Bank Zachodni WBK

Weekly economic update

6 - 12 December 2010

Stabilisation in global markets after the official decision on financial aid for Ireland was rather temporary. Market moods deteriorated already Monday afternoon, which led to sharp downward move of EURUSD to 1.30 and significant weakening of the zloty (EURPLN above 4.10). However, Tuesday brought some improvement in sentiment amid positive macroeconomic indicators published globally (though some of them disappointed during the week, e.g. the US non-farm payrolls). The additional supportive factor for the Polish currency and domestic assets was high GDP growth rate in 3Q (4.2%YoY) and strong PMI reading for November (55.9, the third highest in the history). Similarly as data from abroad, Polish statistics were not entirely positive – fixed investments rose in 3Q10, but only moderately and below expectations.

This week there are no important events scheduled in Poland, so the local financial market will be almost exclusively influenced by global factors. As the number of key data releases abroad will be limited, the focus will be again on the debt crisis in Europe. From this point of view, important events for the markets will be meetings of finance ministers of the EU on Monday and of the euro zone on Tuesday. Also, presentation of details of the Ireland's budget for 2011 on Tuesday will be important. We believe that this week the EURPLN will stay within the range of 3.98-4.05, while key for the EURUSD rate is the support zone 2.98-3.00. Hard to predict fate of the Irish budget may temporarily trigger an increased volatility in the markets. On the domestic debt market, short end of the curve should remain stable, while the rest of the curve would remain under the influence of situation abroad, and also a profit-taking may appear after the strengthening in the past week.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (6 December)					
10:30	EZ	Sentix sentiment index	Dec	pts		-	14.0
		TUESDAY (7 December)					
12:00	DE	Industrial orders	Oct	%MoM	1.8	-	-4.0
		WEDNESDAY (8 December)					
11:00	**PL**	**Auction of bonds WZ0121 and IZ0823**					
12:00	DE	Industrial output	Oct	%MoM	0.9	-	-0.8
		THURSDAY (9 December)					
	CN	Trade balance	Nov	$bn	21.0	-	27.2
14:30	US	Initial jobless claims	week	k	428	-	436
14:30	US	Wholesale inventories	Nov	%MoM	0.8	-	1.5
		FRIDAY (10 December)					
14:30	US	Import prices	Nov	%MoM	0.8	-	0.9
14:30	US	Trade balance	Oct	$bn	-43.3	-	-44.0
15:55	US	Flash Michigan	Dec	pts	70.0	-	71.6

Source: BZ WBK, Reuters, Dow Jones

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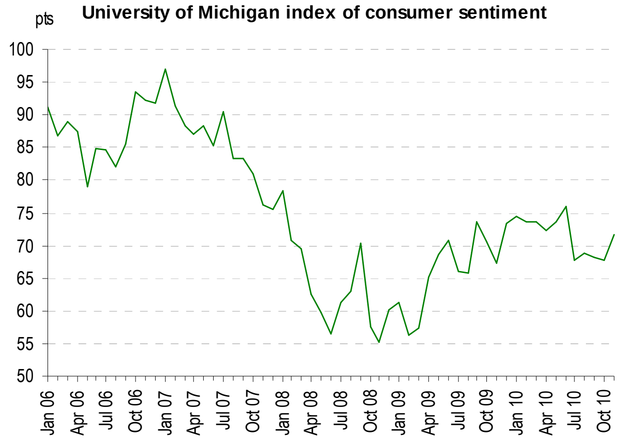
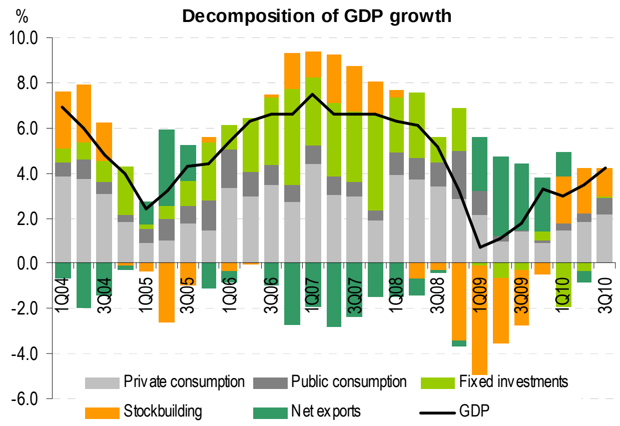
What's hot this week – Fed data releases, focus on sovereign debt crisis

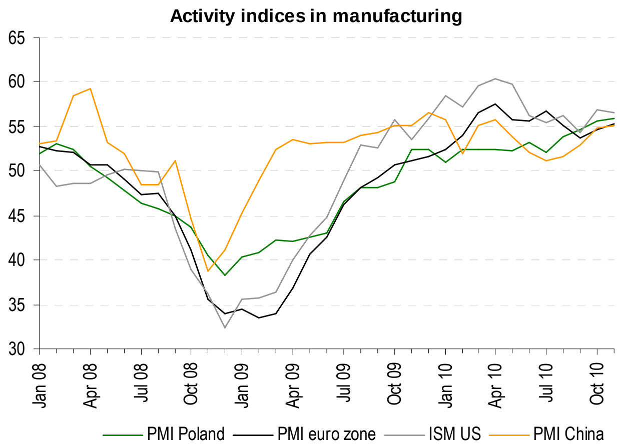


- This week the calendar of publication is rather light and US consumer confidence will be the most important figure. With limited data releases, concerns about eurozone debt levels look set to continue to dominate headlines. with markets watching closely any comments from meetings of finance minister of EU (Monday) and euro zone (Tuesday). Ireland's much awaited Budget for 2011 will be unveiled on Tuesday and is likely to receive plenty of international attention. The exact details in terms of the taxation measures and spending cuts that lie ahead for next year in Ireland will be presented and parliamentary discussion and decisions may be important factor for global sentiment, especially given uncertain political situation in Ireland.
- Domestically, there are no data publications and only comments by central bankers and government's officials may have some market impact.

Economy last week – Positive macro data locally and abroad



- GDP growth in Poland in the third quarter was higher than most of forecasts, and amounted to 4.2%YoY, versus 3.5% in Q2. This was largely due to acceleration of private consumption growth to 3.5%YoY from 3.0%YoY. Investment growth rate was above zero, but only slightly (0.4%YoY), and was smaller than we predicted (ca. 6%).
- Looking at national account from the supply side, Value added growth in industry has slowed down (to 10.2% from 11.4%), while acceleration took place in the construction sector (to 6.1% from 3.8%) and market services (to 2.0% from 0.8%).
- We forecast that real GDP growth rate will remain at a similar pace in the last three months of this year, which would bring GDP growth in the year as a whole to ca. 3.8%. Next year we expect a slight acceleration with stronger role of domestic demand.



- PMI index in Polish manufacturing sector rose in November to 55.9, in line with our forecast and above market consensus, confirming that industrial output growth in that month was high. Pressure on expanding firms' production capacity, resulting from high inflow of new orders, is supporting expectations of investment rebound in the private sector in the coming quarters. Inflation of production costs and output prices remained above average, however it was lower than in October.
- The Ministry of Finance predicts that the CPI inflation stabilized in November at 2.8%YoY (our forecast is 2.9%YoY) amid price increase of 0.2%MoM. Ministry estimates that monthly rise in prices of food and soft drinks was 0.4% (our forecast 0.7%MoM), alcoholic beverages and tobacco prices rose 0.5%MoM (our forecast 0.1 %) and prices of other categories rose on average by 0.2%.

Quote of the week – Zloty doomed to appreciation

Marek Belka, NBP governor, Reuters, 2 Dec

In the long-term, as I earlier said, the zloty is doomed to appreciation.

Jacek Rostowski, finance minister, Reuters, 2 Dec

Currently we do not have any target for the zloty exchange rate, we have fully floating exchange rate. Currently there is no need to intervene. If there are serious turbulences, the NBP will be able to intervene.

Elżbieta Chojna-Duch, MPC member, Reuters, 1 Dec

The zloty is now undervalued and will surely return to below 4.0 per euro.

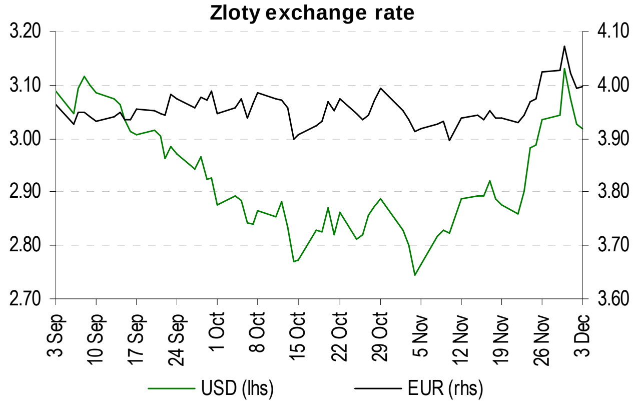
Anna Zielińska Głębocka, MPC member, Reuters, 30 Nov

The Council should consider a swift hike in interest rates, in December or in Q1 2011. One should also take into account situation in the FX market – such a decision could help to stabilise the situation.

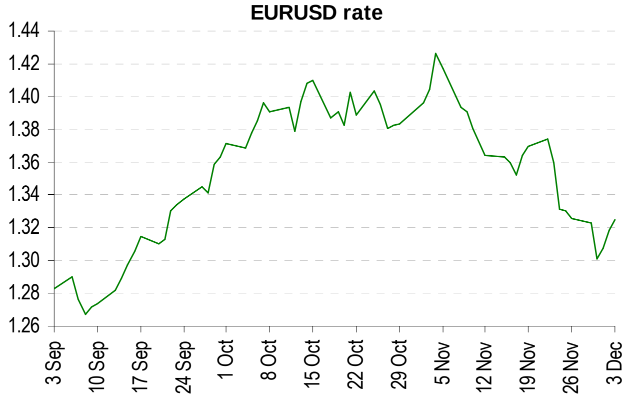
Numerous comments from central bankers and government's officials referring to the exchange rate indicate that in case of rapid changes of the zloty exchange rate in isolation to fundamentals (especially when the market is shallow), the central bank and the government may send signals to the market that the current market exchange rate departures from equilibrium and this may be primarily verbal interventions. Actual interventions in the markets are also not excluded – with approval of the FinMin, reiterated last week. Volatility of the zloty may lead to volatility in opinions of MPC members on timing of first interest rate hikes. Until recently the risk of excessive zloty appreciation was an argument against swift rate hikes while now (when the zloty rapidly weakened) comments from Anna Zielińska-Głębocka suggest a hike would be helpful.

Market monitor

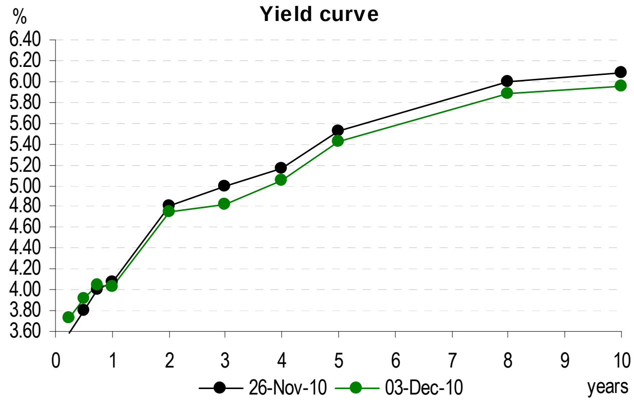
Zloty exchange rate



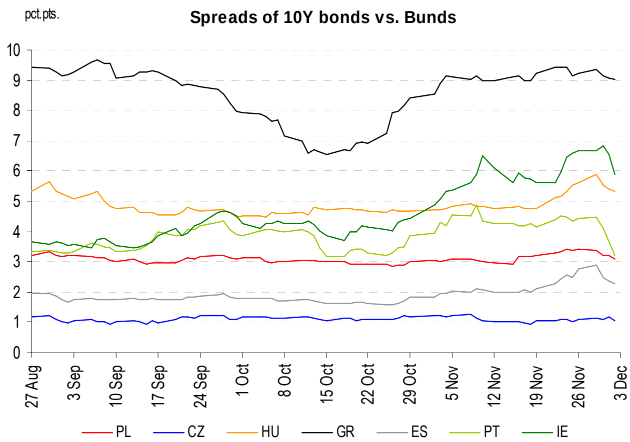
EURUSD rate



Yield curve



Spreads of 10Y bonds vs. Bunds



High volatility due to foreign factors

- Since the beginning of the week the zloty was under negative pressure due to persisting worries over situation on the European debt market. Revealing the details and conditions on Irish financial aid did not calm investors, that pointed Portugal and Spain as next countries that would need external help. The EURPLN quickly broke 4.05 and soon approached 4.11. Verbal interventions of Polish government representatives. MPC members and ongoing improvement of market sentiment pushed the EURPLN just below 4.0 at the end of the week. The USDPLN after surge to 3.11 declined due to rising EURUSD and stronger zloty and ended the week at ca. 3.01. We expect that the EURPLN will remain in the range of 3.98-4.05, while in case of USDPLN the support area at 2.98-3.0 is vital. Unpredictable result of Tuesday's voting on the budget in Ireland may temporarily increase volatility.
- Uncertainty prevailing on the European debt market in the first days of the past week dragged the EURUSD further down, temporarily below 1.30. Later in the week, as information that the ECB is active on the debt market, euro started to recover. High volatility occurred on Thursday. After disclosure of the communiqué the US dollar sharply appreciated, because the bank did not announce the scale of direct intervention in the European debt market. However, Trichet's confirmation that the ECB started buying Irish and Portuguese bonds aggressively. Additionally, he stressed that no limits had ever been put on that program. That all together pushed the EURUSD up and euro pared looses. This week we expect the continuation of the upward trend, though the voting in Ireland is a vital risk factor for that scenario.

Middle and long end of the curve in the spotlight

- Just as we expected, in the first part of the week the yields of Polish bonds, particularly those middle- and long-term ones, were under the influence of swings of global market mood. Official announcement of details on Irish financial aid did not calm the situation and triggered further sell-out of bonds. After publication of higher than expected Polish GDP growth some recovery occurred. Yields in the middle and on the long end of the curve declined, fuelled additionally by gradual improvement on the global market. Short end was pretty stable and we do expect this to change this week. Remaining part of the yield curve may still be under influence of foreign factors, also some profit taking may take place.
- On the core debt markets yields declined in the first part of the week, as the prevailing risk aversion dominated the worries over financial condition in Germany due to possible next bailouts. Later in the week demand for riskier assets played the main role, though after publication of weak US labour data dragged yields down.
- During the first days of the past week yields of bonds of peripheral euro zone countries continued to rise. Sunday's announcement of details on agreement with Ireland did not calm the market. Later in the week the sentiment connected with situation on the European debt market slightly improved, as rumours emerged that the ECB was buying Portuguese and Irish bonds. Jean-Claude Trichet confirmed that information on the conference after ECB meeting. He added, that there are no that no limits put on funds that may be allotted for purchases. The speech of ECB governor clearly supported prices of peripheral bonds (mainly Portuguese ones), as well as the single currency.

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