Bank Zachodni WBK

Weekly economic update

17 – 23 May 2010

The stabilization package of the European Union with the support of the IMF with a value of €720bn positively surprised investors, similarly as the ECB decision to purchase government bonds and private sector debt of the euro area countries. This stabilized situation in financial markets and gave time for fiscal reforms in the European Union. Yields of domestic bonds fell again, and the zloty clearly strengthened against the euro, which has only temporarily rebounded versus the dollar.

Even if the economic data releases planned for this week abroad will show positive surprises, the optimism of investors will be constrained by prospect of tightening fiscal policy in Europe, which may have a negative impact on the scale of economic recovery. Domestic data should show a clear increase in foreign trade volume in March, a small slowdown in pay growth, maintenance of two-digit growth in industrial production, and a bottoming-out in the building sector in April. Inflation data should confirm the lack of upward pressure on prices.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (17 May)					
11:00	**PL**	**Tender of PLN0.6-1bn of 52-week T-bills**					
14:00	**PL**	**Current account deficit**	**Mar**	**mln €**	**-543**	**-555**	**-475**
14:00	**PL**	**Exports**	**Mar**	**mln €**	**10533**	**10931**	**9140**
14:00	**PL**	**Imports**	**Mar**	**mln €**	**10941**	**11406**	**9388**
14:30	US	NY Fed index	May	pts	30.0	-	31.86
15:00	US	Capital flows report	Mar		-	-	9.0
		TUESDAY (18 May)					
11:00	DE	ZEW index	May	pts	47.0	-	53.0
11:00	EZ	Final HICP	Apr	%YoY	1.5	-	1.4
14:30	US	PPI	Apr	%MoM	0.1	-	0.7
14:30	US	House starts	Apr	m	0.65	-	0.626
		WEDNESDAY (19 May)					
11:00	**PL**	**Auction of BGK bonds**					
14:00	**PL**	**Wages in corporate sector**	**Apr**	**%YoY**	**4.0**	**4.1**	**4.8**
14:00	**PL**	**Employment in corporate sector**	**Apr**	**%YoY**	**-0.2**	**-0.2**	**-0.6**
14:30	US	CPI	Apr	%MoM	0.1	-	0.1
20:15	US	Fed minutes					
		THURSDAY (20 May)					
14:00	**PL**	**Industrial output**	**Apr**	**%YoY**	**10.4**	**10.9**	**12.3**
14:00	**PL**	**PPI**	**Apr**	**%YoY**	**-1.4**	**-1.5**	**-2.4**
14:00	**PL**	**MPC minutes**	**Mar**				
16:00	US	Leading indicators	Apr	%	0.2	-	1.4
16:00	US	Philadelphia Fed index	May	pts	22.0	-	20.2
		FRIDAY (21 May)					
	PL	**Business climate indicators**	**May**				
14:00	**PL**	**Core inflation**	**Apr**	**%YoY**	**1.8**	**1.8**	**2.0**
9:58	EZ	Flash PMI – manufacturing sector	May	pts	57.5	-	57.6
9:58	EZ	Flash PMI – services sector	May	pts	55.5	-	55.6
10:00	DE	Ifo index	May	pts	102	-	101.6

Source: BZ WBK, Reuters, Parkiet daily

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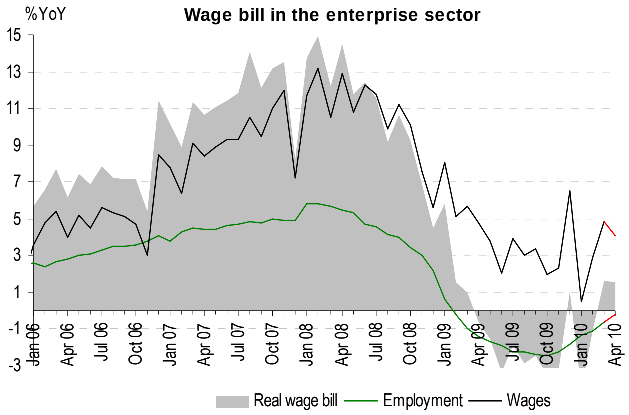
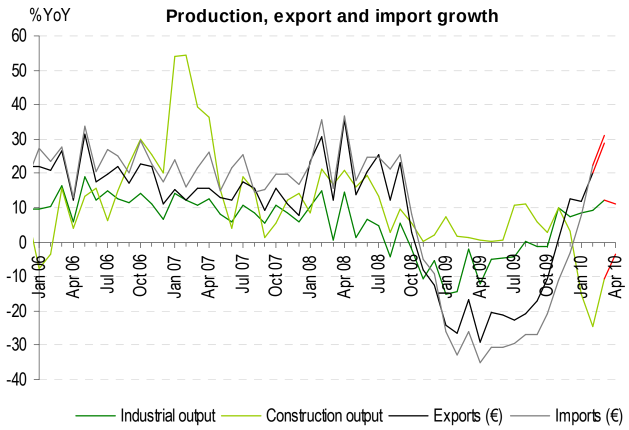
What's hot this week – Series of domestic data releases

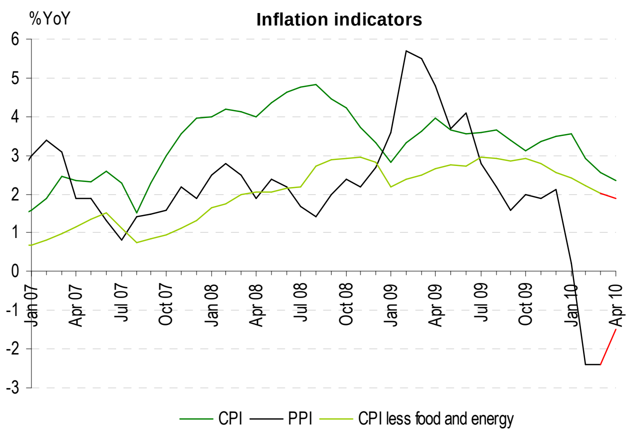


- This week, a number of data releases will take place. We expect a deepening of current account deficit to €555m amid a significant rise in trade volume. We predict acceleration of exports to ca. 29%YoY and imports to ca. 31%, which would imply a rise in trade deficit. At the same time, we expect improvement in services balance and deterioration in transfers account versus February.
- We predict a slowdown in wage growth in April to 4.1% amid a stabilisation of wage growth in manufacturing, and slight growth in construction. Lower number of working days may have negative effect on monthly change in salaries. We expect a slight monthly increase in employment and a smaller scale of its decline in year-on-year terms.



- We expect that industrial production slightly decelerated in April to ca. 11%YoY. This is confirmed by a fall in PMI output component (yet remaining above 50 pts.) and the fact that data for March were affected by higher number of working days.
- We also expect further bottoming-out in construction sector after delays caused by severe weather conditions at the start of the year. Construction output is predicted to fall by 3.6%YoY.
- According to our predictions, PPI growth increased in April to –1.5%YoY, mainly due to higher price growth in manufacturing.
- After publication of CPI data we expect a fall in core inflation after excluding food and energy prices to 1.8-1.9%YoY.

Economy last week – CPI above forecasts and below target, NBP governor after election



- Inflation in April fell to 2.4%YoY and was slightly above expectations. The most surprising element was hike in prices of clothes and footwear, but it was rather temporary phenomenon. Prices of fuel and food rose significantly, but in other categories there was stabilisation of prices with no demand-side pressure.
- Money supply growth accelerated in April to 6%YoY (below expectations). Total loans, after eliminating FX effect, fell 0.5%MoM, amid rise in households' credit and continuation of decline in loans to corporate sector.
- Acting President Bronisław Komorowski said that if there is a good candidate for NBP Governor, which will be acceptable by the Sejm, he may indicate the candidate for the post before the election. However, the PSL is against appointment of the new NBP Governor before the presidential election.

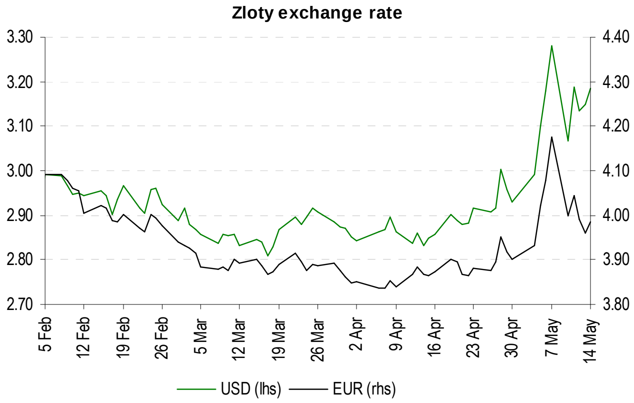
Quote of the week – Euro is not the most urgent issue

Jacek Rostowski, minister of finance, Dziennik GP, 14 May

We went through the first wave of crisis, taking ad hoc actions. In order to fix public finances, we have to approve bills. This depends on the outcome of the election. [Q: 2015 as a date of euro zone entry is still realistic?] Yes. According to convergence programme in 2012 or 2013 we should exit the excessive deficit procedure. Then it would be good to wait for a year and maintain low deficit, to prove that we have debt under control. From our point of view, it is not bad to be outside the euro zone right now, when it is being repaired. [Q: Will this government make a decision on launching agenda of euro zone preparations?] Yes. But if we are talking about entry in 2015, this issue, even though important, is not the most urgent.

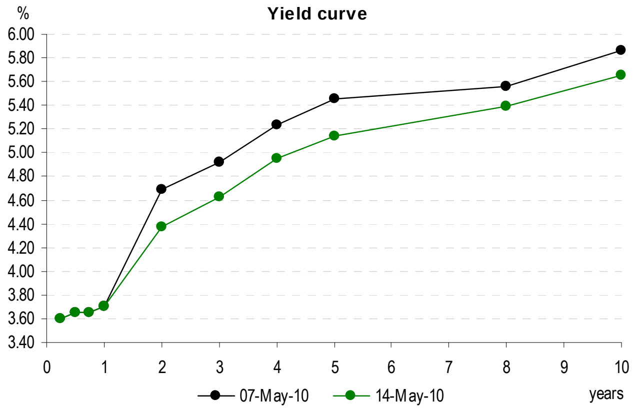
Last week the Prime Minister Donald Tusk said that building agenda for euro zone entry is not a top priority. This week he said that the crisis and aggressive speculation against the zloty showed that Poland should join the euro zone as soon as possible, but the time needed to fulfil all the Maastricht criteria should be realistically assessed. NBP deputy president Witold Koziński also mentioned a possible delay in the adoption of the euro due to the situation in the euro zone. Finance Minister said that 2015 is still realistic, but first fiscal performance should be improved. In our view, the descent of the deficit to 3% of GDP in 2012 may be very difficult. Minister of Finance conditioned introduction of fiscal reforms on winning the presidential election.

Market monitor



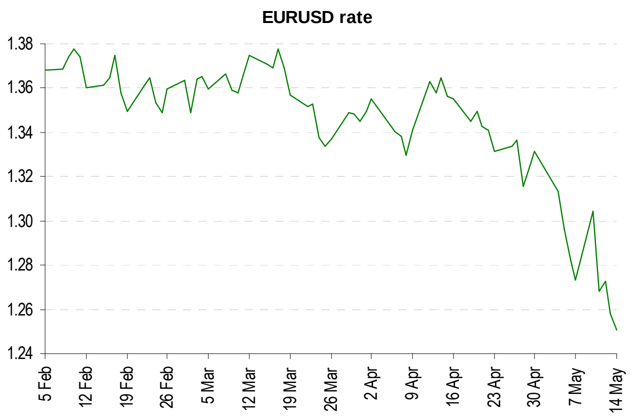
Clear recovery of the zloty ...

- Stabilisation package of EU and the IMF as well as decision of the ECB to purchase assets led to significant recovery of the zloty and calming down moods in the international markets. The EURPLN rate was falling in fast pace as it rose in the previous week. The zloty recovered vs. the euro to 3.94 vs. 4.18 in the previous Friday, though at the end of the week there was a slight correction. During the week the zloty appreciated the most in the region (ca. 3.7%, vs. 1.2% forint and 0.6% Czech crown).
- Weak euro should support the German economy and thus also the Polish one which should limit negative pressure on the zloty. Important support level for the EURPLN rate is at 3.94. We expect stabilisation of the EURPLN rate this week in range of 3.94-4.06.



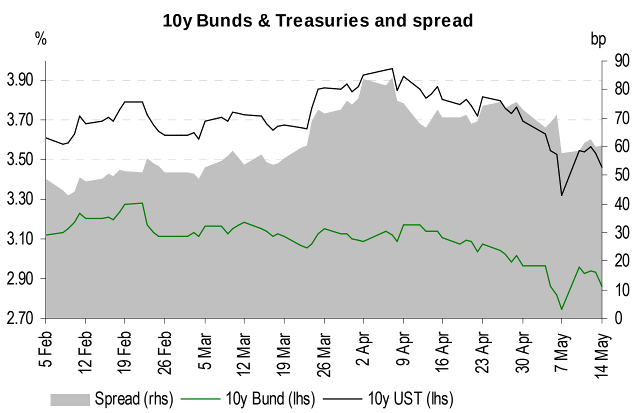
... as well as bonds

- After weakening in the debt market on the wave of asset sell-off in the emerging markets, this week there was a recovery. Results of 5Y bond auction were good. Yields of 2Y bonds returned to levels from the mid April before the crisis intensification. Recovery at the longer end was much weaker leading to yield curve steepening. The longer end of the curve was negatively affected by comments of the Prime Minister and finance minister that euro is not a priority now.
- After recovery in the debt market this week there may be some stabilisation. Domestic data may lead to higher rates at the short end of the curve. The longer end will be under negative influence of bond BGK supply and expectations that euro adoption may be delayed, which is reflected in high 5x5 spread.



Euro the weakest vs. the dollar in 18 months

- Although the EU and IMF stabilisation package was introduced under market pressure, it was still surprisingly large (€720bn) and decreased the nervousness in the markets leading to temporary rebound of EURUSD to above 1.30. Next days brought gradual slide of the euro to below 1.25, i.e. the lowest level in 18 months. Apart from this there was a further drop of the EURCHF, which temporarily fell below 1.40.
- Problems of some euro zone countries and introduction of the fiscal cuts plans will negatively affect the economic recovery in the euro zone and may cause later rate hikes by the ECB. Amid sooner rate hikes and economic recovery in the US this should lead to further pressure on the euro.



Sudden fall of prices of safe-heaven bonds

- After adopting the EU's stabilization package and purchase of bonds of purchases peripheral euro area countries by the ECB, there was a decline in demand for safe assets and a fall in bond yields of southern euro zone countries (spread on two-year bond of Greece vs. Germany fell by 10 pp). End of the week saw a slight strengthening in the core markets, due to investigations against banks in the US. Yields of 10Y Treasuries and Bunds during the week increased by 15 bps to 3.48% and 2.88%.
- Spread between yields of Bunds and other countries of the euro area may continue to fall, but probably will not return soon to levels seen before the spike of concern about PIIGS debt. There may be a rebound in spread between Treasuries and Bunds. Upward move in yields may be limited by the risk for the economic rebound resulting from the situation in the euro area.

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