdown to 11.1%YoY from 12.8% in February. At the same time the employment growth declined slightly in March to 5.8%YoY instead of expected stabilisation at 5.9%YoY. Stronger than forecasted decline of average wage and wage bill in enterprises is a positive news for the MPC, though one should remember, that to some extent this is due to high statistical base effect from march 2007.



- Industrial production in March decelerated to 0.9%YoY from 15.0% in February, which surprised the market. Median of market forecasts was 8.3% and our forecast of 5.1%YoY was the most pessimistic. The seasonally adjusted industrial output growth also slowed down, to 6.1%YoY from 11.4%YoY in February.
- PPI increased in March by 2.9%YoY, which was also below market expectations (3.2%YoY).
- The current account deficit in February rose to €1.32bn from €1.1bn in January. Exports (29%YoY) and imports growth (32%YoY) substantially accelerated in February. The cumulated 12-month deficit amounted to 4% GDP against 3.9% in January amid high trade deficit of €933bn. The services account deteriorated as well, while the income deficit declined. The inflow of direct foreign investments was high again at €1.3bn.

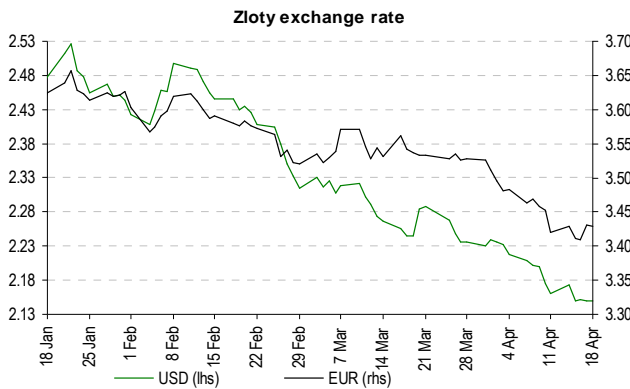
## Quote of the week – Rate hikes dependant on economic activity indicators

Jan Czekaj, MPC member, PAP, Reuters, 15 April

*Taking into consideration decisions on interest rates, we have to take into consideration, how they will affect the zloty. If data for March shows high growth, we will take into consideration further interest rate hikes. (...) This is neutral [about data on CPI and wages].*

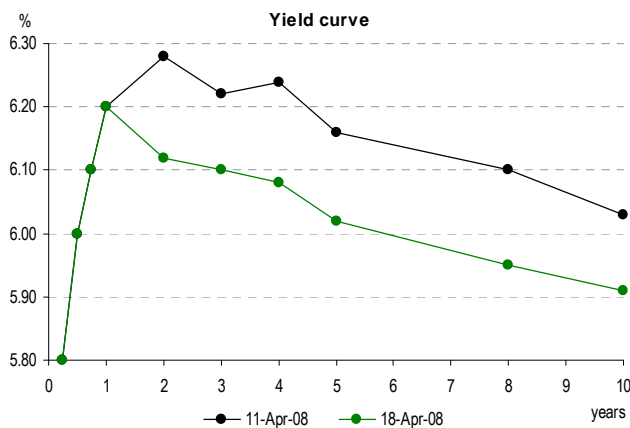
MPC member Jan Czekaj said that in his opinion the data on inflation and labour market are neutral from the point of view of probability of potential further interest rate hikes. Economic activity indicators as well as the influence of the zloty rate on the economy will be crucial for the Council in his opinion. Although the hawkish members of the Council opt for an interest rate hike already in April, in our view taking into consideration the recently released data, our forecasts of retail sales and a very strong zloty, the majority of the Council members will decide for a pause in interest rate hikes cycle at the this month's meeting.

**Market monitor**



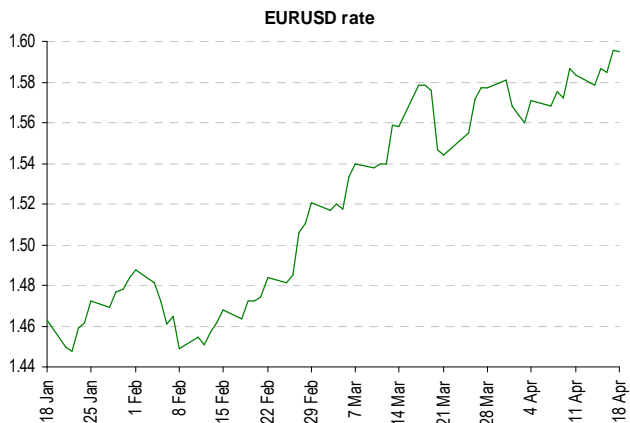
**Zloty failed to break 3.40 versus the euro**

- Last week the zloty remained at strong levels against the major currencies. EURPLN was testing 3.40 in the first days of the week, but failed to break it. Thus, a correction took place on profit taking and due to weaker sentiment in the region. The zloty gained more significantly versus the dollar amid rise in EURUSD to fresh highs.
- We still believe in a correction of the zloty exchange rate, driven among others by retail sales data (our forecast is below market consensus), which may weaken expectations of another rate hike already in April. We predict that this week EURPLN will range in 3.40-3.50 and USDPLN in 2.13-2.23.



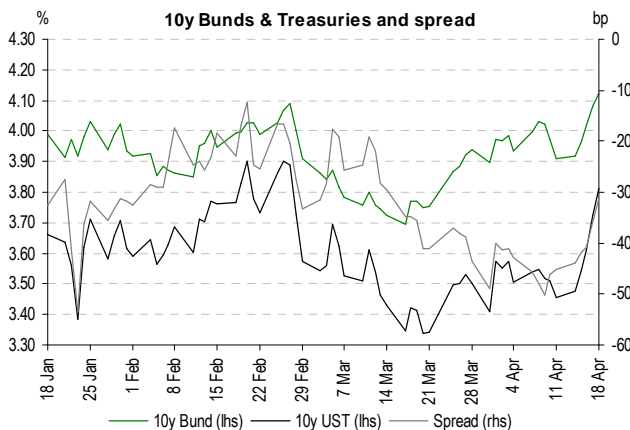
**Local debt market stronger**

- The domestic debt market strengthened in first days of the week, already before release of the key data on CPI and wages. The numbers proved lower than expected, which supported the upward move in bond prices. However, later in the week a slight correction took place. Possibly because comments from central bankers after release of inflation and labour market data were not particularly dovish. Output figures released at the end of the week added to bonds strengthening.
- This week the Polish debt market should be positively affected by publication of retail sales data for March and possible weakening of the view in the market that the MPC will deliver another hike in April. Apart from the data, an important factor will be possible next comments from rate-setters.



**EURUSD reached new highs**

- Last week, the dollar weakened against the euro again. EURUSD reached new all time high, close to 1.60. The main reason for the move were higher than expected inflation numbers from the EMU. Final HICP data for March proved higher than predicted, reaching the highest level in 16 years, which weakened market expectations regarding rate cuts in the EMU. Besides, more hawkish comments from EBC officials appeared. Additional factor were weaker than expected data from the US (housing market, Philly Fed index). At the end of the week the dollar recovered.
- In our view the dollar may still weaken in the next weeks and EURUSD may break 1.60 soon. However, this may increase market fears of joint intervention of major central banks in defend of the US currency.



**Increase in risk appetite harms the core debt markets**

- The dominant tendency in the core debt markets last week was a rise in yields. This was related to increase in risk appetite and strengthening of the stock markets. News from the US, both macro data and earnings results by large companies, were mixed and generally moods in the markets were quite positive. Debt in the euro zone was additionally affected by higher than predicted inflation. During the day, yields of 10Y Treasuries and Bunds increased by 40 and over 20 bps to 3.85% and 4.16%.
- This week market sentiment will be shaped by next earnings results from large US companies, including major banks. Markets will also watch data from the US housing market and Michigan index of consumers sentiment. In the euro zone the key focus of attention will be on the German Ifo index and preliminary PMI indices.

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