

Tri-weekly economic update

27 December 2010 – 16 January 2011

Last week passed in the holiday mood amid reduced investors' activity and limited volatility. Moods in the global markets were influenced by both negative and positive factors. Among the former was again a rise in tensions on the Korean Peninsula and bad news from the rating agencies. China's declaration on readiness to help the euro area provided some relief for markets, while the zloty was additionally supported by rumours that state-owned BGK bank was selling foreign currencies on the market. MPC meeting and retail sales data had no impact on the Polish market. The tone of the MPC statement has changed to slightly more hawkish, but not enough to expect the first rate hike already at the meeting on 18-19 January, when there will be no complete data set for December. In February, there will be no decisive meeting, so in our opinion the first rate hike of 25 bp will take place in March, when the Council will already have information about the scale of price hikes at the start of the new year and will have a new projection of the NBP for inflation and GDP.

In the coming weeks, market liquidity will be reduced and in such circumstances any surprises for the market (for example, data significantly different than forecasts) may be a source of increased volatility.

We wish a Merry Christmas and a Happy New Year to all our readers!

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
TUESDAY (28 December)							
15:00	US	S&P/Case-Shiller home price index	Oct	%MoM	-0.5	-	-0.7
16:00	US	Consumer confidence index	Dec	pts	56.1	-	54.1
THURSDAY (30 December)							
3:30	CN	PMI – manufacturing	Dec	pts	-	-	55.3
14:30	US	Initial jobless claims	week	k	-	-	420
16:00	US	Pending home sales	Nov	%MoM	2.7	-	10.4
MONDAY (3 January)							
9:00	PL	PMI - manufacturing	Dec	pts	-	56.1	55.9
9:58	EZ	PMI – manufacturing	Dec	pts	-	-	55.3
16:00	US	ISM – manufacturing	Dec	pts	56.9	-	56.6
FRIDAY (7 January)							
14:30	US	Non-farm payrolls	Dec	k	128	-	39
14:30	US	Unemployment rate	Dec	%	9.8	-	9.8
TUESDAY (11 January)							
4:00	CN	Industrial output	Dec	%YoY	-	-	-
4:00	CN	CPI	Dec	%YoY	-	-	-
6:00	CN	Trade balance	Dec	\$bn	-	-	-
THURSDAY (13 January)							
14:00	PL	CPI	Dec	%YoY	-	3.2	2.7
14:30	US	Trade balance	Nov	\$bn	-	-	-38.71
FRIDAY (14 January)							
14:30	US	Core CPI	Dec	%MoM	-	-	0.1
14:30	US	Retail sales excluding autos	Dec	%MoM	-	-	1.2
14:30	US	Capacity utilization rate	Dec	%	-	-	75.2
15:15	US	Industrial output	Dec	%MoM	-	-	0.4

Source: BZ WBK, Parkiet, Reuters

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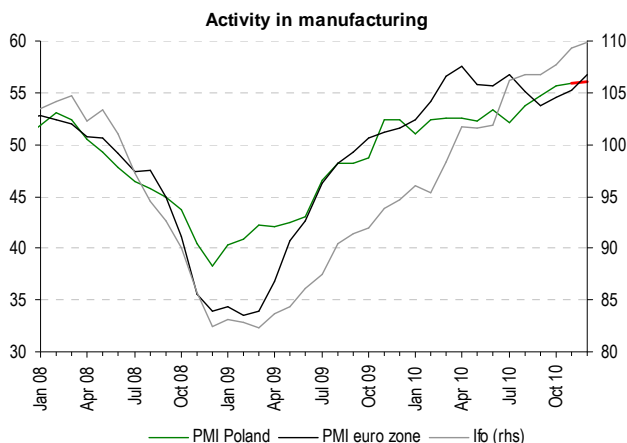
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What's hot the next weeks – Activity indicators and CPI



- In the period just after Christmas and just after the New Year the market liquidity will be reduced, as usually. In such circumstances, the news potentially surprising for the market (eg. data releases far from forecasts) may be sources of increased volatility. Global investors will be especially sensitive to debt problems in euro zone, prospect of monetary policy tightening in China (inflation data) and strength of global economic recovery (activity indices in the euro zone, US, and China, US jobs report).
- On the domestic market, the focus will be on PMI and FinMin's inflation forecast, and later on CPI inflation data. We predict further increase in PMI (following further improvement in Germany), yet not as strong as in November. Inflation is predicted to grow above 3%, under influence of solid rise in fuel prices; core inflation should go up as well.

Economy last week – Interest rates unchanged, retail sales slightly disappointing

Selected fragments from the December MPC statement (marked significant changes versus the November statement)

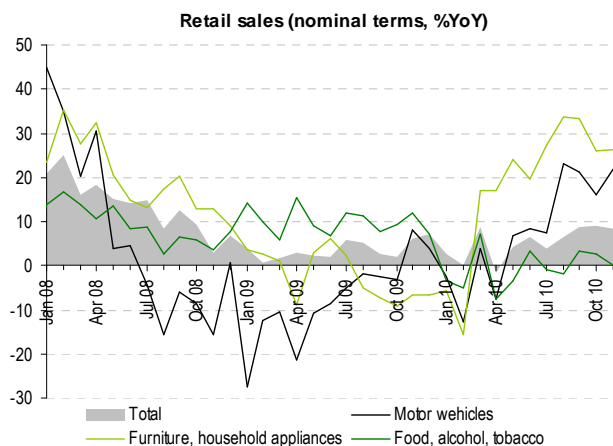
The moderate recovery in the world economy is continuing. (...) Data from the United States and the euro area point to stabilizing growth in economic activity. Favourable economic situation has continued in Germany where GDP growth is to a growing extent supported by strengthening domestic demand. Yet, economic growth in the majority of developed countries is still being curbed by high unemployment and ongoing adjustments in the balance sheets of households, enterprises and financial institutions.

Following the previously observed depreciation connected with intensification of fiscal problems in some euro area countries and the ensuing uncertainty in the financial markets, the zloty exchange rate has stabilized in the recent period. At the same time, global markets have seen a rise in the prices of crude oil and other commodities.

In the Council's assessment, the still limited inflationary and wage pressure in the Polish economy and the persistent risk of increased capital inflows to the emerging economies, including to Poland, amidst the extended period of expansionary monetary policy of major central banks, combined with the risk of weakening of global economic growth, uncertainty about the scale of acceleration of GDP growth in Poland and the global economic recovery justify keeping the NBP interest rates unchanged.

At the same time, the Council will analyse the signs of a possible rise in inflationary pressure.

- The MPC kept interest rates on hold in December. This means that NBP interest rates remained unchanged all year long, at the record low level, to which they were trimmed in H1 2009 in reaction to outbreak of global crisis.
- There was some change in the tone of the MPC statement towards more hawkish one (first of all, the Council deleted sentence saying that argument against rate hike is possible inflow of portfolio capital amid loose monetary policy abroad), but it is hard to say whether a hike could take place as soon as in January. The MPC will not have entire set of data for December at that point, and it may want to wait for January's data (to see a scale of price hikes at the start of the year).
- As there is no decisive meeting in February, it is likely that the MPC will wait with the first 25bp hike until March when the new NBP projections will be revealed.



- The retail sales growth in November proved to be weaker than expected (deceleration to 8.3%YoY while market consensus pointed to stabilisation of growth at October's level of 9.0%YoY and we forecasted a slight acceleration to 9.2%YoY), but still it was a pretty good result, confirming that consumers are doing well.
- Deceleration in growth of overall retail sales was mainly due to weaker results in two categories, in which there has been clear rise in prices recently: food and fuels. Sales growth in other categories remains high, confirming that consumption demand is still in good shape.
- In our view, situation in the labour market will be supporting further acceleration of private consumption. Seasonal unemployment rise this year is weaker than a year ago and further rise in employment and wages is improving households' incomes.

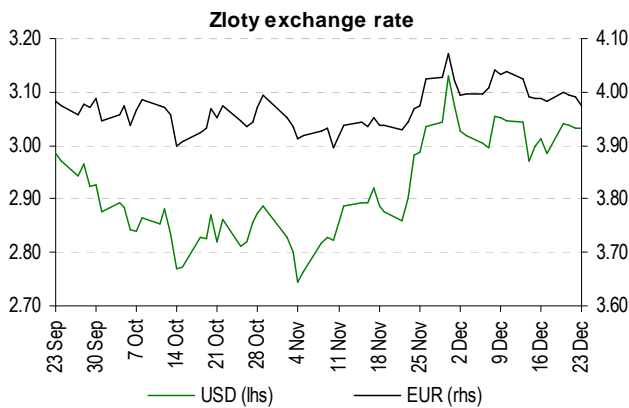
Quote of the week – Balance of risks tilted towards rate hikes

Marek Belka, NBP governor, Reuters, 22 Dec

Undoubtedly, the last weeks were marked by extremely severe turbulences in the European financial markets, as a result of which the assessment of risk of investing in our region has increased. Taking into account that the nearest months may see another round of such turbulences, omitting this factor is justified. This slightly changes the balance of risk for inflation target, in favour of interest rate hike, in favour of starting a monetary tightening cycle.

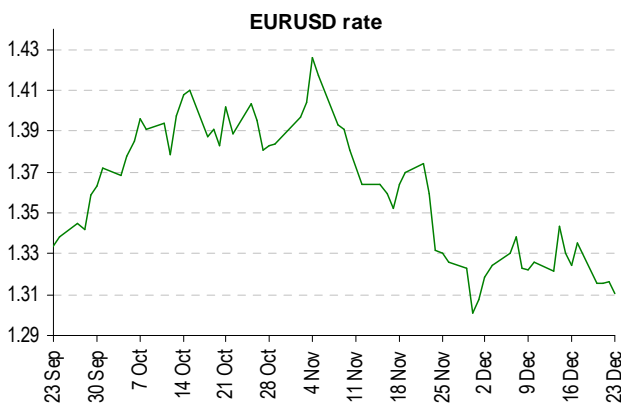
At the press conference after the MPC meeting, the main topic of discussion was the situation on the currency market. This was due probably to the fact that the MPC's statement this time has omitted the sentence about "persistent risk of increased capital inflows to the emerging economies, including to Poland, amidst the extended period of expansionary monetary policy of major central banks". The Council wrote in the statement that the zloty has stabilised recently. President Marek Belka acknowledged that these changes in the statement confirm that "the balance of risks has changed in favour of rate hikes". On the other hand, he reiterated his view that "the zloty has a significant potential for appreciation".

Market monitor

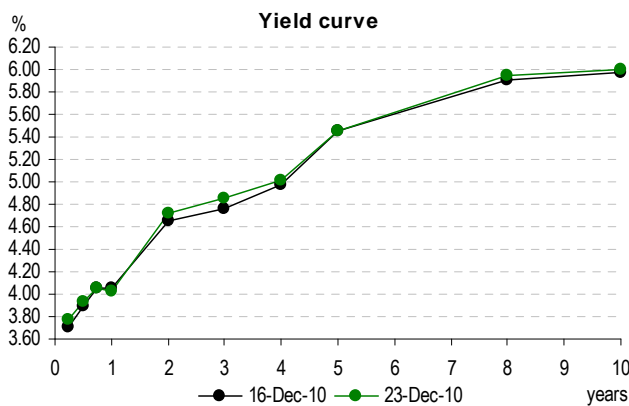


Horizontal trend, though pretty volatile

During the last week before Christmas the horizontal trend in the range of 3.97-4.01 persisted on the EURPLN market, though the border values were seen only temporarily. The higher risk aversion due to military exercises on the Korean Peninsula and negative information from rating agencies. On the other hand, market sentiment was supported by declaration of China on readiness to help European countries in their attempts to solve the debt problems. Additionally, rumors that the state-owned BGK banks was selling the euro on the market supported the zloty. We expect that in the coming weeks the range of changes in EURPLN will be even more limited as the triangle formation emerges from the charts. From the top it is bordered by line of downward trend lasting since May and by level of ca. 3.97 from the bottom. The direction will be determined by the character of the impulse that will pull the exchange rate out of the described formation.



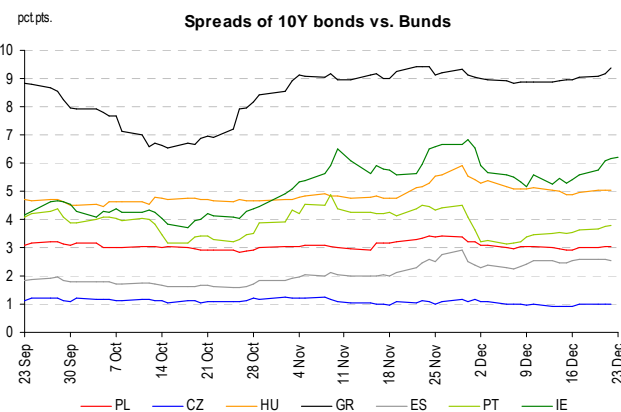
EURUSD remained in the horizontal trend ranging 1.308-1.318 during the past few days. Interestingly, there was a similar scenario of a few sessions as during the European trading hours the euro was depreciating and overnight it was recovering. We expect that there is not much room for a rise in EURUSD, as there is continued flow of negative news regarding the euro zone. The coming days may bring stabilization around present level, though there is pretty high possibility of further drop to 1.30 that is the closest support level. It seems that only after rebounding from crucial level the single currency may gain fuel for visible appreciation.



Domestic debt market in holiday mood

Domestic yield curve was stable for the better part of the previous week amid low activity of investors and low turnover in the market. The market ignored all macro figures, but on the day following the MPC meeting yields clearly rose at the short end of the curve. We predict that torpor in the market will last until the end of the year. First weeks of the new year may bring increased volatility, as this is a period of changes in portfolios of investors. Information about acceleration in domestic CPI inflation in December will act towards rise in yields at the short end of the curve.

At the core debt markets yields of 10-year Bunds started the week below Friday's close levels, and decreased slightly in the coming days. Despite changes in investors' sentiment, scale of movements was clearly limited. In the case of Treasuries, a fall in yields was also recorded at the start of the week, and it was followed by upward move.



On the bond markets in the euro area peripheral countries, spreads versus 10-year Bunds have clearly increased. This was a result of news from rating agencies. Initially, Moody's announced that it may trim the rating of Portugal, and a few days later Fitch said that the rating of Greece may be reduced below investment level. The review of fiscal situation in Greece will be concluded in the first days of January. Rating agencies also made decision regarding countries in CEE region. Namely, the Fitch Ratings downgraded Hungary.

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