

Weekly economic update

28 February – 6 March 2011

Last week was marked by rise in risk aversion in the global markets under influence of events in MENA region and concerns that related to that surge in oil prices could undermine global economic growth. Stock markets lost while core debt markets gained. EURUSD rose as negative impact of heightened risk aversion was less important than strengthening expectations for rate hikes in the euro zone. Meanwhile, expectations for rate hikes in Poland were cooled by MPC members, which added to zloty weakening connected with risk aversion. At the same time, dovish message from the MPC and disappointing retail sales data lowered the short end of the yield curve. Drop in yields at the long end was limited by negative moods abroad.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST VALUE
				MARKET	BZWBK		
MONDAY (28 February)							
11:00	PL	Tender of 52-week T-bills worth PLN1.2-1.7bn					
11:00	EZ	HICP	Jan	%YoY	2.4	-	2.2
14:30	US	Personal income	Jan	%MoM	0.4	-	0.4
14:30	US	Consumer spending	Jan	%MoM	0.4	-	0.7
14:30	US	Core PCE	Jan	%MoM	0.2	-	0.0
15:45	US	Chicago PMI	Feb	pts	67.3	-	68.8
16:00	US	Pending home sales	Jan	%MoM	-2.5	-	2.0
TUESDAY (1 March)							
3:30	CN	PMI – manufacturing	pts	Feb	52.5	-	54.5
9:00	PL	PMI – manufacturing	pts	Feb	56.0	56.1	55.6
9:58	EZ	PMI – manufacturing	pts	Feb	59.0	-	57.3
11:00	EZ	Flash HICP	%YoY	Feb	2.4	-	2.4
16:00	US	ISM – manufacturing	pts	Feb	60.5	-	60.8
WEDNESDAY (2 March)							
	PL	MPC decision	%		3.75	3.75	3.75
10:00	PL	PKB	%YoY	Q4	4.4	4.5	4.2
10:00	PL	Private consumption	%YoY	Q4	1.0	1.0	0.4
10:00	PL	Gross fixed investments	%YoY	Q4	4.3	4.0	3.5
14:15	US	ADP report	k	Feb	165	-	187
20:00	US	Fed's Beige Book				-	
THURSDAY (3 March)							
9:58	EZ	PMI – services	pts	Feb	57.2	-	55.9
11:00	PL	Bond switching auction					
11:00	EZ	Revision of GDP	%QoQ	Q4	0.3	-	0.3
13:45	EZ	ECB decision	%		1.0	-	1.0
14:30	US	Initial jobless claims	k	week	386		391
16:00	US	ISM – usługi	pts	Feb	59.9	-	59.4
FRIDAY (4 March)							
14:30	US	Non-farm payrolls	k	Feb	160	-	36
14:30	US	Unemployment rate	%	Feb	9.1	-	9.0

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

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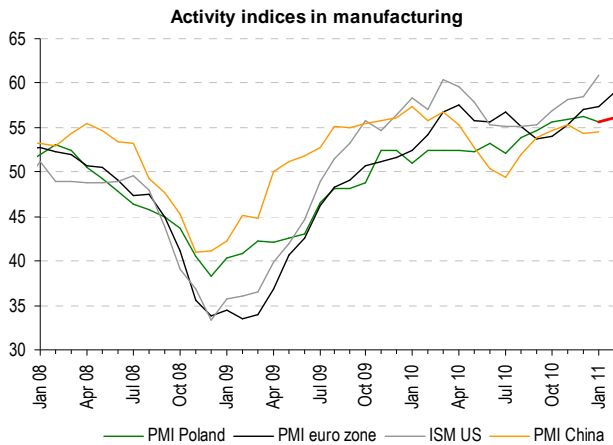
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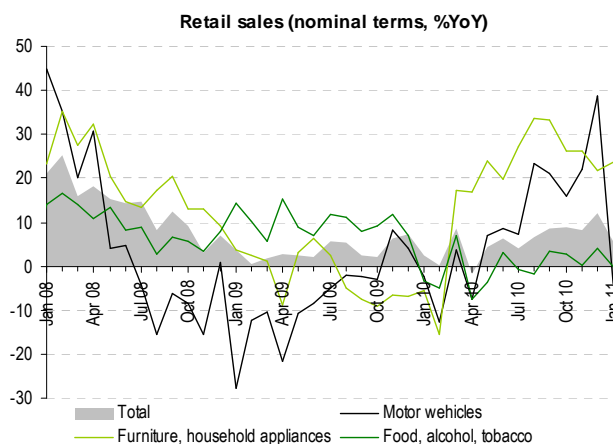
Marcin Luzziński

What's hot this week – Meetings of the Polish MPC and ECB

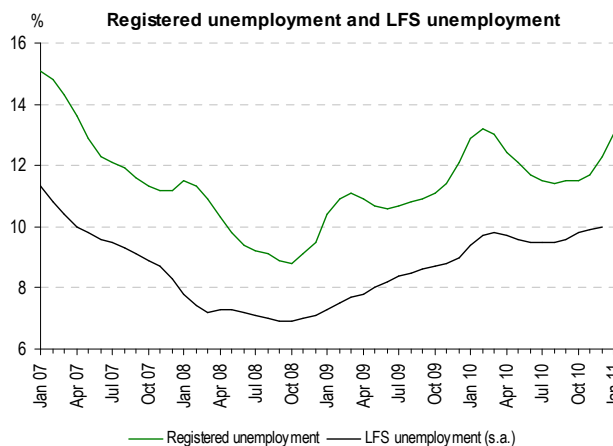


- Significant rise in the euro zone's and German PMIs as well as strong improvement in CSO's business climate indicator support our forecast of rise in Polish PMI.
- The MPC meeting (with main results of NBP projection for inflation and GDP) will be the key domestic event this week. Despite the surprisingly high CPI inflation in January, the disappointing readings of some other indicators (construction production, retail sales) as well as dovish comments from MPC members caused that we stick to our forecast assuming no interest rate hike in March.
- The outcome of the ECB meeting this week will be an important factor for prospects of MPC policy (changes in monetary policy in the euro zone can affect decisions of Polish central bankers). ECB interest rates are widely expected to remain on hold but the new forecasts of the bank, tone of Trichet's comments and any decisions on liquidity operations will be of high importance.

Economy last week – Arguments for doves



- The annual rise of retail sales in January was well below expectations decelerating in nominal terms to 5.8% from 12% in December. Our forecast was at 9.9% and market consensus pointed to 8.5%. In real terms annual growth dropped to 2.1% from 9.1% in December.
- It seems that the effect of shifting some part of consumption demand to late 2010 ahead of introduction of VAT hike and other regulations (i.e. deduction of cost related to car purchase) at the beginning of 2011 was stronger than we anticipated. This seems to be confirmed by deeper than we estimated lowering of annual growth rate for autos sales (in nominal terms to -4.1%YoY from 38.6%YoY in December). In other categories of durable goods that effect was that visible. The "furniture and electronics" sales growth improved to 23.6%YoY from 21.8%YoY in December.



- In January the registered unemployment rate climbed to 13%, which was mostly the seasonal effect, but there was also a slight rise in annual terms.
- The number of unemployed reached 2.1m after an increase by 2.6%YoY (further deceleration from average of ca. 3.5% in Q4). Due to bad weather conditions one cannot exclude that the unemployment rate will rise slightly also in February. However, this does not alter the overall quite positive outlook for Polish labour market in 2011. In the next months we expect a decline in unemployment rate, increase of employment and acceleration of wage growth, which will support consumption demand. It is noteworthy that the increase in unemployment rate in the last months was accompanied by an increase in employment, which reflects rising labour participation and this is undoubtedly a positive factor weakening tensions in the labour market.

Quote of the week – There will not be a cascade of rate hikes

Marek Belka, NBP governor; obserwatortfinansowy.pl, 21 Feb

It has to be clearly said: as long as the price increase does not translate into clear signals of greater pressure on wages, the central bank should be moderate in its reactions. (...) The monetary council has sent a signal [in January] - we see the inflationary threat and we will not be passive, but that does not mean a Hungarian scenario, meaning a cascade of rate increases in the following months.

Elżbieta Chojna-Duch, MPC member; Reuters, 22 Feb

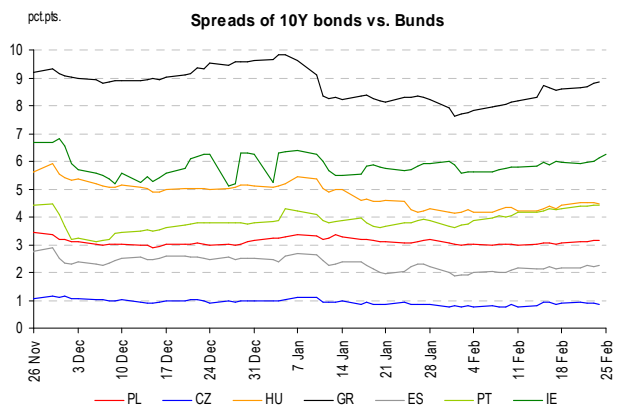
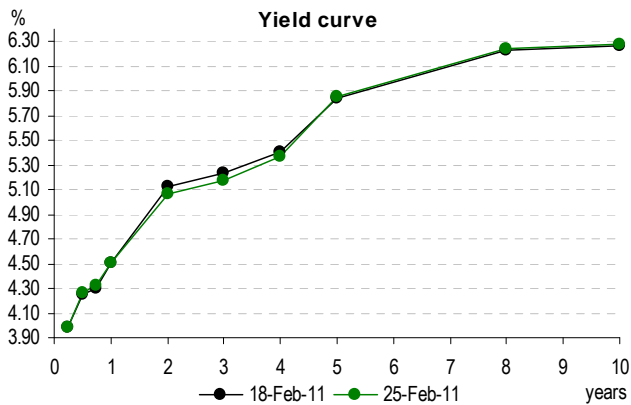
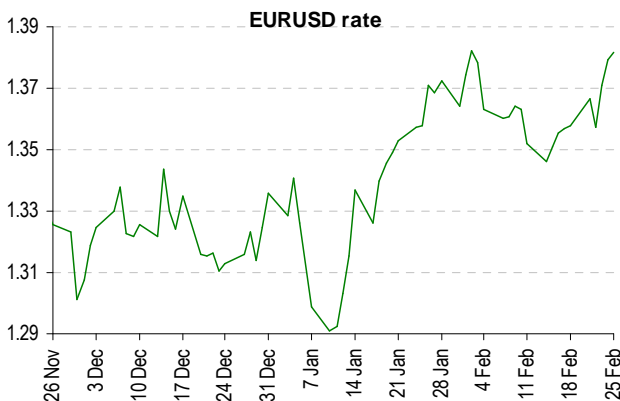
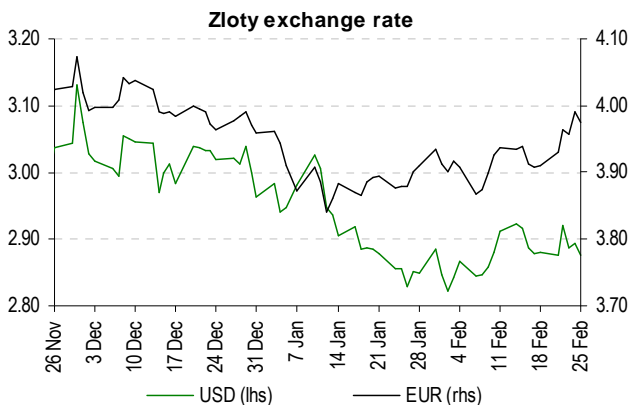
I share the views on monetary policy expressed recently by Mr. Belka. Global geopolitical situation is uncertain. There is no evidence of second round effects in Poland.

Adam Glapiński, MPC member; PAP, 22 Feb

For the time being I can see no reasons for a rate hike. (...) We can not be guided by incidental fluctuations.

Recent comments from MPC members cooled expectations for rate hikes which strengthened earlier due to surprisingly strong CPI inflation rise in January. It is worth reminding that beside dovish statements from Belka, Chojna-Duch and Glapiński, strong objections against quick second rate hike were expressed before CPI release by Andrzej Kaźmierczak and Zyta Gilowska (high CPI reading probably did not change their views). Therefore, even if we assume that the remaining five MPC members would like to tighten the monetary policy, they will not be able to pass such a motion. At the end of the week the cooling effect of dovish comments from MPC members was offset by a surprising PAP interview with acting CSO President, in which he presented a forecast that the CPI inflation will rise to as much as 4.1-4.2% in March.

Market monitor



Zloty weaker amid higher risk aversion

As we expected, there was continuation of the zloty depreciation, which started on Friday a week earlier. The zloty stayed under pressure due to risk aversion (stemming from turmoil in Middle East and North Africa) and dovish statements of MPC members. After breaking the resistance at 3.95, the exchange rate continued to rise in the consecutive days and thanks to the improvement of sentiment which at the end of the week the zloty depreciation halted at a psychological barrier of 4.0. The Czech crown and forint weakened last week as well, although the Hungarian currency rebounded after successful bonds auction. The MPC decision may be crucial for the zloty this week. The Tuesday's presentation of reforms plan in Hungary is also important for the CEE region. If the MPC leave interest rates on hold, this may have negative impact on the zloty, but we assumed improvement in global sentiment which together with the technical situation should support the Polish currency. The first support for EURPLN is 3.97, next support is 3.95.

The EURUSD exchange rate fell at the beginning of the week near to 1.35 due to increasing risk aversion. Later the rate rebounded thanks to hawkish comments from ECB members (Mersch, Wellink, Weber). The increase in expectations for EBC interest rate hike pushed EURUSD to its highest level since the beginning of February (1.384). This week a number of important data will be released, but the outcome of the ECB meeting will have the deciding impact on the exchange rate. Besides, the results of parliamentary election in Ireland are important. The technical analysis suggests that the decline of EURUSD is more probable than the increase. The first support is 1.36.

Steepening of the domestic yield curve

Over the past week the yields on the long end of the domestic curve were quite stable, while on the short end visible decline due to dovish comments of the MPC members occurred. This week the Council's decision due on Wednesday should play main role on the domestic debt market. In the last few day there was some correction of the market expectations for interest rate hike in March but the monetary policy tightening by 25bps this week is still anticipated by some investors. We predict the MPW will keep rates unchanged and thus we expect that yields on the short end may drop by 10-15bps in reaction to the MPC decision announcement. The developments in the following days may depend on the tone of the post-meeting statement and comments from central bankers at the press conference as the market will look for any hints regarding the most likely timing of further steps in domestic monetary policy.

Yields on the core debt markets declined over the past week amid high risk aversion on the global markets. Strong demand for safe assets dragged yields down to the lowest level since early February.

Spreads of PIIGS bonds versus 10Y Bunds increased over the past week. That was due to both higher yields on the periphery of the euro zone's debt market and falling yields on German bonds. The auctions conducted by Italy was well received, but the negative pressure on PIIGS's bonds was put by uncertain situation in the MENA region. This week there will be switch auction of bonds in Portugal and ordinary auction of bonds in Spain.

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