Bank Zachodni WBK

Weekly economic update

13 – 19 June 2011

The MPC communiqué, signalling a break in interest rate hikes, has contributed to strengthening of domestic debt market. In spite of decline in EURUSD rate, the zloty has gained, in line with our expectations, which was supported by the information about privatisation plans and exchange of foreign currencies on the market.

After a clear message from the MPC, we expect that the domestic data due to release this week will have relatively small impact on the market. As regards the foreign events, crucial will be macro indicators from the USA and China. These will help the markets to assess how strong can be the slowdown of global economy, which was already signalled in the previous figures. In our view the overtone of the data will be good enough not to deteriorate the market sentiment.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 June)					
	DE, CH, FR	Banking holiday					
		TUESDAY (14 June)					
4:00	CN	CPI	May	% YoY	5.4	-	5.3
4:00	CN	Industrial output	May	% YoY	13.2	-	13.4
14:00	**PL**	**Current account**	**Apr**	**€bn**	**-950**	**-825**	**-1 376**
14:00	**PL**	**Exports**	**Aor**	**€bn**	**10 622**	**10 419**	**11 122**
14:00	**PL**	**Imports**	**Apr**	**€bn**	**11 220**	**10 924**	**11 837**
14:00	**PL**	**Money supply**	**May**	**%YoY**	**8.1**	**7.8**	**9.1**
14:30	US	Retail sales	May	% MoM	0.2	-	0.6
		WEDNESDAY (15 June)					
11:00	EZ	Industrial output	Apr	% YoY	-0.1	-	-0.2
14:00	**PL**	**CPI**	**May**	**% YoY**	**4.5**	**4.6**	**4.5**
14:30	US	Core CPI	May	% MoM	0.2	-	0.2
14:30	US	NY Fed Index	Jun	pts	11.0	-	11.88
15:15	US	Industrial output	May	% MoM	0.3	-	0.0
		THURSDAY (16 June)					
11:00	EZ	HICP	May	% YoY	2.7	-	2.8
14:00	**PL**	**Minutes RPP**					
14:00	**PL**	**Wages in corporate sector**	**May**	**% YoY**	**5.5**	**5.5**	**5.9**
14:00	**PL**	**Employment in corporate sector**	**May**	**% YoY**	**3.8**	**3.8**	**3.9**
14:30	US	House starts	May	k	535	-	523
14:30	US	Building permits	May	k	550	-	563
14:30	US	Initial jobless claims	week	k	420	-	427
16:00	US	Philly Fed index	Jun	pts	4.1	-	3.9
		FRIDAY (17 June)					
14:00	**PL**	**Industrial output**	**May**	**%YoY**	**8.2**	**8.2**	**6.6**
14:00	**PL**	**Construction output**	**May**	**%YoY**	**13.9**	**18.1**	**15.6**
14:00	**PL**	**PPI**	**May**	**%YoY**	**7.2**	**7.4**	**8.9**
15:55	US	Flash Michigan Index	Jun	pts	74.4	-	74.3
16:00	US	Leading indicators	May	%MoM	0.2	-	-0.3

Source: BZ WBK, Parkiet, Reuters

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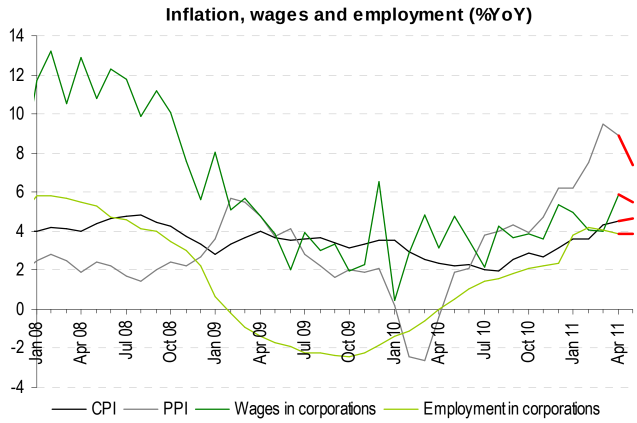
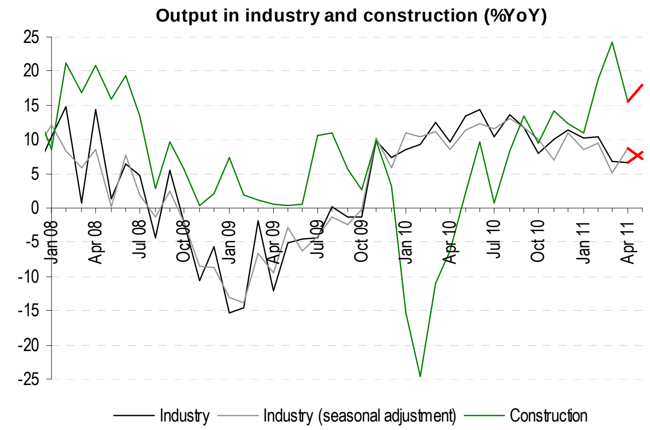
What's hot this week – Large set of domestic data



- We expect a slight acceleration of annual CPI growth due to low base effect. The monthly pace of growth should drop due to lower monthly dynamics of food prices, indicated by FAO food price index.
- We anticipate further slowdown of annual PPI growth. The main factors supporting our forecast are: substantial drop of oil prices and further strengthening of the zloty versus the euro.
- In our view May brought a continuation of positive labour market tendencies. A forecast of employment growth maintaining at April level is supported by PMI report, which showed the strongest employment growth in three months.
- All in all, we expect the data to confirm the improving labour market conditions and will bolster concerns about second round effects. These will – on the other hand – support our expectations of another interest rate hike.



- Our forecast indicates an acceleration of industrial output on yearly basis, although we see some downward risk for this scenario due to recent disappointing PMI reading. On the other hand, the yearly dynamics will be pushed upwards by one working day more than in May 2010. We expect the yearly growth rate in construction to improve, thus confirming the continuation of upward trend relevant to, among others, increasing scope of works in infrastructure.
- We expect a further setback of exports and imports, although not as strong as in March. Our forecast is in line with industrial output figures for April, which showed a slowdown in yearly dynamics. The current account balance will improve due to stronger decrease of imports dynamics and upswing in services and transfers.

Last week in the economy – Third interest rate hike in a row

Fragments of the MPC statement in June
Recently, however, signs of a possible weakening of global economic activity could be observed; the growth in commodity prices in the world markets has also been halted. Furthermore, concerns about the stability of public finances in some peripheral euro area countries have intensified, which has contributed to increased risk aversion in the international financial markets.
The acceleration in price growth, although mainly connected with a further rise in food and energy prices, concerned also core inflation, which is reflected in a faster price growth in most of the other categories of goods and services. PPI inflation and inflation expectations of households remained at a relatively high level.
In the opinion of the Council, the elevated level of current inflation and inflation expectations, as well as the risk of rising wage pressure amidst a considerable growth in employment, justify increasing the NBP interest rates at the present meeting. The Council assesses that the substantial monetary policy tightening implemented since the beginning of 2011 should enable inflation to return to the target in the medium term. The Council does not rule out further adjustment of monetary policy, should the outlook for inflation's return to the target deteriorate.

- In line with our expectations, the MPC has decided to hike interest rates by 25bp. Since the beginning of the year, the NBP interest rates have been raised by 100bp. The Council has made it clear in its post-meeting statement what was the reason to hike rates (for the third consecutive time and fourth time this year). In Council's view the accelerated tightening should enable inflation to return to the target in the medium term. However, it was highlighted that a further adjustment is possible should the outlook for this scenario deteriorate.
- We think that the Council will deliver another rate hike by 25bp in the further part of the year (probably in Q4) due to CPI persisting above target, increasing inflation and elevated inflation expectations. Ending the monetary tightening cycle with the reference rate at 4.5% would be possible in the case of disinflationary surprise and considerable economic slowdown.

Quote of the week – Now time for vacation break

Marek Belka, NBP governor, post-meeting conference, Reuters, 8th June

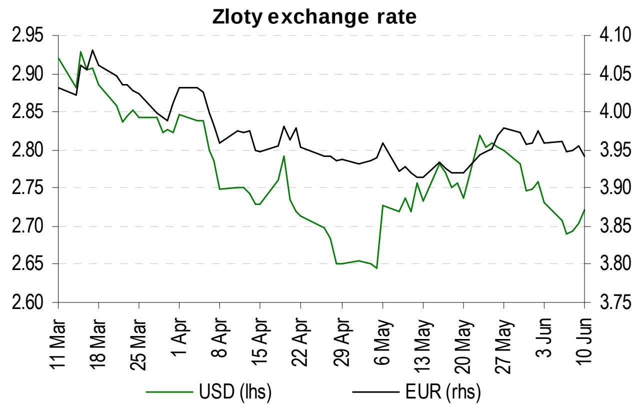
We intend to wait, but of course, it is clearly said in the communiqué, we do not rule out a further adjustment (of monetary policy) should the outlook for inflation's return to the target deteriorate.

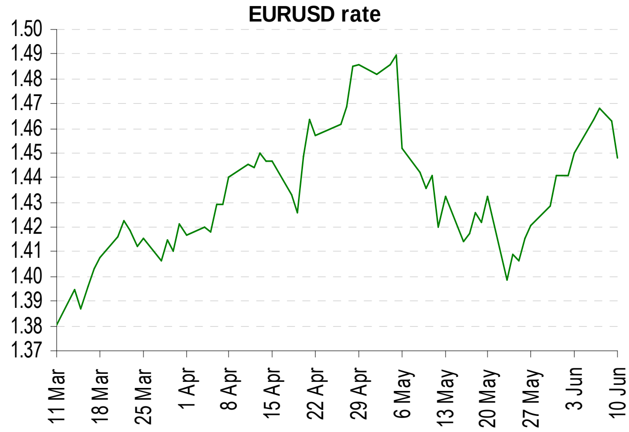
(…) after four hikes, strongly concentrated in time, it seems clear that is high time to assess what is going to happen in the economy.

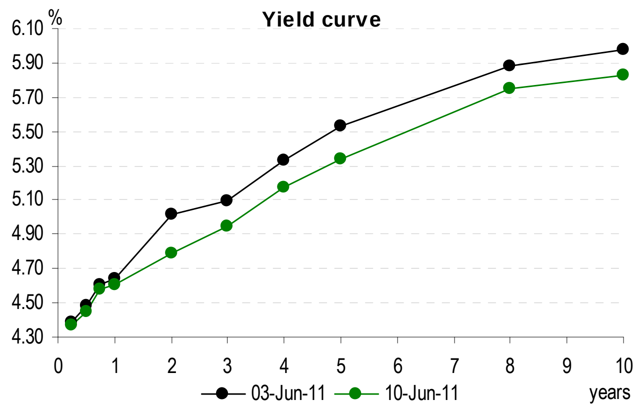
While the PLN rate was quite volatile, after the decision the volatility is limited. Provided that this is no coincidence, then a regular presence of BGK on the market has limited the rate's fluctuations, which is good.

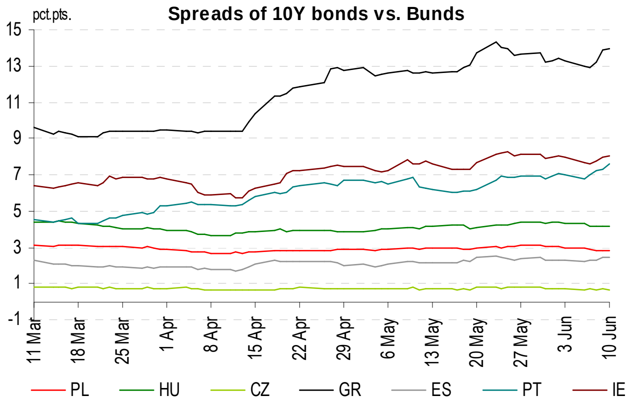
When asked about the informal policy bias (which the Council has stopped using last year), the NBP governor Marek Belka stated that it remains restrictive, although after monetary tightening delivered so far the room for further hikes is limited. Mr Belka stated that the Polish central bankers want to wait for the further development of the situation in order to assess the inflation outlook in the medium term. From this point of view the important factors for the MPC may be: the new NBP's inflation and GDP projection due for release in early July as well as the inflation figures for the upcoming months. In our view, in the near future the conditions triggering the risk of second round effects and of persistence of CPI above medium-term target will remain valid.

Market monitor









Possible zloty weakening after slight appreciation

- Just as we expected, last week the EURPLN rate dropped moderately. The zloty was supported by: MPC decision, the government's decision to sell 10% of PZU shares, deputy finance minister's comment about possibility of exchanging means from foreign issues of bonds as well as loans granted by foreign institutions on the market and by the BGK's exchange of the euro. The rate has tested the indicated level of 3.94 for a couple of days to break it finally on Friday. The domestic currency lost slightly against the dollar due to considerable slump of EURUSD rate. In our view the figures due to release this week will not have a substantial impact on trading in context of clear MPC's message concerning the further development of monetary policy. We expect that the EURPLN rate will not drop below 3.93 persistently. The zloty will be undermined by anticipated by us declines of EURUSD pair, dwindling expectations for rate hikes and the fact that the rate has approached an important support on Friday. Factors limiting the scale of growth can be government's statements concerning further privatisation. Resistance is at 3.96.
- At the beginning of the week the EURUSD rate was stable below 1.47. The single currency was undermined by uncertainty about the bailout for Greece, which was offset by the warning from China against holding excessive dollar-denominated assets. The ECB's signal on hike in July was broadly expected and it has triggered a correction of recent euro appreciation. Also the uncertainty about Greece contributed to weakening of single currency at the end of week. In our view, the rate can continue declining towards support range at 1.435-1.44 at the beginning of the week. Resistance is at 1.47.

Stabilisation after drop of yields

- Last week a substantial strengthening took place on the domestic debt market. At the beginning of the week an upward impulse was due to the fact that the 5 and 10Y bonds' prices has broken through psychological resistance levels. In the following days the demand for domestic assets was supported by MPC communiqué, indicating a pause in rate hikes and by lack of hints about further steps towards monetary tightening by the ECB (this factor has supported the debt on the core markets and the domestic bonds headed in the same direction). This week a raft of domestic data is due to release but we do not expect them to trigger a considerable impulse to sell bonds. A potential rebound after recent strengthening can be rather an effect of profit-taking.
- On the core debt markets the yields dropped at the end of week as compared to its start. At the very beginning the potential to yields' increase was limited by persisting sour sentiment relevant to Greece. A strengthening took place also after ECB press-conference, as the governor did not give clear hints about changes of rates after July.
- At the euro zone peripheries a strong weakening took place due to uncertainty about situation in Greece. At the beginning of the week a German finance ministry's official said that a bailout for Greece is not sure yet. The most substantial sell-off occurred in case of Portuguese, Italian and Irish bonds.

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