Bank Zachodni WBK

Weekly economic update

24 – 30 May 2010

The last week was marked by rise in risk aversion in the global markets, which translated into clear weakening of the zloty and local bonds. Lower risk appetite was related to increased uncertainty in the market after Germany introduced a ban on naked short sale of the euro zone's government bonds, CDS contracts and key financials stocks. Market sentiment was also negatively affected by disappointing data from the US economy, although they lifted the EURUSD at the same time. Towards the end of the week the zloty rebounded against majors, especially that on Friday global stock markets recovered. The zloty was also helped by rise in EURUSD and by rumors (not officially confirmed) that the state-owned bank BGK sold on the market foreign currencies from EU funds. On Friday the Sejm amended the NBP Act, clarifying rules for taking over duties of the NBP governor in case of his death. At the same time, it seems that it will not be possible to win majority for appointment of the new NBP governor before presidential elections.

This week the key driver for the Polish market will still be changes in moods on the global market. The MPC meeting (no changes in monetary policy parameters are expected) and next local data will be in the background.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (24 May)					
	CH	Market holiday					
11:00	**PL**	**Tender of 48-week T-bills worth PLN0.9-1.4bn**					
16:00	US	Existing home sales	Mar	m	5.62		5.35
		TUESDAY (25 May)					
	PL	**MPC decision**		**%**	**3.50**	**3.50**	**3.50**
11:00	EZ	Industrial orders	Mar	%MoM	2.0	-	1.5
15:00	US	Case/Shiller house price index	Mar	%YoY	2.4	-	0.6
16:00	US	Consumer confidence	May	pts	59.0	-	57.9
16:00	US	Home prices	Mar	%YoY	-	-	-3.4
		WEDNESDAY (26 May)					
8:00	DE	Gfk index of consumer confidence	Jun	pts	3.6	-	3.8
10:00	**PL**	**Retail sales**	**Apr**	**%YoY**	**3.8**	**3.5**	**8.7**
10:00	**PL**	**Registered unemployment rate**	**Apr**	**%**	**12.3**	**12.3**	**12.9**
14:30	US	Durable goods	Apr	%MoM	1.5	-	-1.2
16:00	US	New home sales	Apr	m	0.42	-	0.411
		THURSDAY (27 May)					
11:00	**PL**	**Switch auction of bonds**					
14:30	US	Preliminary GDP	Q1	%QoQ	3.4	-	3.2
14:30	US	Core PCE	Q1	%QoQ	0.6	-	0.6
14:30	US	Initial jobless claims	w/e	k	457.0	-	471.0
		FRIDAY (28 May)					
14:30	US	Core PCE	Apr	%MoM	0.1	-	0.1
14:30	US	Personal income	Apr	%MoM	0.5	-	0.3
14:30	US	Consumption spending	Apr	%MoM	0.3	-	0.6
15:45	US	Chicago PMI	May	pts	61.8	-	63.8
15:55	US	Final Michigan index	May	pts	73.3	-	72.2

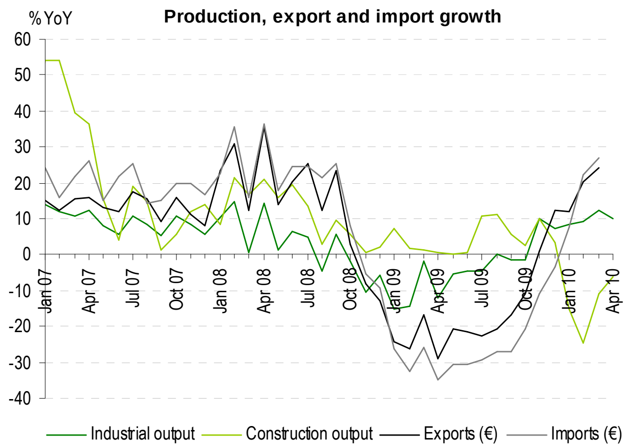
Source: BZ WBK, Reuters, Parkiet daily

Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

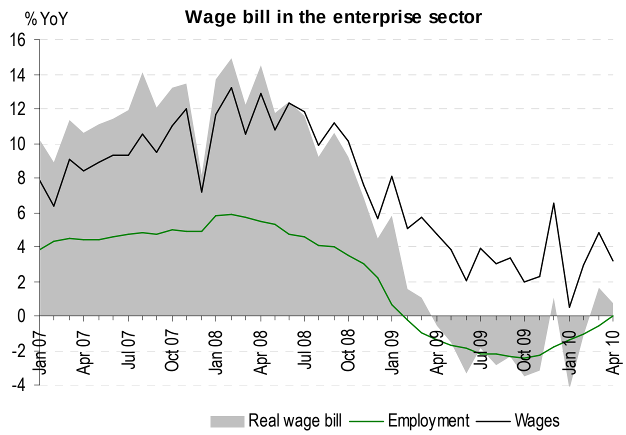
What's hot this week – Domestic events overshadowed by developments abroad

- At the MPC meeting this week, interest rates are likely to remain unchanged again, similarly as the informal policy bias. Monthly macro data from the first quarter strengthened the optimism about GDP growth, but the expected recovery is still not strong enough to convince the Council to proceed with monetary tightening amid uncertainty about economic outlook in the euro area.
- Data on retail sales and unemployment will be released after the MPC meeting. We expect sales growth in April by 3.5%YoY, lower than in March (8.7%), when the Easter shopping was made, but greater than in the first two months of 2010.
- Fluctuations in risk appetite in the world will remain crucial for the Polish market. The focus of attention will be on presentation of fiscal austerity measures in the euro area to be proposed by German Chancellor Angela Merkel.

Economy last week – Fresh data without significant surprises



- Balance of payments for March was broadly in line with expectations. C/A gap was ca. €0.5bn with continued clear acceleration in exports and imports growth (to much above 20%YoY). It is also noteworthy that there was again solid inflow of EU funds and large inflow of FDIs (more than €1bn). Good state of balance of payments should be seen as an important factor counteracting the sustained weakening of the zloty.
- Data on industrial and construction production for April were slightly below forecasts. The difference was not as big as to negatively affect our GDP forecasts, though one should remember about a new risk factor for the second quarter, which is the impact of flood. So far we maintain our estimates of GDP growth till the year end at slightly above 3%YoY.



- Disappointment in case of wages (annual growth 3.2%) and positive surprise in employment (0.3%MoM and 0%YoY) translated into slightly lower wage bill growth in firms than we forecast. The difference is not large enough so that significantly change our assessment of consumption demand prospects. From the point of the view of the MPC the data may calm down concerns about intensification of wage pressure and confirm our view that the NBP interest rates will stay unchanged until the final quarter of this year, when we forecast one rate hike by 25 bp.
- Core inflation measures for April confirmed that fundamental inflationary pressure remains muted. CPI excluding food and energy prices fell to 1.9%YoY.
- PPI was above expectations in April, mainly due to increase in commodity prices. However, there are no signals of demand pressure in the producer sector.

Quote of the week – We have to wait until the flood ends

Michał Boni, head of PM advisors, PAP, 21 May

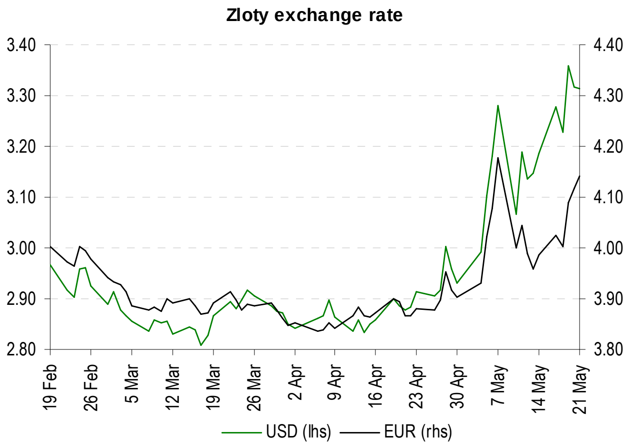
[Will the flood negatively affect GDP and inflation?] I don't think so, because the scale seems to be smaller than in 1997. I think about opposite effect, some elements of restoration will have positive impact.

Artur Ławniczak, deputy agriculture minister, PAP, 20 May

We have to wait until the water goes down to estimate losses in flooded areas. Then we will see what will be the effect of flood on crops and prices. It may happen that there will be some increase in price of cereals. Flood affected northern Hungary, Czech Republic, Slovakia, southern Poland, and this is a large acreage of crops.

The economic effects of flood have so far been difficult to determine because it is not over and the situation is not yet stabilized. Nevertheless, it is hard to agree that a rebound in some areas and branches associated with removal of flood damage may outweigh the negative effects of loss of property and a temporary reduction in activity of businesses and consumers in the affected areas. Much of the downtime of production and shopping, however, should be made up for later in the year. Inflationary effects of flood in Poland and other countries in the region will be in our view limited by imports. The most important of all may be budgetary effects of flooding, making it impossible to reduce state budget deficit versus the originally planned level.

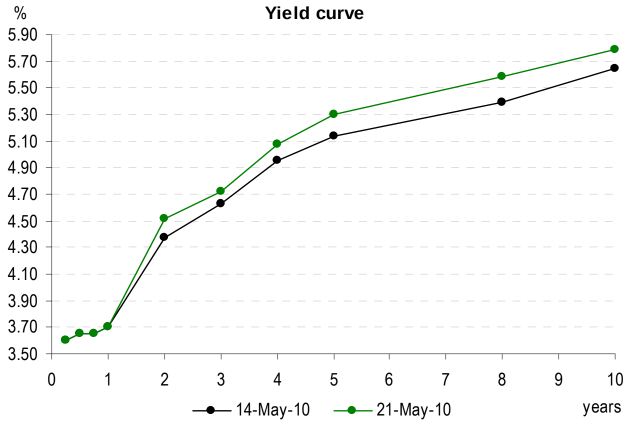
Market monitor



Zloty again under pressure of higher risk aversion

▪ At the start of last week the zloty, in line with our expectations, was fairly stable around 4.0 to the euro, but later on it depreciated due to a surge in risk aversion in global markets. On Thursday EURPLN approached the 4.20 level. Then the unconfirmed rumours appeared about the sale of foreign currencies from EU funds by BGK and the zloty rebounded to below 4.15 at the end of the week, although the main equity indices in the world continued falling. The zloty has lost more than other currencies in the region.

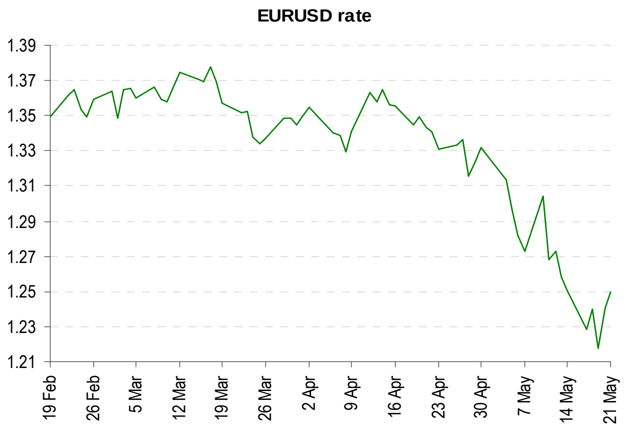
▪ We assume that this week nervousness in global markets will persist, preventing the zloty from a strong rebound. Before returning to 4.0 the EURPLN will have to deal with barrier at 4.06. The key resistance level is 4.20.



Domestic debt market

▪ Higher risk aversion hurt domestic bonds, although the pass-through of negative events in the world onto the Polish debt market was weaker than on the zloty. Yield curve rose during the week by 9-14 bp. Despite difficult conditions in global markets, BGK has sold PLN3bn (out of offered PLN1.5-3bn) of road bonds maturing in 2018. The demand was almost PLN5bn, and the average yield was 5.975%.

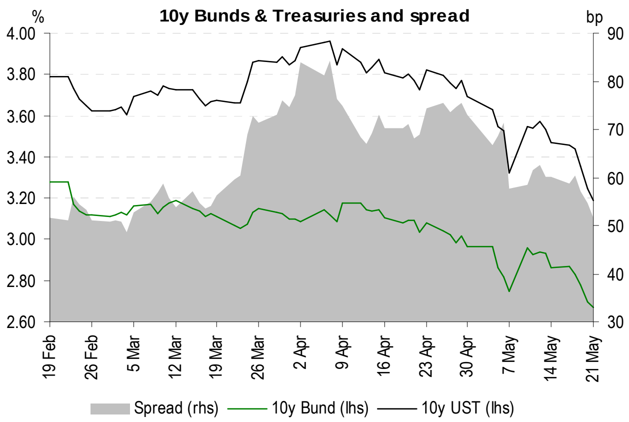
▪ This week, the domestic debt market, similarly as the zloty, will continue to be largely influenced by changes in risk appetite in global markets. The result of MPC meeting will be in our opinion neutral for the domestic interest rate market.



EURUSD rebounding after further fall

▪ Concerns about situation in the euro area and fall in risk appetite led to temporary fall of EURUSD below 1.22 in the first part of last week, its lowest level for four years. Later on, euro rebounded on speculation about central banks' intervention and because of disappointing US macro data (unexpected rise in new jobless claims and a fall in leading indicators). At the end of the week EURUSD was around 1.26, which is higher than the week before, when it had decreased below 1.24.

▪ Behaviour of EURUSD this week will depend on the shape of the proposed changes to the rules of fiscal discipline in the euro area. Statements of Fed governor on Wednesday and another set of US macro data may be also important.



Clear strengthening in the core debt markets

▪ Clear increase in risk aversion in the international markets pushed capital into Treasuries and Bunds, which yields recorded significant decline. At the end of the week yields of 10Y Treasuries and Bunds were at 3.13% and 2.63% respectively vs. 3.47% and 2.86% a week earlier. There was also a significant drop of yields in other tenors. It is worth to note the drop of 2Y German yields to the record low level below 0.4%and yields of 30Y bonds below 4.0%.

▪ Taking into account the scale of recent strengthening in the core debt markets, this week the scale of yields decline of US Treasuries and Bunds will decelerate in our view even with further increase of risk aversion.

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