

Weekly economic update

6– 12 June 2011

The zloty recorded in the previous week a moderate strengthening among numerous fluctuations relevant to swings in global sentiment. On one hand, a negative impact on the global risk appetite was exerted by clearly disappointing activity indices in manufacturing of main economies (euro zone, China and especially the US) and by the warning of Moody's agency for the US rating. On the other hand, the market sentiment was positively influenced by information raising hopes that Greece will be granted further financing. Another positive factor for the risk appetite and for the euro against the dollar was provided by the successful auction of Spanish bonds, scaling down the concerns about diffusion of Greek debt crisis. The domestic debt market gained on substantial drop of yields in the core markets and on information about planned reduction of bonds' supply and still strong demand for Polish sovereign securities. The domestic GDP figures for Q1 matched the forecasts, showing an economic growth of 4.4%YoY, a stronger than expected increase of private consumption and confirmed the revival in investment activity. In line with expectations, the measure of households' inflation expectations showed an increase in May. The PMI for domestic manufacturing in May surprised on the downside. All in all, the domestic data released in the previous week do not change our view that the MPC will hike interest rates by another 25bp this week.

This week the situation of the domestic debt market will depend to a large extent on the result of MPC meeting. In our view the Council will raise the interest rates for the third consecutive time by 25bp, supporting the zloty and pushing upwards the market rates on the shorter end of yield curve. Except for the MPC's decision and post-meeting statement, the situation in the domestic financial market will depend on events abroad. The most important will be further information about the Greek problems, outcome of the ECB meeting (the tone of Trichet's comments and new forecasts will come to the fore) and about the statement of Fed's governor scheduled on Tuesday.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (6 June)							
10:30	EZ	Sentix index	Jun	pts	9.3	-	10.9
11:00	EZ	PPI	Apr	%YoY	6.6	-	6.7
TUESDAY (7 June)							
11:00	EZ	Retail sales	Apr	%MoM	0.4	-	-1.0
12:00	DE	Industrial orders	Apr	%MoM	2.0	-	-4.0
WEDNESDAY (8 June)							
	PL	MPC decision		%	4.50	4.50	4.25
8:00	DE	Exports	Apr	%MoM	-3.0	-	7.3
12:00	DE	Industrial output	Apr	%MoM	0.0	-	0.7
20:00	US	Fed's Beige Book					
THURSDAY (9 June)							
11:00	PL	Auction of OK0713 bonds					
13:00	GB	BoE decision		%	0.50	-	0.50
13:45	EZ	EBC decision		%	1.25	-	1.25
14:30	US	Trade balance	Apr	%bn	-48.8	-	-48.2
14:30	US	Initial jobless claims	week	k	415	-	422
16:00	US	Wholesale inventories	Apr	%MoM	1.0	-	1.1
FRIDAY (10 June)							
-	CN	Trade balance	May	\$bn	20.40	-	11.42
14:30	US	Import prices	May	%MoM	-0.7	-	2.2

Source: BZ WBK, Reuters

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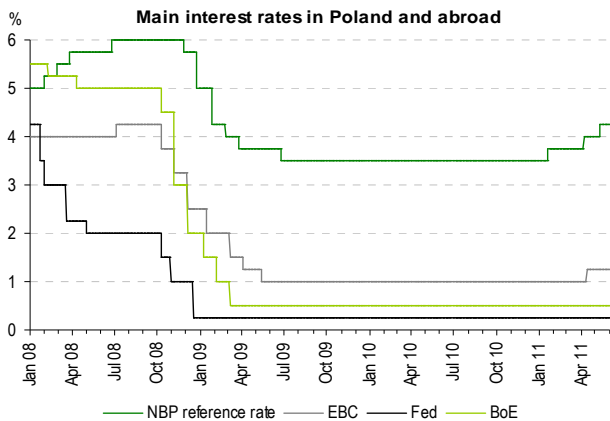
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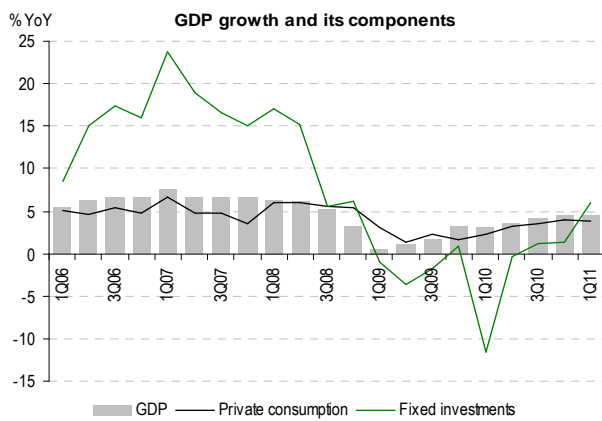
What's hot this week – Decisions of central banks



▪ This week no domestic macro data are due to release as well as not much foreign data are on schedule. However, the further information concerning Greece will be of importance. On such a background the Polish financial market is likely to focus on the Wednesday's MPC decision and results of ECB sitting on Thursday.

▪ Taking into account the domestic data released since last MPC sitting (rise in CPI inflation, core inflation, inflation expectations, considerable acceleration of dynamics of wages, retail sales, robust employment, industrial and construction output, revival in investment in GDP figures), we expect that the Polish central bankers will hike the interest rate by 25bp for third consecutive time. An argument against hike can be recent bleak data from the global economy.

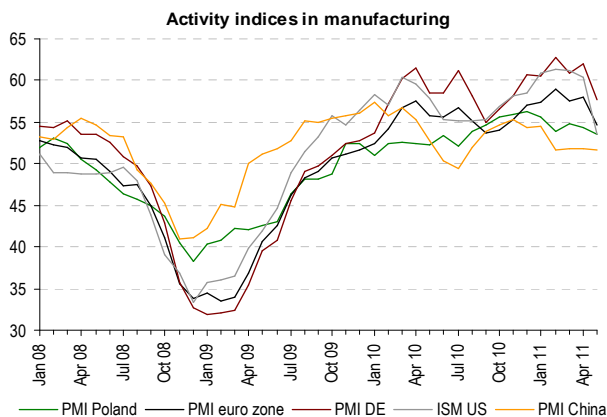
Economy last week – Robust GDP figures for Q1, weak PMI for May



▪ GDP growth in Q1 matched our forecast and market consensus of 4.4%YoY.

▪ As to breakdown of the growth, it is worth to note acceleration in fixed investment growth to 6%YoY (although one could expect stronger rise given low base effect), only a slight deceleration in private consumption growth (despite a shift of a part of consumption demand to last months of 2010 before tax changes in 2011) and just a minimal negative contribution of net exports to GDP growth. On the other hand, public consumption growth was quite weak.

▪ All in all, the data do not change our forecasts for the next quarters and we still expect GDP growth to remain above 4% in the remaining quarters of this year with larger role of domestic demand, including acceleration in fixed investment growth.



▪ Poland's PMI manufacturing for May dropped stronger than expected, to 52.6, the lowest level since July 2010. Such clear slowdown in pace of industry growth was mainly the result of decline in sub-indices for output and new orders (both were at lowest levels in 10 months). Index for new export orders recorded the strongest fall in the survey's history and was just above the neutral level of 50 pts. In spite of these negative tendencies, the employment indicator increased for the consecutive time. The strongest fall ever was also recorded by production cost sub-index. Growth in producer prices slowed down for the second straight month. The deeper than expected slump of domestic PMI occurred together with clearly disappointing indicators from abroad.

▪ NBP data showed that households' inflation expectations in May rose to 4.3% (inflation rate expected in upcoming 12 months) from 4.0% in April.

Quote of the week – Proper moment to act

Jerzy Hausner, MPC member, PAPczłonek RPP, PAP, 30th May

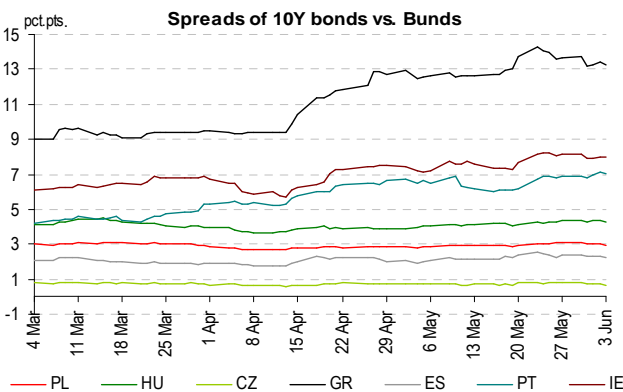
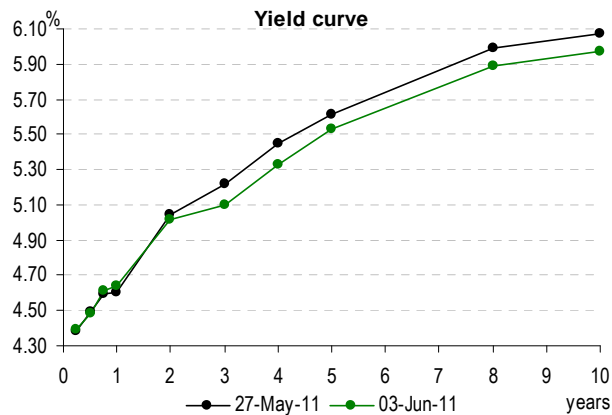
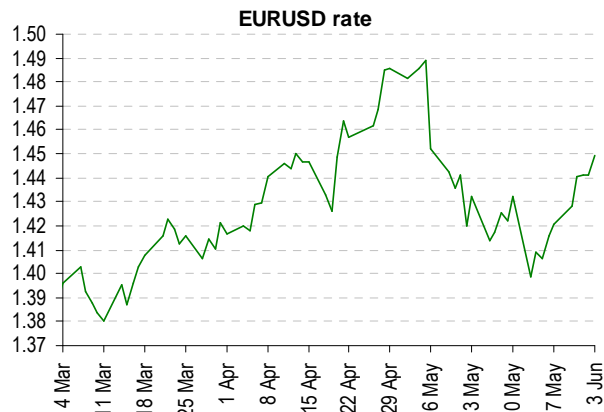
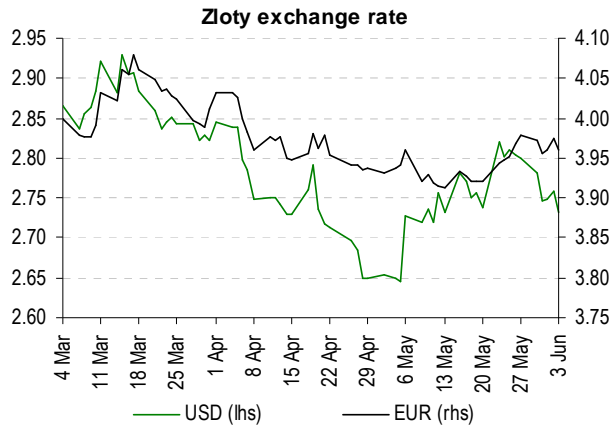
The current moment is a proper moment to act as regards rate hike. It seems obvious to me. (...) It can happen next month, in two months time or even later. It can be one hike, two hikes or even three. (...) We can think today that this will be a projection [NBP's inflation projection in July] sending us signs of necessity of changes in that policy [monetary tightening] rather than of need to continue it. But this is my view. (...) It does not mean that I anticipate now that it will happen in June, July or September.

Waldemar Pawlak, deputy PM, Economy Minister, PAP, 1st June

Such an approach aiming at hiking the interest rates is very dangerous right now. I want to stress that (...) the government of Jerzy Buzek had been done in by Mrs. Gronkiewicz-Waltz [NBP governor at that time] with high interest rates and it seems that colleagues appointed by PO to the MPC follow the same path by raising the cost of money. They can cause brutal political consequences.

The newest comments of MPC's Hausner indicate that the current moment is - in his view - most proper for continuation of interest rate hikes. It is true that Mr. Hausner did not indicate if it means a need of hike during the upcoming meeting this week, but in our view the recently released domestic data will invigorate the MPC members to such an action. At the same time, Mr. Hausner suggested that the new NBP's inflation projection can change the current policy of MPC, i.e. finish the hiking cycle. In our view the rally of CPI inflation in the further part of the year and a solid GDP growth over 4% will cause that the anticipated by us hike in June will not be the last one in the cycle. The swelling pressure exerted by Mr. Pawlak, the deputy PM, will not have any impact on the Council.

Market monitor



The interest rates hike will support the zloty...

▪ The start of the week was not favourable for the zloty, but the following days brought an expected by us appreciation of the domestic currency towards 3.95 per euro. The domestic currency was supported by gradual increase of EURUSD rate and strengthening hopes for agreement concerning aid for Greece. A factor, which has limited the zloty appreciation, were weak US figures, in particular the Friday's labour market data, which increased by concerns about persistence of economic recovery in the worlds' largest economy and triggered drops in the stock markets. This week we expect a further slight zloty appreciation, which can be supported by the expected by us MPC's rates hike. Zloty should be also supported by the probable general improvement of sentiment relevant to news about new aid for Greece. However, a potential for zloty appreciation will be limited by the enhanced uncertainty about persistence of global economic recovery. We expect that this week the zloty should gain moderately. The key support for EURPLN will be 3.94 and then 3.92.

▪ The EURUSD rate climbed throughout the week to its highest level in one month, ending the week above 1.45. This border was broken temporarily already prior to Friday's labour market figures for the USA, but only this release invigorated the rate to break through this level more substantially. The euro gained on hopes for further help for Greece, while the dollar was affected by weak US figures and Moody's warning. This week the dollar can still stay under pressure after Friday's disappointing labour market data and prior to ECB meeting, which should confirm market expectations for rate hike in the euro zone in July.

...and flatten the yield curve

▪ The previous week was marked by a strengthening domestic debt market due to considerable drop of yields in the core markets. This week the domestic debt market situation will depend on the outcome of MPC meeting. Another important factor for the debt market will be the result of scheduled for Thursday auction of 2Y securities, while some impact on the market can be exerted by expected Monday's information on scale of bonds' supply. In the current Reuters' poll, the rate hike is expected by 13 out of 22 respondents and 13 out of 19 in the PAP poll. OIS and FRA trading price-in the hike only partially. The anticipated by us NBP's rates hike will probably come as a surprise for the considerable part of the market and should lead to substantial jump of market interest rates at the shorter end. The longer end will be supported by low yields in the core markets.

▪ The core debt markets have gained substantially in the first part of the week due to rising concern about condition of global economy. In due course, in the middle of the week the yields of 10Y Bunds and Treasuries were below 3%, which relevant, among other, to Moody's warning for the US rating, but on Friday the yields dropped again below 3% on weak US labour market data. At the very end of the week yields were again above 3%, as the Greek government said officially that EU/ECB/IMF delegation approved its program of additional austerity measures.

▪ The yields of bonds of euro zone peripheries (as well as CDS rates and spreads to Bunds for these countries) recorded a decline thanks to increasing hopes for new bailout for Greece.

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