

Weekly economic update

25 – 31 July 2011

The previous week began in quite nervous atmosphere, due to persisting concerns about further development of the debt crisis in the euro zone and the deadlock in talks about raising the debt ceiling in the USA. A sell-off on stock markets and increasing prices of assets perceived as safe havens pushed the gold prices and the Swiss franc exchange rate against many currencies (euro, US dollar, British pound, as well as CEE currencies) upwards to new all-time-highs. The following days brought a significant improvement of sentiment amid growing optimism about outcome of the euro zone summit as well as thanks to good earnings reports of companies for Q2. The result of summit in Brussels, where new bailout for Greece was agreed on, was welcomed by the markets with a lot of enthusiasm, which began to wane on Friday. The macro data abroad brought mixed signals about the outlook for economic growth in upcoming months, similarly as in case of domestic indicators (strong labour market figures, weaker industrial output). However, these data were overshadowed by the issue of debt crisis.

After agreement on measures aiming at solving the debt problems in the euro zone, the USA issues will come to the fore, as 2 August is the deadline for making a deal concerning raising the debt ceiling. The most recent information suggests close agreement, which should support the moods. A large raft of important macro releases abroad and upcoming results of companies will influence the expectations about outlook for global economic growth. The domestic retail sales and unemployment figures will probably recede in the background. If there is no new negative information from abroad, boosting risk aversion, the EURPLN may be gradually descending, going below 3.98 and moving towards 3.95.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
MONDAY (25 July)						
No important releases						
TUESDAY (26 July)						
8:00	DE	GfK index	Aug	pts	5.6	5.7
10:00	PL	Unemployment rate	Jun	%	11.8	12.2
10:00	PL	Retail sales	Jun	% YoY	11.8	13.8
10:30	GB	Flash GDP	Q2	% QoQ	0.2	0.5
15:00	US	S&P/Case-Shiller home price index	May	% MoM	0.6	0.7
16:00	US	Consumer confidence	Jul	pts	55.0	58.5
16:00	US	New home sales	Jun	k	320	320
WEDNESDAY (27 July)						
10:00	EZ	Money supply	Jun	% r/r	2.3	2.4
14:30	US	Durable goods orders	Jun	% m/m	0.5	2.1
20:00	US	Fed Beige Book				
THURSDAY (28 July)						
11:00	EZ	Economic sentiment	Jul	pts	104.0	105.1
14:30	US	Initial jobless claims	week	k	415	418
16:00	US	Pending home sales	Jun	% MoM	-2.0	8.2
FRIDAY (29 July)						
11:00	EZ	Flash HICP	Jul	% YoY	2.7	2.7
14:00	PL	Inflation expectations	Jul	% YoY	-	4.2
14:30	US	First GDP estimate	Q2	% QoQ	1.9	1.9
14:55	US	Michigan index	Jul	pts	64.0	63.8

Source: BZ WBK, Parkiet, Reuters

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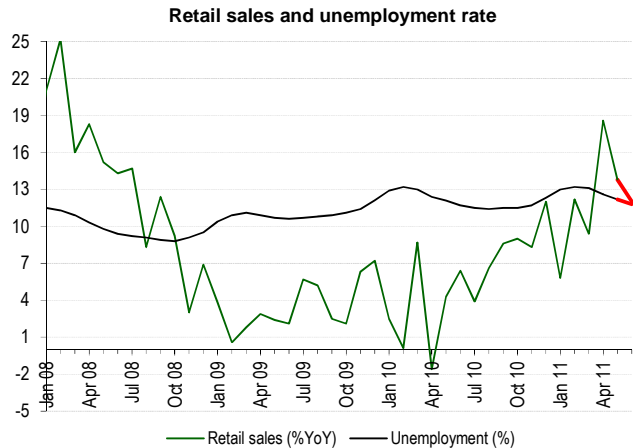
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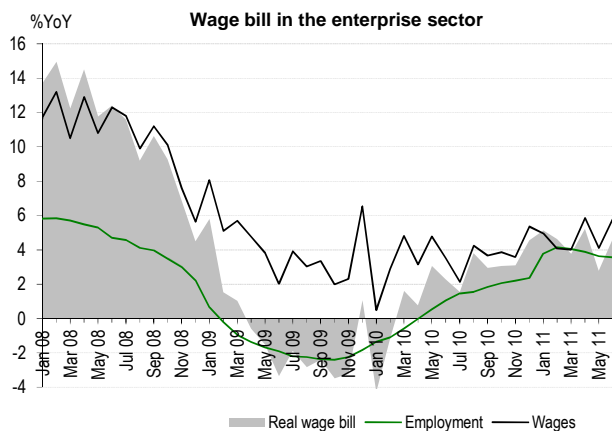
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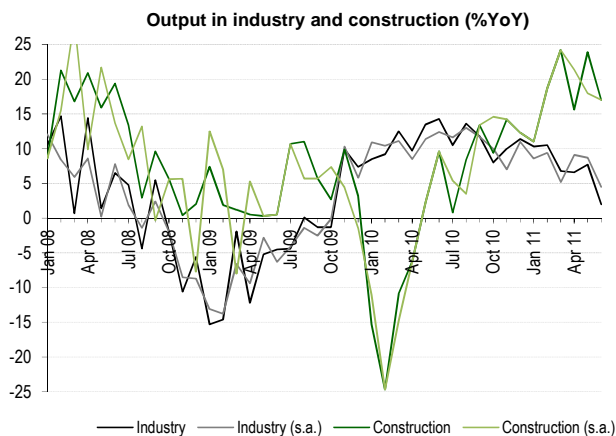
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What's hot this week – Next domestic data overshadowed by events abroad

- Next macro data due for release this week are likely to be overshadowed by developments in the global markets in reaction to outcome of the euro zone summit last week.
- In case of retail sales for June we predict a slight deceleration in annual growth due to quite high base last year. However, still two-digit growth will be a decent result and average growth in Q2 would be in light of our forecasts the highest since Q2 2008 (both in nominal and real terms).
- In line with tentative information from the labour ministry, we expect that the registered unemployment rate in June dropped to 11.8% from 12.2% in May, mostly due to the seasonal effect.
- Inflation expectations may show a rise, following a surge in May inflation to 5%.

Last week in the economy – Output below expectations, labour market figures surprised on the upside

- Annual wage growth in corporate sector accelerated in June to 5.8% from 4.1%. This was probably partly a result of wage raise with compensation for January-May in the mining industry, but a full assessment will be possible after release of CSO' Statistical Bulletin.
- Employment in companies expanded in June by 0.2%, stabilising the yearly growth at 3.6%. After 3 months' stagnation, a considerable rise in employment supports our expectations for further increase in labour demand in H2.
- Annual growth of nominal wage bill rose to 9.6% from 7.9% in May. The real pace improved even more substantially – to 4.6% from 2.8%. The growth of wage bill means that on average in Q2 it was not much lower than in Q1, which supports our estimate that slowdown in private consumption growth in Q2 was not significant (to 3.8% from 3.9%).



- The increase of industrial output amounted to 2%YoY, the lowest since October 2009. We have entered a period of a slowdown in Polish industry, which is caused by waning economic activity abroad. Nevertheless, we see the June's figure, similarly as the May's one (7.7%YoY) as a deviation from trend. In H2 we expect an average pace of growth of industrial output to sit near 5%YoY.
- Construction output in June rose by 17%YoY, confirming continuation of revival in investment activity, based to a large extent on realisation of infrastructural projects.
- PPI dropped in June to 5.6%YoY, suggesting a weakening of price pressure at the producers level. The core inflation stabilised at 2.4%YoY in spite of drop in CPI. We expect the core inflation to increase in the upcoming months.

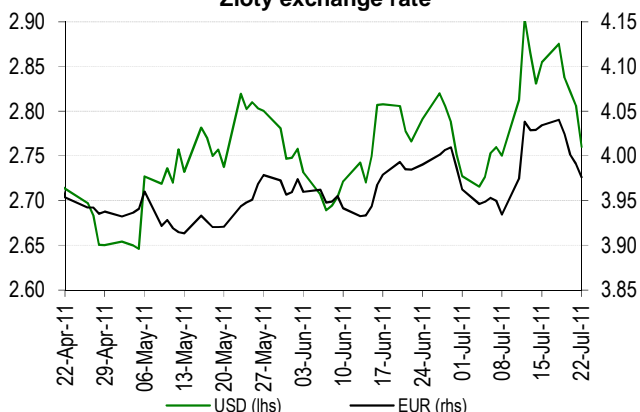
Quote of the week – The trends we are observing now justify hikes**Anna Zielińska-Głębocka, MPC member, Bloomberg, 22 July**

The trends we are observing now justify one or two hikes within the next two to three quarters, although I wouldn't set the timing. (...) Even if it [inflation] stops rising and hovers above 3.5 percent, that would still be an important reason to act. (...) Another important factor, besides core inflation, is wage demands. Up to this time they have been moderate and there are no signs of second-round effects. Still, high inflation can enhance the wage pressure. This is another reason for continuing the hiking cycle. (...) Real interest rates are very low, so I'm not concerned that we'll hurt economic activity.

After the last MPC meeting the NBP Governor Marek Belka said that the assessment of financial market, which does not rule out hikes this year, is not far away from the feeling of most MPC members. Since then, the market's assessment altered slightly (after lower than expected CPI and industrial output figures), but some MPC members still consider a continuation of hiking cycle. Anna Zielińska-Głębocka belongs to hawkish faction in the MPC, so her opinion does not necessarily has to be representative of the majority, but the expected by us scenario for inflation and labour market situation should convince the MPC in the autumn that a slight upward correction of interest rates is justified.

Market monitor

Zloty exchange rate

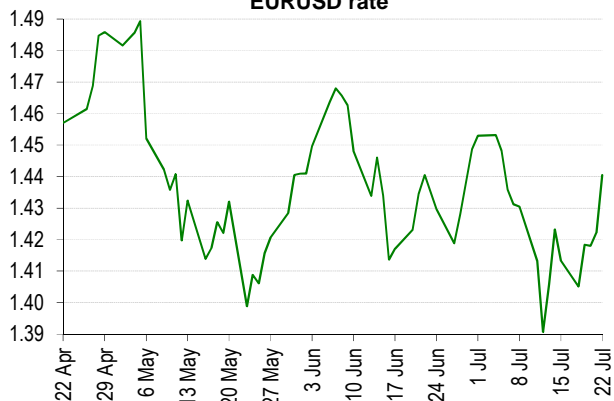


Zloty may strengthen

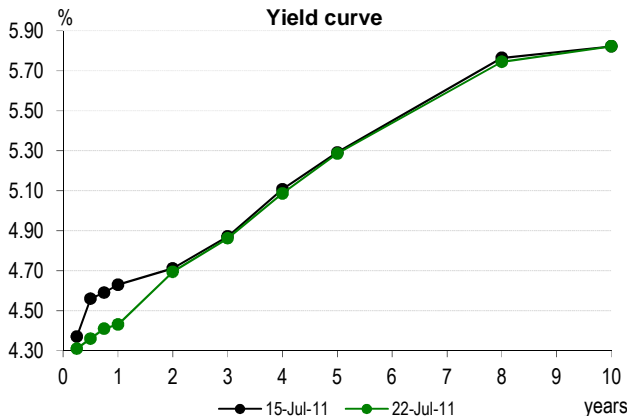
▪ The beginning of the previous week was, similarly as the one before, rather nervous. A sell-off on stock markets due to euro zone and US debt problems pushed the EURPLN rate upwards, above 4.04, and the CHFPLN to ca. 3.54. The euro also hit all-time low versus the franc (EURCHF dropped to ca. 1.14). In the following days a moderate optimism about the outcome of summit in Brussels and good companies' results increased gradually the risk appetite and strengthened the zloty. EURPLN broke a psychological barrier at 4.00 and temporarily dropped below 3.98 after agreement on bailout for Greece was announced. The satisfactory for the markets outcome of the euro zone summit caused a major strengthening of single currency. The EURUSD rate climbed on Thursday to 1.44. On Friday a profit taking after euro zone summit occurred, weighing on the euro and zloty.

▪ The decisions made in Brussels allayed concerns about solvency of Greece and other European countries, but the question is for how long. The Friday's abating optimism indicates that the markets are still anxious. In the upcoming days the markets will be awaiting results of negotiation in the US Congress about raising the debt ceiling. It seems that a deal will be made before deadline on 2 August, which should support the moods. Nevertheless, the exchange rate market may be still volatile. The EURUSD rate can hover in 1.400-1.445 range, similarly as in the previous week. If there is no renewed risk aversion, the EURPLN may breach the support 3.98 again, moving towards 3.95; the resistance is at 4.00 and next at 4.04.

EURUSD rate



Yield curve

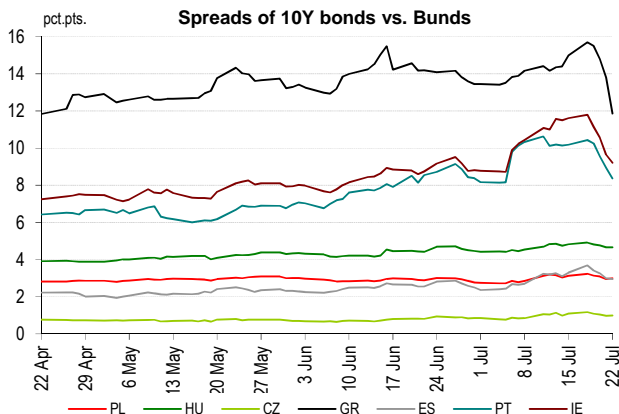


Possible correction in debt market

▪ Risk aversion seen at the start of the week triggered a rise in yields of domestic bonds, which was cancelled out in the following days, under influence of cautious optimism regarding the aid package for Greece and (to smaller extent) after publication of lower than predicted data on industrial output growth. At the auction of 10Y bonds investor's demand was not as high as expected, which triggered a minor correction. After profit taking on Friday, yield curve ended the week only marginally below previous Friday's close. Bonds in core debt markets weakened considerably after the announcement of deal on support for Greece (yields of 10Y Bunds and Treasuries peaked at 2.93% and 3.03%). Also, the CDS rates of euro zone peripheral countries and their spreads versus German Bunds dropped markedly.

▪ This week, we do not exclude a continuation of correction in the Polish bond market, following the recent strengthening. Especially that domestic data on strong retail sales growth and high inflation expectations may reinforce market expectations for a rate hike after the holiday break. The deal in the US on lifting the debt limit may support the US Treasuries, but will be negative for Bunds, decreasing the global risk aversion.

Spreads of 10Y bonds vs. Bunds



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