Bank Zachodni WBK

Weekly economic update

5 – 11 July 2010

Foreign markets remain under pressure of worries about economic slowdown, fuelled by a worse-than-expected data releases in major economies (last week among others PMI and ISM, US data from the labour market and real estate market), and fluctuations in global risk aversion are still a key factor in the behaviour of financial markets. Against this background, the results of the Polish economy look very positive. A series of optimistic local data published in recent weeks was supplemented by PMI index, which rose in June to the highest level for almost three years, suggesting continued rapid growth in industrial output driven by foreign demand (still very strong inflow of export orders). Inflation is still on a downward trend (Ministry of Finance, like us, predicts a decline in June to 2.1%, and below 2% in summer), but with the economic recovery and the turmoil in financial markets (weaker zloty) there is a number of risks for inflation in the medium term. They were spotted by the MPC and the tone of the communiqué in June was more hawkish than before. This confirms expectations that the first interest rate hike by 25 basis points will take place in the final quarter of 2010.

After the first reaction to the outcome of the presidential election (which we think should be short-lived, regardless of the result), this week once again market attention will focus on events abroad. Not too numerous data publications in the US and the euro area will be further guidance on economic growth in the world and main determinants of risk appetite. As usually, the tone of the press conference after the ECB meeting and comments of J.C. Trichet will be important for markets.

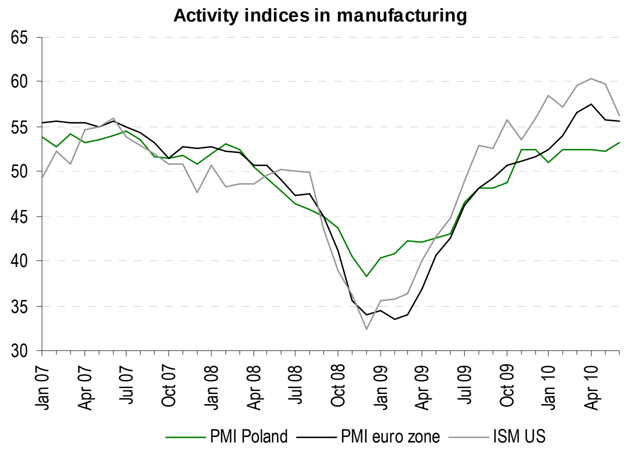
Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (5 July)					
11:00	**PL**	**Tender of 52-week T-bills worth PLN1.3-1.8bn**					
9:53	DE	PMI – services	Jun	pts.	54.6	-	54.6
9:58	EZ	PMI - services	Jun	pts.	55.4	-	55.4
9:58	EZ	PMI composite	Jun	pts.	56.0	-	56.0
11:00	EZ	Retail sales	May	%YoY	-0.3	-	-1.5
		TUESDAY (6 July)					
	PL	**MPC meeting**					
16:00	US	Non-manufacturing ISM	Jun	pts.	55.0	-	55.4
		WEDNESDAY (7 July)					
	PL	**2Y bond tender OK1012 (PLN3-5bn)**					
11:00	EZ	Final GDP	Q1	%YoY	0.6	-	0.5
12:00	DE	Industry orders	May	%MoM	0.5	-	2.8
		THURSDAY (8 July)					
8:00	DE	Trade balance	May	€ bn	13.5	-	13.1
12:00	DE	Industrial production	May	%MoM	0.9	-	0.9
13:00	GB	BOE decision		%	0.5	-	0.5
13:45	EZ	ECB decision		%	1.0	-	1.0
14:30	US	Unemployment claims	week	k	460.0	-	472.0
		FRIDAY (9 July)					
16:00	US	Wholesale inventories	Jun	%MoM	0.5	-	0.4

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

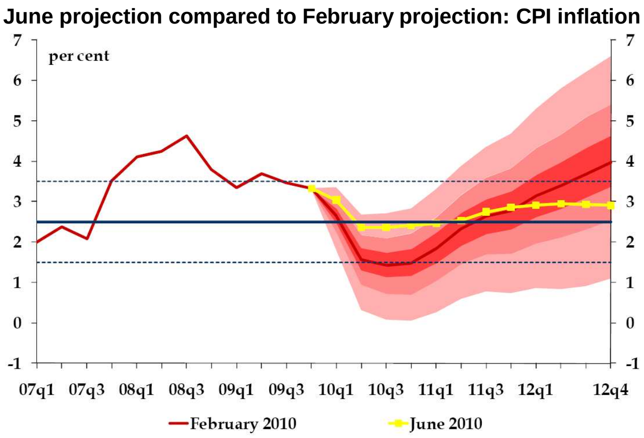
Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
e-mail: ekonomia@bzwbk.pl

What's hot this week – Another week under impact of events abroad

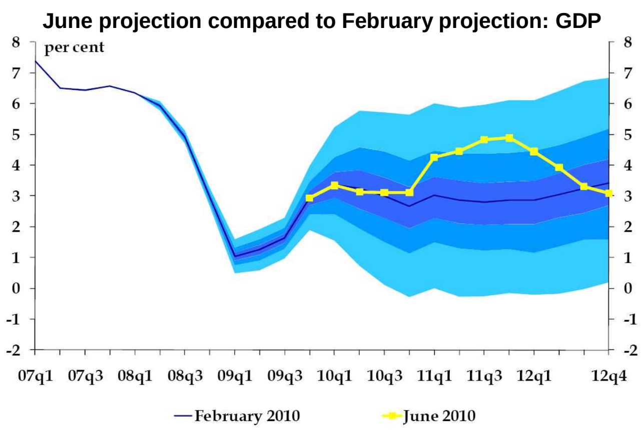


- At the start of the week we will see the market reaction to the results of 2^{nd} round of presidential elections in Poland. Market has been pricing-in Bronisław Komorowski's victory, so the opposite result could trigger a slight (temporary) correction.
- In the absence of domestic data releases, the sentiment during the week will be once again dictated by developments in international markets. Agenda of data releases abroad is quite light, with the focus of attention on the ECB meeting and indicators of economic activity in the US and the euro area.
- MPC meeting scheduled for Tuesday (the only one in July) will not be decisive.
- During the week the government may show assumptions to the 2011 budget after taking into account estimates of flood effects. According to a preliminary FinMin proposal, GDP growth was assumed at 3.5% and the average annual inflation at 2.3%.

Economy last week – More hawkish MPC, PMI above forecasts



- The Monetary Policy Council left interest rates unchanged, but the arrival of the new NBP President triggered a change in the communication. The sentence about the balance of risks to inflation, considered as an informal bias of monetary policy, has disappeared from the statement. Also, several factors that may limit inflation were erased (the only remaining were base effects). Marek Belka pointed out that the central bankers discussed the factors which may strengthen inflationary pressures, which "shows the direction of interest" of the Council.
- Overall, the tone of the communiqué and the press conference was more hawkish than in the previous month, but it seems to us that the prospects for monetary policy have not changed significantly. We think that the opportune time to start monetary tightening cycle will appear only in the last quarter of this year.



- The new NBP projection showed higher GDP path than in February's report with significant acceleration in 2011 (according to authors resulting from accumulation of investment before EURO 2012 championship and higher individual consumption) and slowdown in 2012. At the same time, the authors draw attention that risks for GDP are biased downwards and it may be below the central path.
- Inflation projection assumes a moderate CPI rise, and its stabilisation at ca. 2.9% in 2012, below the path indicates by previous projection.
- PMI manufacturing index in Poland rose in June to 53.3, exceeding the most optimistic forecasts. It is noteworthy that the rise in PMI was mainly driven by booming orders, particularly in exports. The figure indicates the continuation of rapid growth of industrial production in June (our forecast is nearly 12%YoY).

Quote of the week – Food prices still crucial for inflation

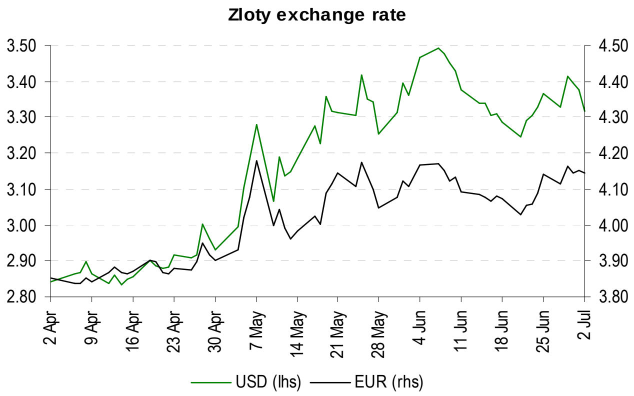
Sławomir Dudek, deputy head of FinMin's research dept., PAP, 1 Jul

What surprised in our estimate was prices of food and beverages, which remained unchanged MoM, while usually we witnessed a seasonal decline in June. It results from lower than in recent years drop in prices of fruits and vegetables. In our view, prices of tobacco and alcohol remained unchanged as well. Hikes in gas prices had increased inflation, in our view fuel prices advanced by 0.5%MoM.

In summer months, July and August, annual inflation rate should keep descending, we belie that inflation will go down below 2% due to statistical base effects.

By MF inflation forecast in June fell to 2.1%, which is consistent with our forecast and market expectations. On a monthly basis the Ministry predicts rise in CPI by 0.2%, slightly higher than we did (0.1%), reflecting inter alia with estimates indicating the stabilization of food prices. By our assumptions there is a fall in this category, although much smaller than last year. Already some time ago we reported that food prices pose the greatest risk factor for inflation in the summer months. It consists of a difficult to estimate the combined effect of disturbances on the agricultural market arising from the floods and the weakening of the zloty, causing More expensive imported food. Still, expect, like MF, CPI fall below 2% in the holidays and growth to the target in the coming months.

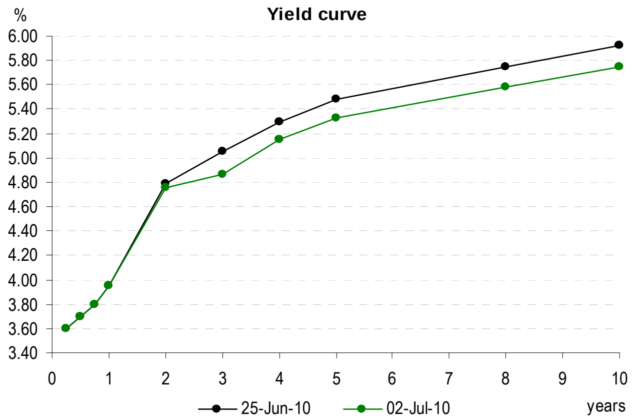
Market monitor



The zloty is still under the influence of the global mood

▪ During the past week we observed major swings of market sentiment. The EURPLN traded in a quite broad horizontal trend ranging 4.12-4.17. The drop below the area of support at 4.11-4.12 was not confirmed. The zloty stabilized at around 4.145-4.15 at the end of the week. The USDPLN declined during the past week below the support at 3.34-3.35 to ca. 3.30 mainly because of rising EURUSD.

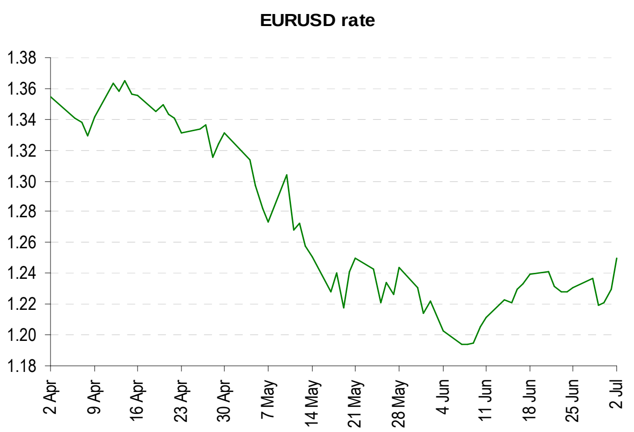
▪ First (short-term) level of support for EURPLN is at 4.14, that is indicated by the upward trend line firmed during the past week. The area at 4.11-4.12 is still a vital support, while the range of 4.17-4.19 is considered as the resistance area. Still, global market sentiment will have decisive impact on the zloty.



Domestic fixed income market firms

▪ The beginning of the week was very calm on the Polish fixed income market, as investors were awaiting the statement after the MPC meeting. The investors' activity was low. At the end of the month investment funds increased demand for Polish bonds and as a result yields in all tenors declined. Additionally, the demand from abroad arrived.

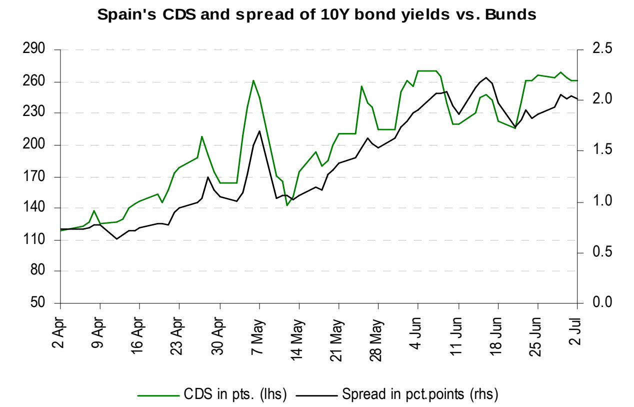
▪ The market defended vital level of support that fuelled prices' rise. After considerable decline of the yield curve, it seems that the potential for further strengthening of bonds is limited. In particular, the potential victory of Jarosław Kaczyński in the presidential elections may be a trigger for correction. Market sentiment abroad will be still very important.



Euro strengthening or dollar weakening?

▪ At the start of the week the EURUSD rate was in the downward trend under impact of liquidity pressure and some worries re. stability in the CEE region. The key support level of 1.224 was broken, Later during the week the situation in Europe has stabilised and a number of weak economic data were published, which brought EURUSD higher. The resistance at 1.245 was exceeded. On Friday the market awaited the key non-farm payrolls figure, which was worse than expected and opened room for further euro gains.

▪ The confirmed breaking of 1.245 resistance (which now becomes support for euro) may theoretically mean further rise in EURUSD to 1.28. However, apart form the data, the important factor for the market will be liquidity in the euro area banking system and a possibility of offering by the ECB operations longer than three months.



CDS surge and the yield's spread widens

▪ There was a systematic fall in yields of 10Y Treasuries during last week (from 3.04% to 2.94%). It was caused by negative sentiment in Europe at the start of the week and unsatisfactory data from the USA. The Bund yields, after fall at the beginning, reached 2.59% at the end of the week.

▪ The CDS rates dropped last week. This was seen especially in the second half of the week after the successful auction of Spanish bonds. The cost of insurance of 5Y Spanish bonds dropped from 265 points on Tuesday to 261 points at the end of the week. The auction triggered a decrease in CDS rates for Greece, Portugal and Italy. There was only a slight fall in spread between yields of 10Y Spanish and German bonds, since the prices of the latter were slightly dropping during the week.

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