

Weekly economic update

19 – 25 July 2010

The earnings reports season started in the US in the past week brought mostly positive news, which was supportive for the risk appetite, despite inflow of disappointing data from the US economy. As a result, stock markets were in a horizontal trend while at the same time EURUSD considerably rose. Core debt markets gained. The zloty was following changes in risk appetite and EURUSD movements, i.e. in a weekly comparison was broadly stable versus basket of the major currencies with depreciation to the euro and appreciation to the dollar. Domestic macro data has not change much the picture of economic situation. The key news was surprising rise in CPI inflation in June and although this was coupled with lowering in core inflation estimate (confirming that underlying inflationary pressure remains subdued), market expectations for rate hikes intensifies leading to weakening of local interest rate market. Our view on MPC policy actions in future has not changed.

This week will bring next important macro data locally. They may affect further developments in the domestic interest rate market, but the zloty will remain dominated by events abroad. The US economic calendar is lighter this week, but we will get important figures from the euro zone (focus of PMIs for July) and next earnings reports. Besides, markets will wait for results of stress-tests for European banks due on Friday. Market sentiment during the week may be also affected by testimony of Fed's Bernanke before the Congress.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (19 July)							
10:00	EZ	Current account	May	€bn	-0.3	-	-5.1
14:00	PL	Industrial output	Jun	%YoY	12.0	11.7	14.0
14:00	PL	Construction output	Jun	%YoY	4.2	3.2	2.3
14:00	PL	PPI	Jun	%YoY	1.6	1.2	1.5
TUESDAY (20 July)							
11:00	PL	Repurchase tender of T-bills maturing in August worth PLN4.63bn					
14:00	PL	Core inflation	Jun	%YoY	1.5	1.5	1.6
14:30	US	Building permits	Jun	k	570.0	-	574.0
14:30	US	House starts	Jun	k	580.0	-	593.0
WEDNESDAY (21 July)							
11:00	PL	Bond switching auction					
THURSDAY (22 July)							
9:58	EZ	Flash PMI – services	Jul	pts	55.0	-	55.5
9:58	EZ	Flash PMI – industry	Jul	pts	55.2	-	55.6
14:00	PL	Business climate indicators					
14:30	US	Initial jobless claims	week	k	447.0	-	429.0
16:00	EZ	Consumer confidence	Jul	pts	-	-	-17.3
16:00	US	Existing home sales	Jun	m	5.1	-	5.66
16:00	US	Leading indicators	Jun	%	-0.3	-	0.4
FRIDAY (23 July)							
10:00	PL	Retail sales	Jun	%	4.0	4.5	4.3
10:00	PL	Unemployment rate	Jun	%	11.6	11.6	11.9
10:00	DE	Ifo index	Jul	pts	101.6	-	101.8

Source: BZ WBK, Dow Jones, Parkiet, Reuters;

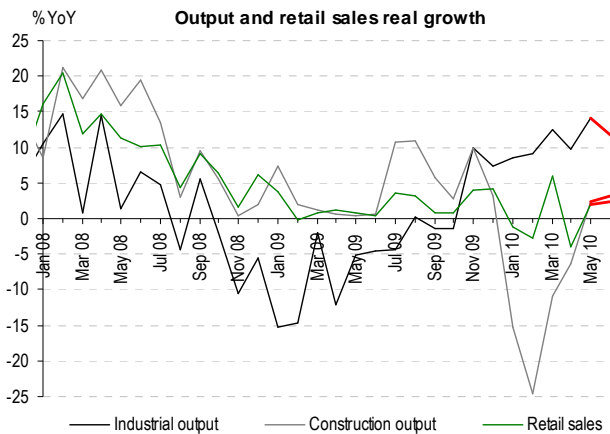
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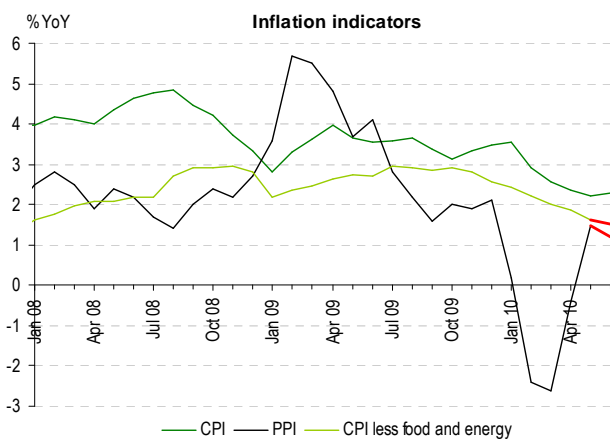
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What's hot this week – New

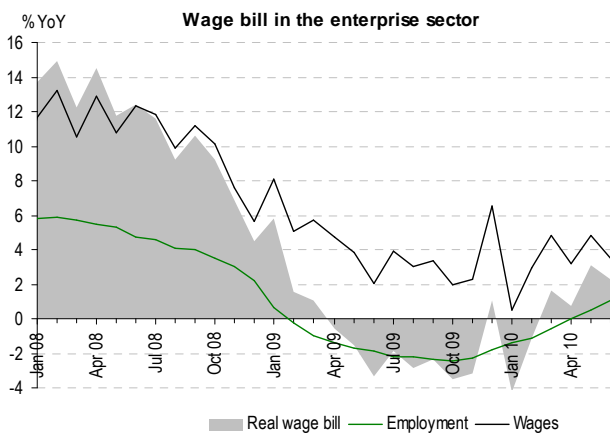


- In our view a bunch of domestic economic activity indicators due for release this week will confirm solid revival. The increase in Polish PMI for June above the most optimistic forecasts suggests that double-digit growth of industrial production was maintained, although at a slightly lower level than in May.
- At the same time, we predict an improvement in the growth rate of construction output in June., resulting from catching up process after unfavourable weather conditions in the first months of the year.
- We predict that also retail sales figures will show a slight improvement, which is related to the initiation of positive trends in the labor market.
- Overseas markets will be waiting mainly for the publication of the results of stress-tests, next earnings reports and macro data.

Economy last week – Higher than expected inflation, foreign trade turnover and wages



- CPI inflation surprisingly rose in June to 2.3%YoY from 2.2% in May, while our forecast, market consensus and the FinMin's estimate pointed to a drop to 2.1%. The key factor that led to surprising rise in CPI inflation was food prices. Price changes in other categories of consumer goods and services were close to expectations. According to our estimates after the publication of today's data, core inflation excluding food and energy prices declined in June to 1.5%YoY (the lowest level since early 2008) from 1.6%YoY in May, while previous estimates indicated that it remained unchanged. Thus, underlying inflationary pressure in the Polish economy remains subdued and we keep our scenario of monetary policy actions.
- The balance of payments data for May confirmed the continuation of the economic recovery in Poland and the lack of threats to the external stability of the Polish economy.



- Domestic labour market data for June showed stronger than expected acceleration in annual employment growth (to 1.1% from 0.5% in May) and deeper than expected slowdown in wage growth (to 3.5% from 4.8%).
- The latter suggests that the upward trend of wage growth is not as strong as it seemed, thus reducing concerns about intensification of inflationary pressure related to the labour market. However, the growth rate of average wage and the wage bill in the enterprise sector in Q2 was higher than in Q1 and we expect further improvement in subsequent quarters, which supports our forecast of acceleration in consumption demand in the second half of this year.
- All in all, the domestic macro data published in the past week has not changed significantly picture of economic situation and has not altered our view on monetary policy scenario.

Quote of the week – Drop or increase in the unemployment rate?

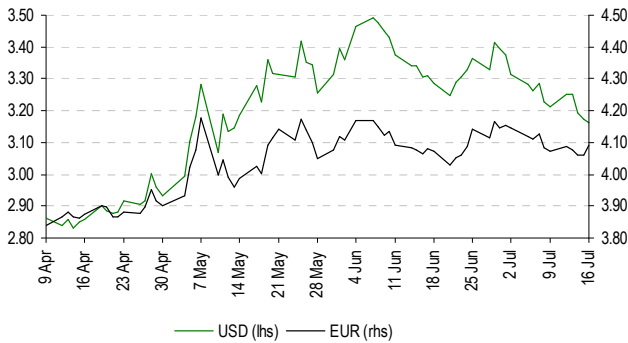
Jolanta Fedak, labour minister, PAP, 14 Jul

By the end of summer we expect a slight drop in unemployment. Since the autumn an increase in the unemployment will take place in relation to the termination of seasonal work. It seems that if the GDP growth will be maintained this year, unemployment at the end of 2010 will exceed the budget assumptions. However, it will be much more difficult to meet the assumptions for the next year - 9.9% at the end of 2011 is a very low rate. It is achievable, but difficult. More realistic, and I suggest it, is the level of 12%. If the GDP growth in the next year will be as high as in this one, it is very hard task. If there will be rebound, it is possible.

The government accepted preliminary macro assumptions to the 2011 budget. GDP growth and average annual inflation is expected to be 3.5% and 2.3%, as proposed by the Ministry of Finance. Salaries in the public sector are to be frozen. However, this step, just as the spending rule presented earlier, is not enough to significantly reduce the deficit of public finance sector. Interestingly enough, the Minister of Labour does not agree with the assumed decline in registered unemployment rate to 9.9% at the end of 2011 and believes that the more realistic level is 12%. In our opinion, more realistic is the first indicator (our forecast is 10.5%), taking into account that an employment in companies started to rise a few months ago and the seasonally adjusted LFS unemployment rate began to decline in May.

Market monitor

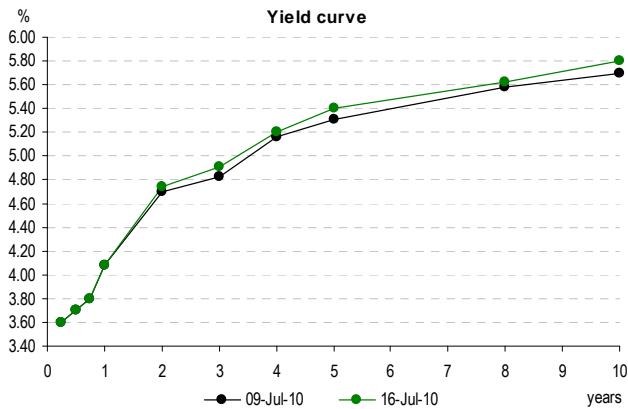
Zloty exchange rate



Zloty weaker to the euro at the end of the week

- The scenario that we had expected partially materialised during the last week. The zloty was gaining during the first part of the week on positive data from the euro zone. The EURPLN a few times dropped below 4.06, temporarily reaching even 4.05. Next days brought poor data from the US, which triggered higher risk aversion and negative pressure on the zloty. At the end of the week the zloty broke the upper band of horizontal trend at 4.08 and reached 4.11.
- We expect that this week the zloty will be under the selling pressure connected with uncertain results of European banks' stress-tests. The resistance level is at 4.11-4.12 (that has already been tested on Friday), while the area of support is at 4.05-4.06. In our opinion, in the coming week the zloty will be traded rather somewhere around the area of resistance.

Yield curve



Yields up due to higher inflation

- As we suggested last week, yields of domestic bonds increased. This was mainly due to higher than expected inflation in June and weak demand at the auction of 5Y bonds. Polish bonds auction results were surprising in relation to the fact that auctions of debt in peripheral countries of the euro zone, as well as in the Czech Republic and Hungary were successful. Yields of Polish bonds increased mainly on the short and in the middle end of the curve.
- In our opinion, this week the prevailing tendency will be rise in yields of domestic bonds. In our opinion, increases in the short end will be minor as an element of a range trading. The growth of yields at the long end of the curve will be a reaction to the expected slight increase in risk aversion in the global markets.

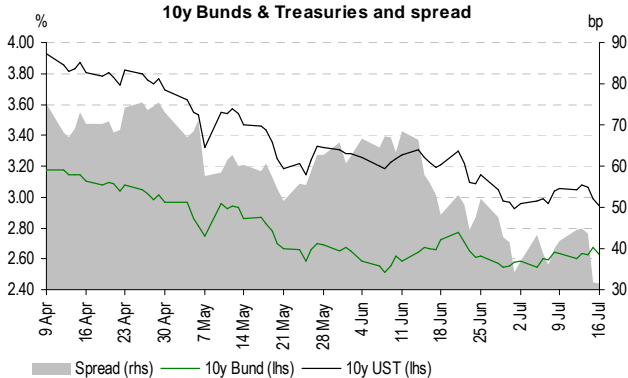
EURUSD rate



EURUSD up after weak macro data from the US

- The past week was marked with a clear increase in EURUSD. This was related to the release of quite positive macro data from the euro zone and at the same time figures from US, which were in vast majority worse than expected. Also the dovish FOMC minutes put a negative pressure on the dollar. EURUSD rate breached the first resistant level indicated by us at 1.28 and at the end of the week went up to nearly 1.30.
- This week, the US data calendar is lighter, so EURUSD will be more under impact of the euro zone figures, changes in risk appetite related to next earnings reports and expectations for results of stress-tests for European banks. Testimony of Fed's Bernanke before Congress may also be important driver for EURUSD. Resistance for EURUSD is an area of 1.32-1.33 and support is 1.26-1.27.

10y Bunds & Treasuries and spread



Strengthening of core debt markets

- As the EURUSD was not strictly reflecting changes in risk appetite last week, bonds in the core markets became took the role of sentiment indicator last week. At the end of the week 10Y yields of Treasuries and Bunds were lower than the previous week, reflecting some rise in risk aversion.
- We expect that stress-tests will be the major topic this week, which may led to declines in yields on the core debt markets. The fiscal situation in the euro zone may remain in the background. CDS rates did not record major changes in the past week. They remained stable, slightly below the levels at the end of the previous week. We expect that ahead of publication of stress-tests results, cautiousness may outweigh in the markets, which should lead to some rise in CDS rates and further drop in yields on the core debt markets.

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