

Weekly economic update

23 – 29 May 2011

The risk aversion has predominated the beginning of the past week. The market has awaited in uncertainty the agreement of euro zone and EU finance ministers concerning the new bailout for Greece. For the first time official suggestions of “soft restructuring” emerged, which raised concerns about negative impact of such a solution for the European the banking system and economy. Additionally, among many macro figures only weekly US labour market data were better than expected, which diminished the optimism about outlook for global economy. However, market sentiment was supported by earnings reports and lack of Fed’s plans to tighten the monetary policy. Minutes of the last MPC meeting showed that the Council has accelerated the hike to May in order to effectively limit the risk of stabilisation of inflation at elevated level and to react to heightened inflation expectations. Fresh comments from MPC members indicate that the camp of members, who back a concentration of hiking cycle in time, is expanding. This tendency may be strengthened by April’s data on wages, CPI and PPI. After an initial weakening, the zloty has gained, mostly thanks to climbing EURUSD rate. The domestic yield curve has lowered slightly and the investors’ activity concentrated on the middle and long end of the curve due to auction of 5Y bonds.

The market’s disappointment with macro data releases in the previous week will probably attract much attention to Monday’s flash PMIs for manufacturing in major economies. Important will be also figures released in the following days and the end of the week seems to be really interesting in terms of data flow. We expect the domestic data will confirm positive picture of the Polish economy and consumers condition. However, we see little potential for the zloty strengthening this week with possible negative influence from falling EURUSD. Local debt market may weaken.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (23 May)							
4:30	CN	Flash PMI – manufacturing	May	pts	-	-	51.8
9:28	DE	Flash PMI – manufacturing	May	pts	61.1	-	62.0
9:58	EZ	Flash PMI – manufacturing	May	pts	57.5	-	58.0
11:00	PL	Tender of 44-week T-bills worth PLN0.5-1.0bn					
TUESDAY (24 May)							
10:00	DE	Ifo index	May	pts	110.0	-	110.4
11:00	EZ	Industrial orders	Mar	%MoM	-1.3	-	0.9
16:00	US	New home sales	Apr	k	310	-	300
WEDNESDAY (25 May)							
8:00	DE	GfK index	May	pts	5.6	-	5.7
10:00	PL	Retail sales	Apr	%YoY	14.9	18.0	9.4
10:00	PL	Unemployment rate	Apr	%YoY	12.6	12.5	13.1
10:30	GB	GDP revision	Q1	%QoQ	0.5	-	-0.5
14:30	US	Durable goods orders	Apr	%MoM	-1.5	-	4.1
THURSDAY (26 May)							
14:30	US	Preliminary GDP	Q1	%QoQ	2.1	-	3.1
14:30	US	Initial jobless claims	week	k	404	-	409
FRIDAY (27 May)							
14:30	US	Consumer spending	Apr	%MoM	0.5	-	0.6
14:30	US	Personal income	Apr	%MoM	0.4	-	0.5
14:30	US	Core PCE	Apr	%MoM	0.2	-	0.1
15:55	US	Michigan index	May	pts	70.0	-	69.8
16:00	US	Pending home sales	Apr	%MoM	-1.0	-	5.1

Source: BZ WBK, Parkiet, Reuters

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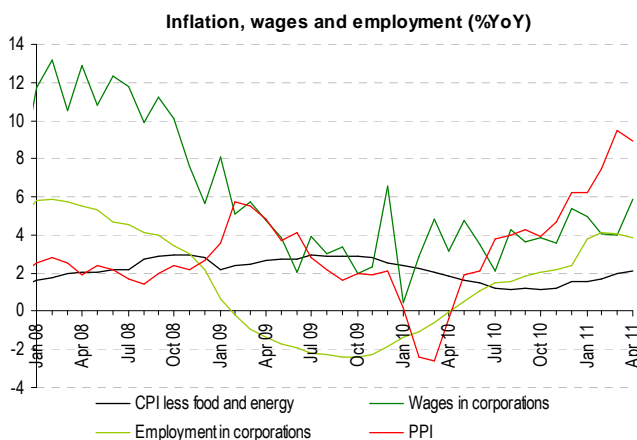
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What's hot this week – Last dose of domestic monthly figures

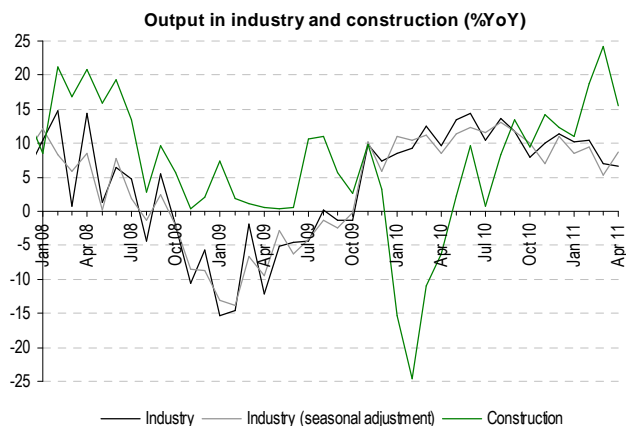


- Our forecast of annual growth of retail sales is more optimistic than the market's. In our view, such a substantial acceleration will be a result of Easter shopping in April. Moreover, the nominal increase of sales will be positively influenced by the further acceleration of inflation. All in all, we expect the April retail sales figure to be an outlier compared to the whole year, as we expect the annual dynamics to go down to 10% in the upcoming months, which will be still a sign of strong consumer demand.
- We anticipate a typical for this part of the year drop of the unemployment rate. We expect that the correction of seasonal increase of unemployment rate, which took place in winter, will be deeper than the market is forecasting.

Economy last week – Hawkish data on wages, PPI and core inflation



- The labour market figures for April showed a deeper than expected slowdown of annual employment growth (to 3.9% from 4.1%) and a stronger than anticipated rise in wages (by 5.9%YoY). The figures confirm continuation of positive tendencies in the labour market, which is favourable for the outlook of consumption demand. The robust increase of wages can raise concerns of some MPC members about the second round effects. This is a factor increasing the probability of rate hike in June.
- The current account deficit was above forecasts with growth rates of both exports (drop to 4%YoY vs 13.9% in February) and imports (drop to 7.2%YoY from 15.5%) lower than expected. Such tendency is in line with our expectations though the scale of slowdown is pretty surprising and we assume that in following months we will observe rebound (and data revisions cannot be excluded).



- The increase of industrial output slowed down in April to 6.6%YoY from 7.0%YoY in March (8.7%YoY against 5.7% after seasonal adjustment). The construction and assembly output advanced by 15.6%YoY. The data did not change the picture of the Polish economy and supported our forecasts, assuming a sustaining GDP growth in Q2 slightly above 4%.
- The PPI inflation decelerated in April to 8.9%YoY versus 9.5% in March, less than expected. Higher than expected PPI in April was partly due to revision of March data. The increase of prices in manufacturing by 0.7%MoM should be underlined as it occurred amid strengthening zloty. The CPI after excluding food and energy prices advanced to 2.13%YoY from 2.0% in March.
- The inflation data (PPI and core inflation) support the decision to hike interest rates by 25bp already in June.

Quote of the week – We have to conduct a restrictive policy

Marek Belka, NBP governor, Rzeczpospolita, 19th May

As I said after the last MPC meeting, we are still in a process of monetary tightening and this process has not ended yet.

Andrzej Bratkowski, MPC member, PAP, 19th May

I think that a concentration is needed, an acceleration of hiking cycle in order to avoid a situation, where inflation will expand because of heightened inflation expectations, while we will be hiking the interest rates slowly and chasing the inflation all the time.

Elżbieta Chojna-Duch, MPC member, Reuters, 18th May

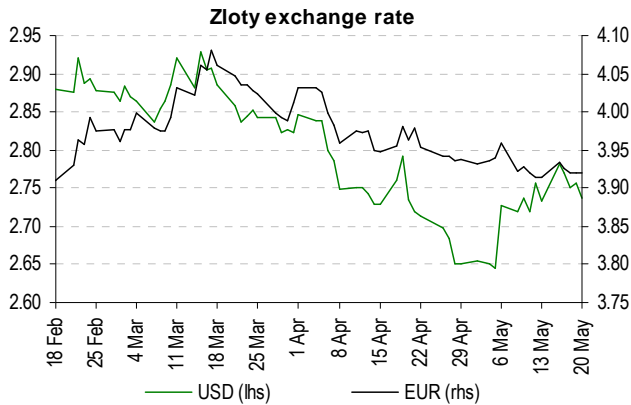
The market expectations of two interest rates hikes this year, by 25bp, can be justified, when taking into account the global conditions and uncertainty resulting from changed macroeconomic circumstances in Poland.

Andrzej Kazmierczak, MPC member, Reuters, 20th May

We need to conduct a restrictive monetary policy. We are in a cycle of monetary tightening, but the question is when and by how much rates will rise. (...) I'm a supporter of small steps.

One week after the surprising decision to hike the interest rates, some hawkish comments appeared, indicating that another hike in June is more probable. Among the cited statements, the words of Mrs. Chojna-Duch are especially important. The MPC member, which had – up to this date – consequently stressed that it is too early for monetary tightening, now suggests that the market expectations of two hikes by 25bp are justified. Apparently, the camp of members, who back a concentration of hiking cycle in time, is expanding. This is indicated by minutes of MPC meeting in May, where the members supporting more gradual hikes were in minority. According to unofficial information released by PAP, in April the hike was supported by 9 members (1 vote against). A similar result was allegedly achieved in May.

Market monitor

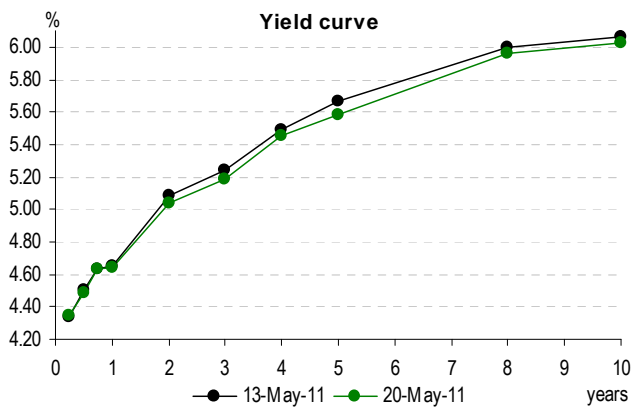
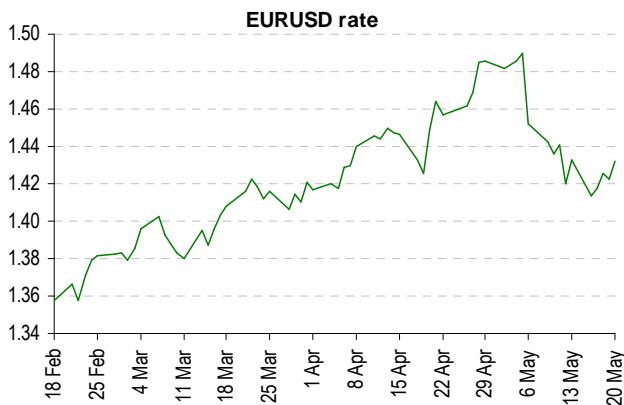


Zloty weaker amid falling EURUSD

▪ The upward trend of EURPLN and USDPLN rates, which began last Friday, was halted already during the US session and the zloty has gained since Monday. The zloty was supported by prospect of exchange of euro by BGK and by increasing EURUSD rate. The domestic currency did not react to MPC members' comments as well as to wages and employment figures. The Friday's declines of EURUSD rate caused a partial correction of earlier zloty's appreciation. We expect the EURPLN not to approach support at 3.89 this week. In the first part of the week the zloty will be undermined by anticipated by us declines of EURUSD rate.

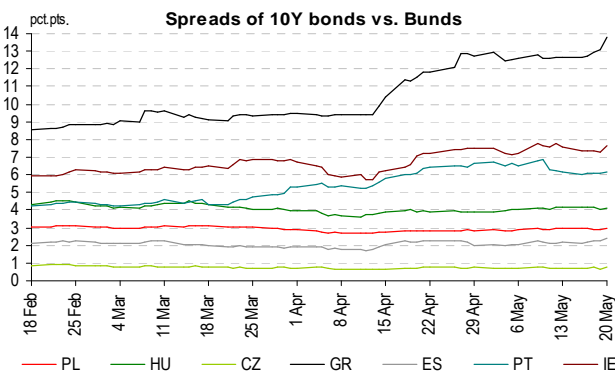
▪ In the middle of the week the forint weakened vs the euro after release of unofficial information that the government is planning to make the banks set fixed euro and franc rates (lower than current) for calculating rates of currency loans in order to help the debtors. The forint pared losses after successful auction of long-term bonds. The Czech koruna weakened vs the euro due to dovish signs from the central bank that the rates hikes will occur only in Q4 2011.

▪ The EURUSD rate increased substantially during the last week. The euro was supported by Fed's announcement of no plans to tighten monetary policy. Last week the rate stayed at its lowest level since end-March, which was utilized to purchase the euro due to prospect of monetary tightening by the ECB. Only on Friday a correction occurred amid raising concern about Greece. On Friday the rate broke through the line of upward trend and we expect the declines to be continued, at least until beginning of the week.



Figures and profit taking will push yields up

▪ The core debt market strengthened last week, especially at the middle of the curve. A strong demand (exceeding the supply more than 4 times) was recorded during the 5Y bonds auction, which additionally supported the debt pricing, especially at this segment of curve. The investors' interest toward the auction may result from approaching maturities of other securities. After the wage figures a slight correction took place, mostly on the shorter end. The enhanced expectations of rates hike in June after a series of hawkish data can contribute to an increase of yields on the shorter end. A substantial strengthening, which took place on the middle of the curve, will encourage profit taking, which can affect the longer end as well, although the yields of 10Y bonds can be stable due to lack of considerable rebound of long-term Bunds.



▪ Core bond markets continued with some stabilisation of yields, which was already observed in the previous week. Worries regarding problems of Greece, as well as disappointing economic data were limiting room for yields' rebound. It is quite clear that the question how to resolve the Greek issue is a dominant factor on the market, so even if the next couple of economic data releases are above expectations his might not be enough to push yields up.

▪ Focus on Greece led to higher bond yields in his country and the spread against Bunds significantly increased. Irish bonds were supported by some expectations that after financial aid will be negotiated for Greece, his country also may have better conditions.

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