Bank Zachodni WBK

Weekly economic update

24 - 30 January 2011

Last week saw volatile moods in the global markets. In Asia risk aversion was prevailing amid growing fear of aggressive monetary tightening in China (following the surprising acceleration in growth of Chinese economic growth in Q4). In turn, European and US equity markets, before a moderate correction towards the end of the week, reached new highs in the current bull market amid strong decent macro figures, strong earnings reports and waning concerns about the European debt problems. With significant rise in EURUSD, the zloty slightly gained to the euro and more clearly to the dollar. The domestic yield curve did not change much, as the MPC decision to deliver the first rate hikes was widely expected by market participants while not that hawkish statement of the Council was offset by clearly hawkish domestic data. Strong growth in industrial and construction output in December gives a positive impression regarding condition of the domestic economy in late 2010 and suggests that anticipated recovery in investments may have started materializing. If such tendencies will be sustained, this induce the MPC to swiftly deliver next interest rate hike. Still, it seems that the next data on inflation and labour market will be key for the Council.

This week the most important local event will be tentative GDP data for 2010. Retail sales and unemployment figures due for release at the same time as GDP numbers are likely to be ignored by the market. Abroad the key focus of attention will be the FOMC meeting, but markets will also closely watch next macro figures from the euro zone and the US as well as earnings reports.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (24 January)					
9:28	DE	Flash PMI – manufacturing	Jan	pts	60.8	-	60.7
9:58	EZ	Flash PMI – manufacturing	Jan	pts	57.0	-	57.1
9:58	EZ	Flash PMI – services	Jan	pts	54.2	-	54.2
11:00	EZ	Industrial orders	Nov	%YoY	16.7	-	14.8
		TUESDAY (25 January)					
8:00	DE	GfK index	Feb	pts	5.4	-	5.4
15:00	US	S&P/Case-Shiller home price index	Nov	%MoM	-0.4	-	-1.3
16:00	US	Consumer confidence	Jan	pts	54.5	-	52.5
		WEDNESDAY (26 January)					
16:00	US	New home sales	Dec	k	300	-	290
20:15	US	FED decision		%	0-0.25	-	0-0.25
		THURSDAY (27 January)					
14:30	US	Flash durable goods orders	Dec	%MoM	0.9	-	-0.3
14:30	US	Initial jobless claims	week	k	409	-	404
16:00	US	Pending home sales	Dec	%MoM	1.5	-	3.5
		FRIDAY (28 January)					
10:00	**PL**	**GDP**	**2010**	**%**	**3.7**	**3.7**	**1.7**
10:00	**PL**	**Individual consumption**	**2010**	**%**	**3.2**	**3.0**	**2.1**
10:00	**PL**	**Fixed investments**	**2010**	**%**	**-1.2**	**-1.0**	**-1.1**
10:00	**PL**	**Retail sales**	**Dec**	**%YoY**	**9.7**	**9.0**	**8.3**
10:00	**PL**	**Unemployment rate**	**Dec**	**%**	**12.0**	**12.0**	**11.7**
10:00	EZ	Money supply	Dec	%YoY	2.0	-	1.9
14:30	US	Advance GDP	Q4	%QoQ	3.5	-	2.6
14:30	US	Core PCE	Q4	%QoQ	0.5	-	0.5
15:55	US	Final Michigan index	Jan	pts	75.4	-	74.5

Source: BZ WBK, Reuters, Parkiet

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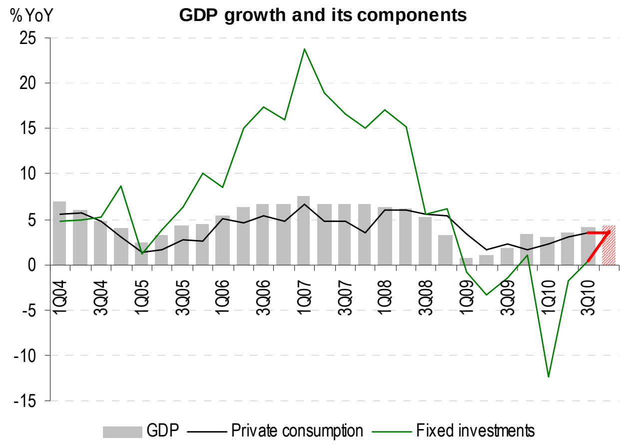
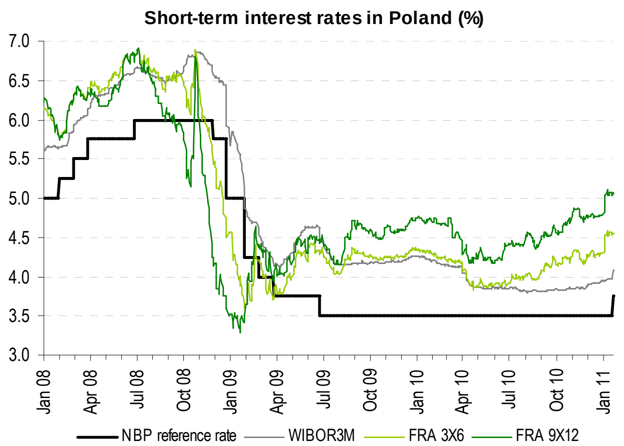
What's hot this week – Local and foreign data, FOMC meeting and earnings reports

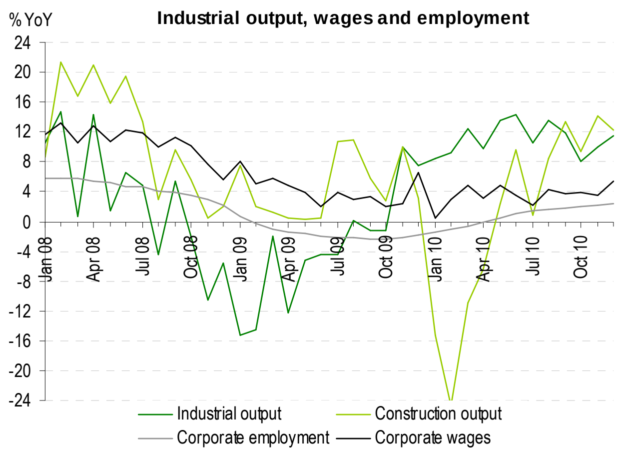


- We forecast that GDP growth in 2010 as a whole was 3.7% with growth in Q4 alone at 4.2%YoY. Our forecasts for individual consumption and fixed investments for the whole year are base on assumption that in Q4 there was growth of correspondingly 3.5%YoY (the same as in Q3) and 3.6%YoY (after rise of a mere 0.4% in Q3).
- Initially, our forecast for fixed investment growth in Q4 was 6%, but under impact of bad weather in December we revised it down. However, robust construction output for December suggest the weather factor was not as strong as we feared and fixed investment may be closer to our earlier forecast. At the same time we see downward risk to net export due to wider than expected trade gap in November.
- As to events abroad, the key focus of attention this week will be FOMC meeting, but markets will also closely watch macro figures in major economies and earnings reports.

Economy last week – Hawkish data and start of interest rate hikes' cycle



- The Polish MPC hiked interest rates by 25bps, the reference rate to 3.75%. As the upward trend of inflation is expected to be continued and general situation of the domestic economy will give room for further monetary policy tightening, next interest rates should be expected. The question is only when and by how much? The post-meeting statement gave no clear clues to answer this questions.
- All in all, we do not change our view that interest rates will go up by a total of 100 bp in the entire 2011, in four steps by 25 bp. The next move is likely to be in the second quarter, although if we will see next as hawkish data from the domestic economy as released in the past week (please see below), then we may see the next hike as soon as at the next meeting in March. Taking into account current WIBOR and FRA rates, the market is pricing in more aggressive tightening (at least next 100bps).



- Annual growth in industrial output accelerated to 11.5% in December from 10.0% in November, with manufacturing output up by 14.3% (one of the best results in 2010). Construction output growth slightly decelerated to 12.3% from 14.2%, but given bas weather conditions in December this was a very decent outcome.
- Labour market data for December proved clearly better than expected, indicating acceleration in annual growth of employment to 2.4% from 2.2% (with nearly no change on a monthly basis, which is extraordinarily strong result for that period of the year) and in average wage growth to 5.4% from 3.6% (bonuses in mining could play a role).
- Annual PPI inflation rose to 6.1% from 4.7% in November, mainly due to surge in commodities prices. This may translate into consumer prices with a lag. CPI less food and energy rose to 1.6% from 1.2%.

Quote of the week – Rate hike was not a one-off adjustment

Marek Belka, NBP governor, MPC press conference, 19 Jan

Some actions indicating the MPC see rising inflationary pressure was taken in the near past – let me remind you hike in reserve requirement ratio. Today's move is not the first one, but the next move in this direction.

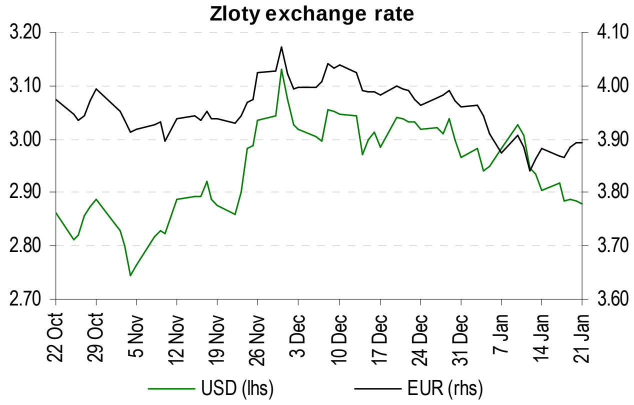
We see the [inflationary] pressure is mounting, we will observe the situation in Poland in real economy, the credit performance as well as European issues and will take actions, if necessary. I would not interpret today's decision as a one-off adjustment.

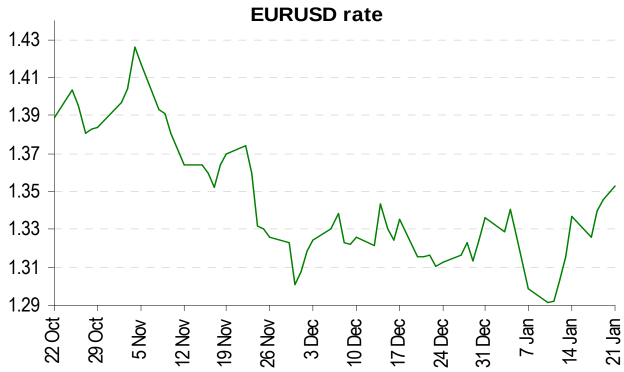
Monetary policy does not have impact on this [exogenous factors], but one cannot ignore that heightened inflation expectations are cementing.

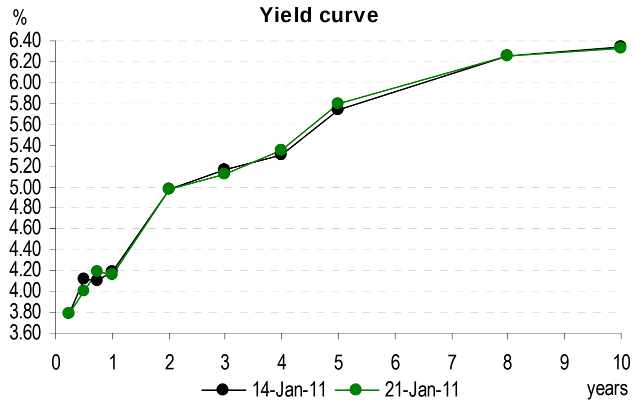
I should reiterate what I said earlier that the exchange rate is not a goal for NBP monetary policy and we do not have either a target rate or a target band. (…) The zloty has appreciation potential and if it translates into actual changes [of the zloty], it will have impact on MPC actions.

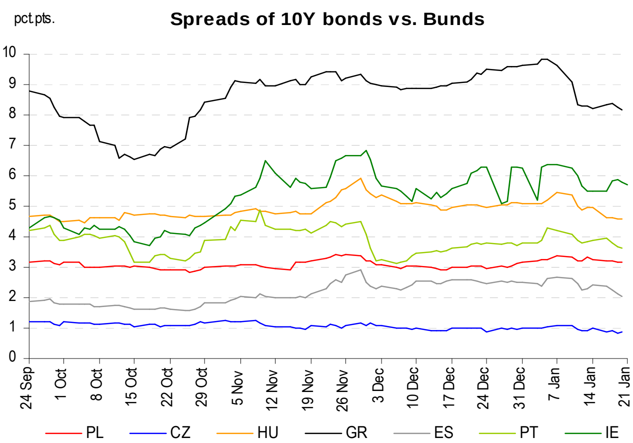
During the press conference after MPC meeting, NBP governor Marek Belka expressed some important views. Firstly, he said that the hike was not the first step towards tightening monetary policy, as earlier there was a rise in reserve requirements, "downplayed" by the market. Secondly, he added that the rate hike in January should not be interpreted as a one-off step. This means it is just the beginning of a cycle, which will run accordingly to the tone of next macro data, indicating strength of inflationary pressures. MPC's Andrzej Kaźmierczak stated that the risk of an excessive rise in wage pressure may pose a risk to inflation. In turn, Jan Winiecki emphasised the increase in commodity prices. Referring to the zloty, NBP governor said that the Council has no target rate and the repeated is view the zloty has the potential to appreciate.

Market monitor









Zloty depreciation after interest rate hike

▪ Until the MPC decision the EURPLN was pretty stable in the range of 3.85-3.88 while the USDPLN started to decline even before Wednesday's meeting of the Council as the upward trend of the EURUSD accelerated. After the announcement of interest rate hike by 25bps the EURPLN dropped from 3.885 to 3.855 and USDPLN from 2.885 to 2.845. After publication of the post-meeting statement, interpreted by the market as not that hawkish, the upward trend of the EURPLN was initiated. The zloty gained versus the dollar as the EURUSD continued the upward trend. The EURPLN reached the resistance area of 3.9168-3.922. We expect that this week the EURPLN will remain in the range of ca. 3.84-3.92. There is a possibility of another attempt to break the resistance area at the beginning of the week.

▪ In the first days of the past week the EURUSD continued the downward trend started on Friday the previous week. However, contrary to our view in the following days euro appreciated as concerns over the euro zone peripheral countries abated. Some hopes emerged that the EU leaders will finally find a way to solve the European debt problems. Additional support for the single currency was provided by better than expected data on ZEW and Ifo indexes. At the beginning of this week the EURUSD may approach next resistance area at just below 1.36. Further changes will depend on swings of market sentiment, which may be determined by statement after FOMC meeting and fresh macro data. In case of breaking 1.36, next resistance for EURUSD is close to 1.37. The support level is at 1.34.

Stable domestic yield curve

▪ On the domestic fixed income market the yields did not change much. A great deal of confusion in the local debt market was caused by the publication of "dovish" interview with Marek Belka in *Super Ekspress* daily. Only with some delay, there appeared information that the interview was carried out on 28 December, before on 4th January Marek Belka made more hawkish comments. Yields declined slightly in reaction to that information. The MPC decision was in line with market expectations and did not have any impact on the bond market. Later on yields declined due to relatively dovish MPC statement, but after hawkish macro data released later in the week the FRA and IRS rates rose. The publication of the GDP data for 2010 (in particular ass regards fixed investments growth) scheduled for Friday will be key factor for the domestic fixed income market this week. In case of visible rebound in investment, yields on the short end may increase, as lack of improvement in that sector of economy could be an argument for some MPC members against prompt interest rate hikes.

▪ On the core debt markets yields increased due to lower risk aversion and abating worries over peripheral euro zone countries.

▪ Spreads over 10Y Bunds declined over the week, dragged down still by good results of bonds auctions conducted in the past week and by hopes that EU leaders will find a solution to European debt problems. Also comments made among others by German Chancellor that there would be done everything which is needed to stabilize the euro zone supported the European debt market.

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