Bank Zachodni WBK

Weekly economic update

7 - 13 February 2011

Global markets last week were under impact of both positive factors (strong macro figures from major economies and positive earnings reports from the US and Asia) and negative elements (escalating protests in the Middle East). A crucial factor for EURUSD was also the ECB meeting. Softer tone of its post-meeting statement on Thursday, cooling expectations for rate hikes in the euro zone, led to correction of EURUSD rise seen earlier in the week. Geopolitical tensions translated into clear rise in commodities prices (and strengthening of fears about inflationary consequences of this trend), but good news from major economies increased risk appetite. This was reflected in upward move of major stock indices (new highs during the current bull market in the US) and appreciation of emerging markets currencies, including the zloty. Currencies in the region were positively affected by quite hawkish signal from the Czech central bank – vote result 4 to 3 in favour of leaving rates on hold, which means that there were two more advocates of monetary tightening as compared to the previous meeting. New comment from Polish central bankers confirmed earlier impression that the MPC is not in hurry to deliver the next interest rate hike (we will expect the next move by 25bps in Q2). No change in wording from the Council was supportive to observed stabilisation of the short end of the Polish yields curve. Meanwhile, the long end of the curve clearly gained thanks to higher risk appetite, information that longer dated bonds will not be offered in February and the FinMin suggestion that it will be active in IRS market (on the receiver side expecting lower rates at the long end). As a result, both the bond curve and the IRS curve clearly flattened. In the debt markets of the euro zone periphery there was continuation of clear drop in spread to Bunds and CDS rates amid hopes of an effective resolution of the European debt problems. Downgrade of Ireland's rating by the S&P has not interrupted this trend.

This week we expect the zloty to weaken, but we forecast that C/A gap in December was narrower than the market expects, which will be supportive for the domestic currency at the end of the week. However, the Polish market this week will be driven mainly by events abroad.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (7 February)					
10:30	EZ	Sentix index	Feb	pts	14.1	-	10.6
11:00	**PL**	**Tender of 51-week T-bills worth PLN0.6-1.1bn**					
12:00	DE	Industrial orders	Dec	%MoM	-1.5	-	5.2
		TUESDAY (8 February)					
12:00	DE	Industrial output	Dec	%MoM	0.3	-	-0.7
		WEDNESDAY (9 February)					
11:00	**PL**	**Auction of OK0113 bonds worth PLN2.5-5.5bn**					
16:00	US	Public speech of Fed's governor					
		THURSDAY (10 February)					
3:00	CN	Trade balance	Jan	$bn	10.2	-	13.1
14:30	US	Initial jobless claims	week	k	411	-	415
16:00	US	Wholesale inventories	Dec	%MoM	0.7	-	-0.2
		FRIDAY (11 January)					
14:00	**PL**	**Current account**	**Dec**	**€m**	**-1568**	**-1264**	**-2286**
14:00	**PL**	**Exports**	**Dec**	**€m**	**9777**	**9769**	**10866**
14:00	**PL**	**Imports**	**Dec**	**€m**	**11146**	**10834**	**12120**
14:30	US	Trade balance	Dec	$bn	-40.4	-	-38.31
15:55	US	Flash Michigan index	Feb	pts	74.6	-	74.2

Source: BZ WBK, Bloomberg, Parkiet, Reuters

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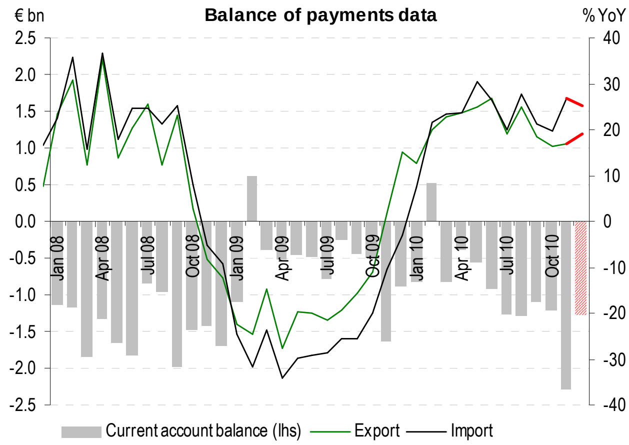
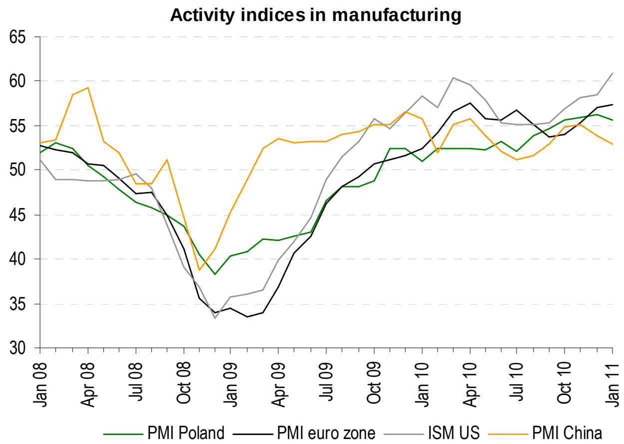
What's hot this week – Auction of 2Y bonds and balance of payments

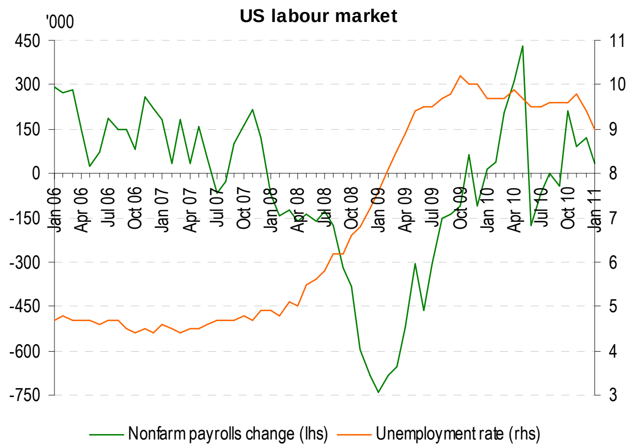


- The only domestic data release this week is the balance of payments for December. After the C/A gap in November proved much wider than expected, the fresh numbers for December may attract much attention and the zloty may be vulnerable to a possible surprise in the data.
- We forecast that December saw narrowing of the C/A gap versus November, stronger than indicated by the market consensus. Our forecast for exports is consistent with market expectations, but we predict lower imports and thus narrower trade gap. We also see clear improvement in current transfers account (which is suggested by the FinMin's data on flows between EU and Poland).
- As to events abroad, this week there are not a whole lot of events to provide direction for the markets. Focus is likely to be on Fed's Bernanke testimony before the House Budget Committee and the Michigan index for February.

Economy last week – Slight drop in Poland's PMI and strong data abroad



- Poland's PMI manufacturing dropped to 55.6 in January, falling short of our forecast and market consensus, but still this was one of five best results in the survey's history.
- Strong elements of the Poland's PMI include indicator for new orders (the highest since May 2004) and for new export orders (record high). At the same time, output index fell, negatively affecting overall PMI (and suggesting some downward risk to our forecast of industrial output in January).
- Rising production backlogs seen in PMI survey suggest that with continued strong rise in new orders enterprises may soon decided for more significant strengthening of investment activity than to date.
- There was considerable rise in inflationary pressure in manufacturing. Cost inflation rose to the highest level in history of the survey.



- Last week brought many upbeat macro data from major economies. Positive surprises included among others PMI for manufacturing and services sectors in the euro zone. Even more optimistic were activity indicators for manufacturing and services in the US. Two PMIs for China's manufacturing were mixed, but their overall interpretation was positive. All in all, activity indicators from major economies released last week strengthened expectations that the global economy is on a recovery track.
- A notable exemption in a series of very positive data from the US were the non-farm payrolls, as it showed much weaker than expected rise in the employment outside the farming sector (36k instead of expected 145k). However, there was upward revision in data for the two previous months and the unemployment rate clearly dropped to 9.0% versus expected stabilisation at 9.4%.

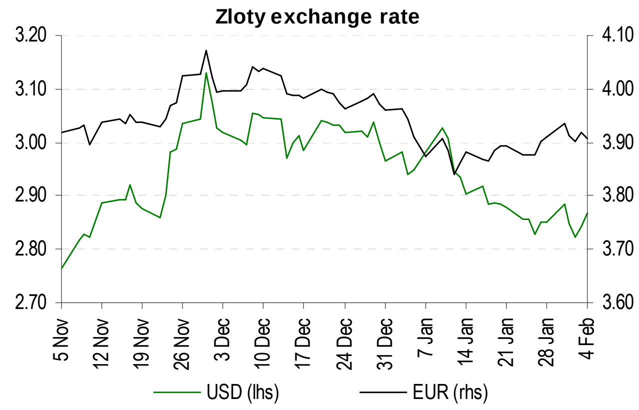
Quote of the week – Nobody knows what will be timing of rate hikes

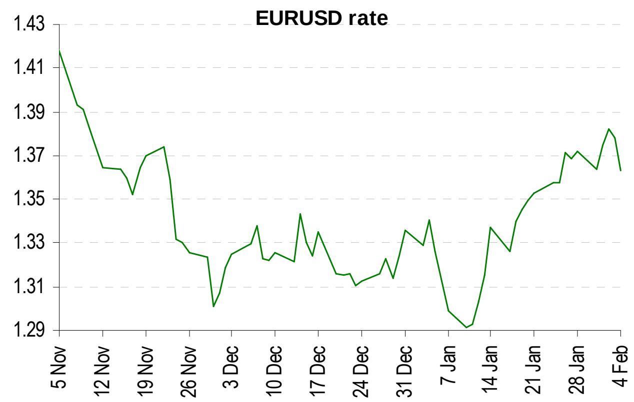
Andrzej Bratkowski, MPC member: Parkiet, 31 January

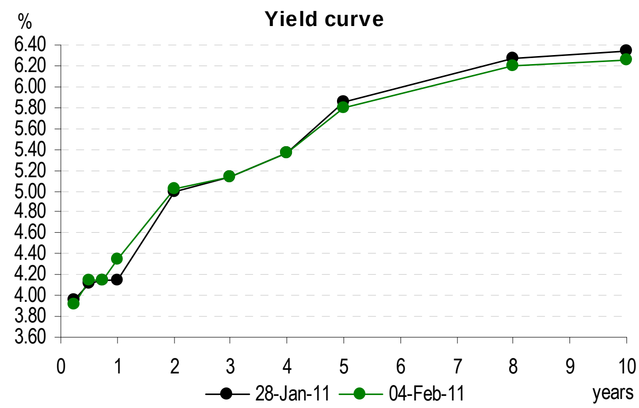
Governor said that one should not interpret the hike as a single event. Nobody talk of a series. It is obvious we are going towards hikes. However, nobody knows what will be timing of hikes and how far we will go with them. (…) I do not say that interest rate hike in March is excluded, but to make such decision we need data for January and GDP figures for Q4 2010. Besides, if EURPLN is at 3.6 in early March, I will not vote for a hike. (…) If it turns out that fixed investments are still sluggish or there is growing turmoil outside Poland, then maybe it will be worth to wait. (…) On the one hand, one cannot comfort oneself that rise in inflation may be temporary, but on the other hand one should not have a temptation that if we did not hike rates a few months ago, now we should catch up. Not always one can catch up. The effects of the catching up would appear too late.

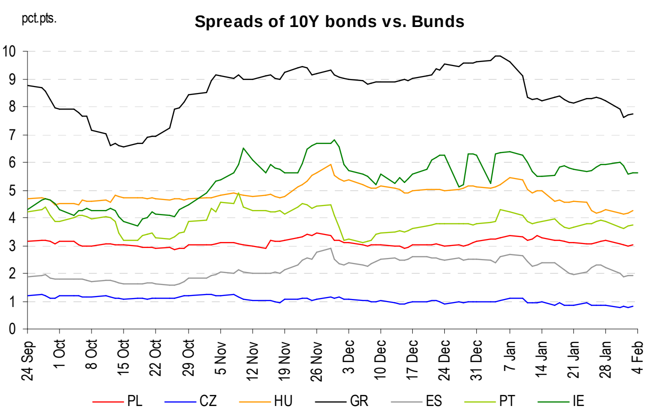
Recent comments from hawkish Andrzej Bratkowski do not differ much from how he sounded a week earlier, when he cooled expectations for next hikes, suggesting that the second step by 25bps will take place rather in Q2 than in March. Although Bratkowski does not exclude the next hike in March, he stressed it depends on the external environment of the Polish economy, the zloty performance and new data (he stressed importance of fixed investments). In our view, monthly data for January will be quite hawkish (CPI inflation 3.5%, average wage growth in firms again above 5%), but one should remember that more dovish rate-setters than Bratkowski are less prone to deliver the next rate hike soon. Dovish Andrzej Kaźmierczak said last week that the MPC should avoid nervous moves that could do more harm than good.

Market monitor









EURPLN close to support level

▪ After considerable zloty's depreciation to nearly 3.95 per euro last Friday, the beginning of the past week brought the downward correction of the EURPLN rate. The zloty also gained versus the dollar. The domestic currency was supported by higher appetite for riskier assets due to positive macro data published around the world. The drop of EURPLN rate was halted after two days and in the reminder of the week it was relatively stable above the support level at 3.89. USDPLN was on the rise amid sharp drop in EURUSD. EURPLN did not manage to break support at 3.89 (which is also on the upward trend line). Therefore, we expect that the zloty will depreciate versus the euro in the upcoming week. If Friday's data on domestic current account are in line with our forecast (deficit lower than market expects) then it may provide some support for the Polish currency.

▪ Since the beginning of the previous week the euro was recovering versus the dollar. The single currency was supported by expectations for more hawkish comment from the European Central Bank and diminishing worries regarding euro zone's peripheral countries. The EURUSD broke the resistance level at 1.375, but after a short stabilisation above this level, it plunged suddenly. The euro's depreciation was triggered by relatively dovish communiqué published after the ECB meeting and lower chances for swift rates hikes in the euro zone. The Friday's US data was another impulse dragging the exchange rate down. Consequently, the EURUSD declined below 1.36 and the further drop to 1.35 is possible. Otherwise, the scenario of relative stabilisation in the range of 1.36-1.375 is likely.

Flattening of the domestic yield curve

▪ The domestic yield curve flattened over the past week due to strong demand for 5Y and 10Y bonds after the Finance Ministry's announcement that there will be no auctions of securities in this segment in February and improvement of the global market sentiment. Additionally, the FinMin suggested, that it might enter the IRS market to switch the fixed rate to floating as it expects long-term interest rates to fall. After the yields' drop, later in the week some correction occurred. Short-term bonds were stable. On Wednesday the auction of 2Y bonds is planned and this week we may observe further flattening of the curve, this time due to higher yields on the short end.

▪ On the core fixed income markets the yields started the week at lower levels due to persisting uncertainty in the Middle East. Later in the week the unrest in Egypt was dominated by positive macro data published all over the world and lower worries over the euro zone peripheral counties.

▪ Spreads over the 10Y Bunds fell significantly last week. It was due to hopes for finding solutions for Europe's debt problem. Some information emerged, that Germany is negotiating extending measures supporting peripheral euro zone countries in exchange for tougher fiscal control. Additionally, the data released in Spain showed that the regional banks are diminishing their exposure to the real estate market and the ratio of bad loans is falling. All these pieces of information caused investors to decide to take advantage of lower prices and to buy high yielding PIIGS's bonds.

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