Bank Zachodni WBK

Weekly economic update

28 June – 4 July 2010

Although the last week started in positive moods after a weekend decision of Chinese central bank to abandon the dollar peg of the yuan, the optimism quickly ran out of steam and was replaced by a returning risk aversion. Investors realized that the scale of the strengthening of Chinese currency will be minor, and will not be able to compensate for the risks to global growth arising, inter alia, from the European debt crisis and the need of fiscal policy tightening in many countries simultaneously. Assessment of the prospects for the US economy deteriorated further after data releases in the US and publication of the Fed statement.

This week, the mood in global markets will remain central to the evolution of the Polish financial market. At the start of the week the determinant of trend may the conclusions of the weekend G20 meeting in Canada. Later on, a lot of data releases in the US and in the euro area may affect the market assessment of the prospects of economic recovery. The key domestic event will be the first meeting of the Monetary Policy Council chaired by the NBP President Marek Belka and the publication of new NBP's projections of inflation and GDP. The finale of the campaign before the second round of presidential elections should not have a significant impact on the market.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (28 June)					
11:00	**PL**	**Tender of 52-week T-bills worth PLN1.3-1.8bn**					
	EZ	Money supply (M3)	May	%YoY	0.3	-	-0.1
		TUESDAY (29 June)					
14:00	**PL**	**Current account balance**	**Q1**	**€ bn**	**-**	**-1.15***	**-2.73**
15:00	US	S&P/Case-Shiller Home Price Index	Apr	%YoY	3.4	-	2.3
16:00	US	Conference Board Consumer Confidence	Jun	pts	62.5	-	63.3
		WEDNESDAY (30 June)					
	PL	**MPC decision**		**%**	**3.5**	**3.5**	**3.5**
10:00	DE	Unemployment rate	Jun	%	7.7	-	7.7
11:00	EZ	HICP flash	Jun	%YoY	1.5	-	1.6
14:15	US	ADP Employment Report	Jun	k	55.0	-	55.0
15:45	US	Chicago PMI	Jun	pts	59.5	-	59.7
		THURSDAY (1 June)					
9:00	**PL**	**PMI manufacturing**	**Jun**	pts	**52.3**	**52.6**	**52.2**
9:58	EZ	PMI manufacturing	Jun	pts	55.6	-	55.6
14:30	US	New jobless claims	week	k	450.0	-	457.0
16:00	US	ISM manufacturing	Jun	pts	58.5	-	59.7
16:00	US	Pending home sales	May	%MoM	-10.0	-	6.0
		FRIDAY (2 July)					
11:00	EZ	PPI	May	%YoY	3.1	-	2.8
11:00	EZ	Unemployment rate	May	%	10.1	-	10.1
14:30	US	Non-farm payrolls	Jun	k	-70.0	-	431.0
14:30	US	Unemployment rate	Jun	%	9.7	-	9.7
16:00	US	Factory orders	May	%MoM	-0.4	-	1.2
		SUNDAY (4 July)					
	PL	**2nd round of presidential election**					

Source: BZ WBK, Parkiet, Reuters;   * sum of monthly data;

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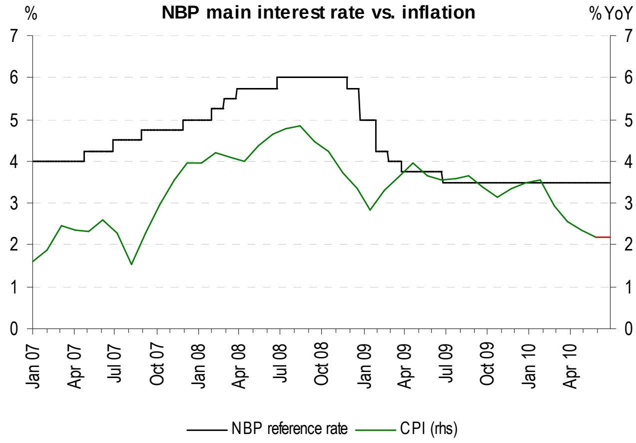
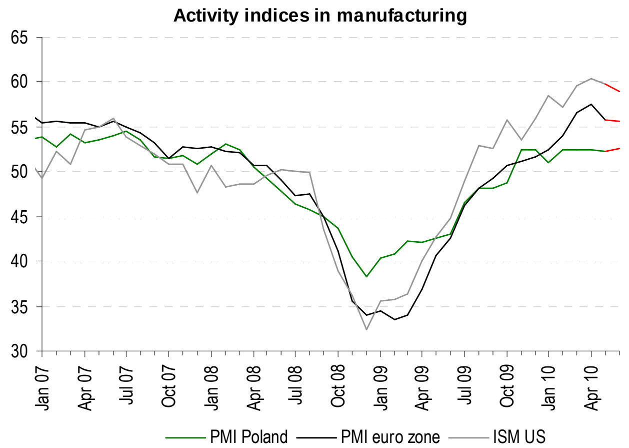
What's hot this week – MPC decision, new NBP projections, a lot of data abroad

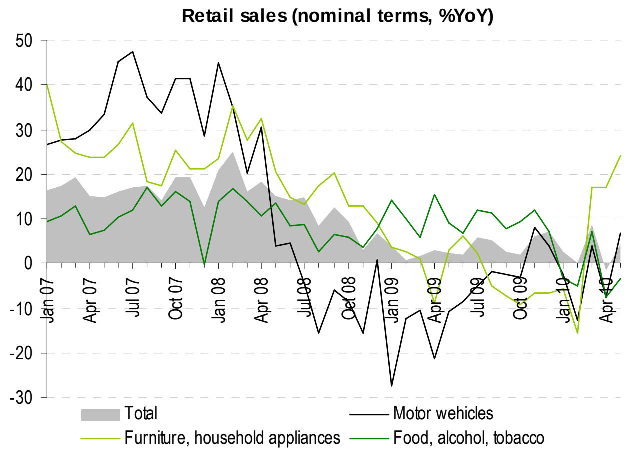


- Start of the week on the domestic market will be marked by waiting for the MPC meeting, the subsequent publication of a new *Inflation report*, as well as the PMI data for June and inflation forecasts of the Ministry of Finance.
- The MPC will leave rates unchanged, but the communiqué and press conference - the first one with the new NBP president on board - will be certainly interesting for the market. Particularly in the context of the recent increase in market expectations for rate hikes after the Council members spoke.
- Important for expectations about prospects of monetary policy will be also the new projections of inflation and GDP, which initially will be presented in the Council statement, and fully revealed in the new *Inflation report* (published on Thursday or Friday). MPC member has suggested recently that the new path of inflation in the projection will be higher than in the previous report.



- We expect a slight increase in the PMI index of Polish manufacturing in June, despite a slight decrease in the euro zone PMI, because the weakening of the zloty should positively affect moods of exporters.
- At the start of July, the MinFin will traditionally give their estimates of inflation for June. We expect stabilization of the CPI at 2.2%YoY with a slight increase in fuel prices, and fairly stable food prices (the latter is again the biggest risk factor because of the hard to quantify impact of flooding on prices of fruits and vegetables).
- Quarterly balance of payments data published on Tuesday, may show considerable revisions to the previous monthly statistics, with little impact on the market.
- A lot of important indicators will be published abroad and may affect global moods and risk aversion.

Economy last week – Another good data for May



- Retail sales growth in May (4.3%YoY) was better than forecast, amid improved results in virtually all categories, indicating a broad-based revival in consumer demand. Partly it was a rebound from weak April results (the impact of national mourning), but also the result of a gradual recovery in the labour market and increased consumer optimism. Effect of flooding on sales appeared to be negligible.
- The unemployment rate fell in May to 11.9%, confirming a gradual improvement in the labour market.
- All the measures of core inflation fell in May. CPI excluding food and energy prices was at 1.6%YoY.
- The CSO survey showed a seasonal deterioration in assessments of business climate in industry and commerce in June and a slight improvement in the construction sector. Seasonally adjusted indicators slightly improved in all sectors.

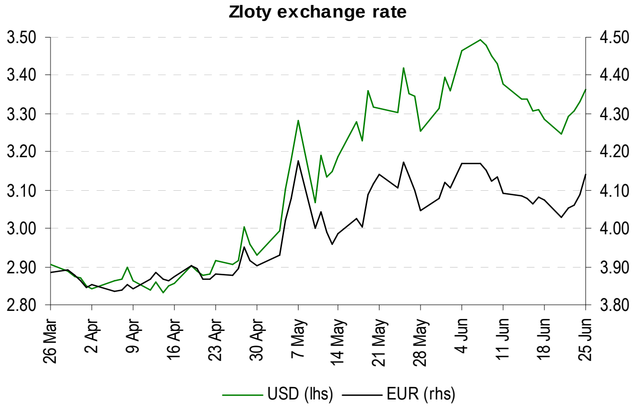
Quote of the week – MPC members revived rate hike expectations

Anna Zielińska-Głębocka, MPC member, Reuters, 23 Jun

I opt for one rate hike by 50 bp in the autumn, which will anchor inflation expectations, with simultaneous signal that monetary policy will remain unchanged after the hike for several months. There are opinions that we should hike the rates right now (after the release of June inflation projection). I believe that it is too early for that, but I am open for discussion. (...) Recovery is still fragile, so I think that currently there is no need to change monetary policy bias nor the interest rates. (...) I think that June projection will show higher inflation path than the February one.

FRA6x9 rates have increased since mid-June by ca. 15 bp, and FRA9x12 by almost 20 bp. This is caused by market reaction to the comments of MPC member Anna Zielińska-Głębocka, as well as similar earlier statement of Adam Glapiński, which influenced the probability priced-in by the market of interest rate hikes in Poland in 2-3 quarters horizon. Interestingly, the market ignored Zielińska-Głębocka's statement that there are opinions in the Council that interest rates should be raised in June. Apparently, investors – like us – believe that the current uncertainty about the pace of recovery of the global economy and the consequences of situation abroad for the Polish economy and Polish zloty in the coming months will prevent the Council from too rapid movements.

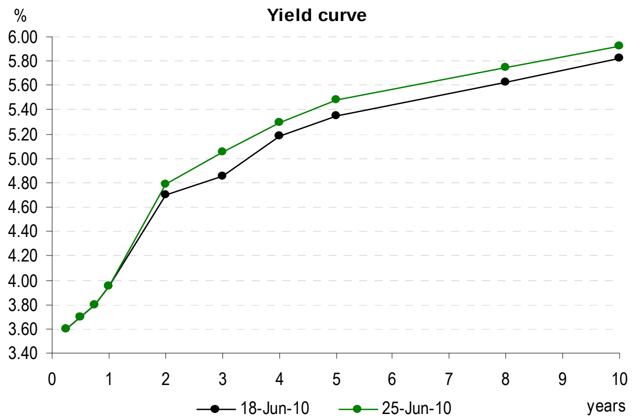
Market monitor



Weaker zloty amid higher global risk aversion

▪ Accumulation of negative information abroad, especially in the second part of the week, negatively affected the zloty. After the EURPLN broke 4.06, it continued the upward trend, breaking a few important resistance levels and exceeding 4.14 on Friday. At the very end of the week the EURPLN moved down slightly to ca. 4.12. As regards USDPLN, rise above 3.30 led to further weakening of the zloty to 3.34-3.37.

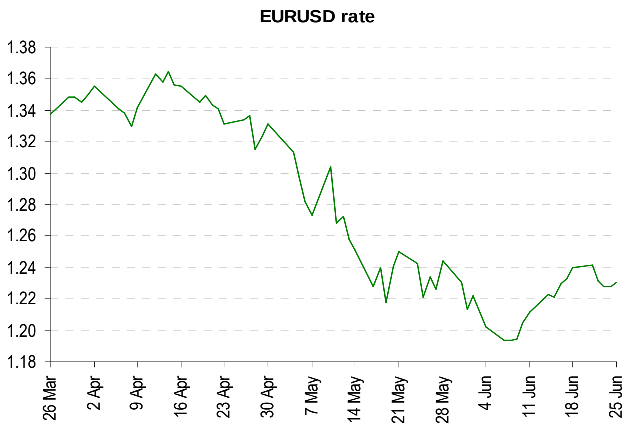
▪ Very dynamic situation in the Polish FX market has to lead to indicate new important levels. Support at 4.11, which is very close to current market level, is the most significant at the moment. Breaking this level down would open the way towards range 4.07-4.09. Any conclusions from G20 meeting during the weekend may influence opening of the market on Monday. It is possible that the opening will be with a gap and important technical levels would be broken.



Long end of the yield curve harmed most

▪ Domestic fixed income market was pretty stable during the past week, though gradual yield's rise was observed in all tenors. Prices of the long-term bonds declined at faster pace at the end of the week, as the market sentiment deteriorated.

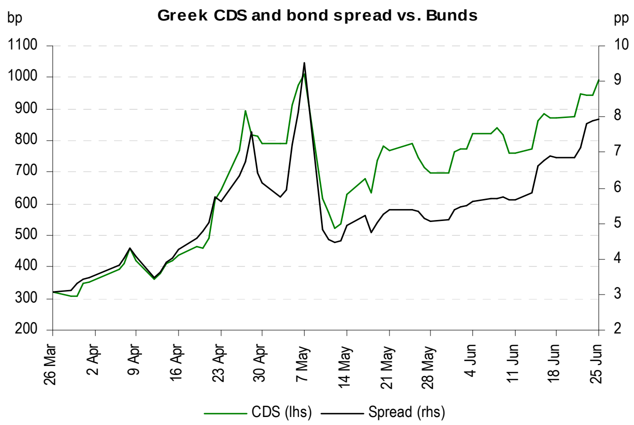
▪ The MPC's decision on interest rates is scheduled for Wednesday. In our opinion, which is in line with the market expectations, the interest rate will be held at present level. Some comments of MPC members suggesting 50bps hike in Autumn have influenced the market recently. Market participants may refrain from higher activity at the beginning of the week, awaiting for the after-meeting-comments that may confirm or deny previous suggestions.



Euro under pressure again

▪ The EURUSD rate was falling at the beginning of last week, breaking support at 1.235. Later during the week this trend was continued, but the 1.224 level was broken only temporarily, which led to some upward correction.

▪ In the upcoming days the most important level seems to be 1.23. In the case of further dollar strengthening, the support range for EURUSD is 1.22-1.227. On the other hand, the room for dollar weakening is limited by the range 1.236-1.24. Possible lower liquidity on the euro market driven by paying back loans to the ECB may affect global markets this week. This was observed already this week with EURIBOR rising by 15-20 bp. Also, economic calendar is quite heavy and some comments may appear after G20 meeting, which may influence markets.



CDS surge and the yield's spread widens

▪ The prices of 10Y Bunds and Treasuries have been consequently gaining during the past week. Finally, the yields declined from 2.75% to 2.62% (Bunds) and from 3.24% to 3.12% (Treasuries) on the weekly basis.

▪ Rising risk aversion triggered the widening of yield's spread between European bonds and 10 Bunds. Greek bonds suffered the biggest loss (spreads up from 6.85pts to 7.88pts). The cost of Greek debt insurance also advanced. CDS rates for 5Y bonds reached record-high at 1130pts. For Poland, we observed some spread rise (from 3.13pts to 3.90pts) and relatively stable CDS.

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