Bank Zachodni WBK

Weekly economic update

20 – 26 June 2011

The beginning of the last week saw a decrease of risk aversion after its surge before the weekend, although the situation in Greece was still the most important issue for investors. The prolonging stalemate in talks about participation of private investors in second bailout for Greece has triggered a rapid surge of risk aversion, which was reflected in depreciation of the euro versus the dollar and especially versus the Swiss franc. The decline in risk appetite contributed to substantial zloty weakening and to increase in bond yields on the domestic debt market. The Polish bond yields were also pushed upwards by the inflation data, which clearly surprised on the upside. A further sell-off on the domestic debt market was halted by dovish wage figures, by comments of the MPC members which calmed expectations for a rate hike in July, and by the Friday's agreement between Germany and France about the voluntary participation of private investors in aid package for Greece. The latter factor has pushed the EURUSD upwards and has supported the zloty as well, helping it to pare some losses.

Though details on establishing new package for Greece need to be approved, it seems that at least at the beginning of the week the global market sentiment will be quite positive. In the following days the case of Greece will of course be vital, though the uncertainty may be limited. In such conditions big impact on the market may have macro data from major economies released along the week. Flash PMI indexes will probably confirm coming economic slowdown. In the US, data from the real estate market will be released and after last week's positive surprises they will probably fuel expectations for readings above forecasts. Also the Fed's assessment of the economic outlook expressed in the communiqué after the meeting will be crucial. Domestic data shall not have impact on the market. The improvement of market sentiment will support the zloty and latest weakening on the domestic market may trigger demand for bonds leading to recovery.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (20 June)					
10:00	EZ	Current account	Apr	€bn	-6.6	-	-3.8
		TUESDAY (21 June)					
DE	11:00	ZEW index	Jun	pts	-3.5	-	3.1
US	16:00	Home sales	May	m	4.85	-	5.05
		WEDNESDAY (22 June)					
PL	**10:00**	**Retail sales**	**May**	**%YoY**	**13.1**	**14.6**	**18.6**
PL	**10:00**	**Unemployment rate**	**May**	**%YoY**	**12.1**	**12.1**	**12.6**
PL	**14:00**	**Core CPI**	**May**	**%YoY**	**2.2***	**2.4**	**2.1**
EZ	16:00	Consumer confidence	Jun	pts	-	-	-9.7
US	18:30	Fed decision		%	0.0-0.25	-	0.0-0.25
		THURSDAY (23 June)					
4:30	CN	Flash PMI – manufacturing	Jun	pts	-	-	51.6
9:28	DE	Flash PMI – manufacturing	Jun	pts	57.0	-	57.7
9:58	EZ	Flash PMI – manufacturing	Jun	pts	53.7	-	54.6
14:30	US	Initial jobless claims	week	k	415	-	414
16:00	US	New home sales	May	m	0.31	-	0.32
		FRIDAY (24 June)					
10:00	DE	Ifo index	Jun	pts	113.6	-	114.2
14:30	US	Durable goods orders	May	%MoM	1.0	-	-3.6
16:00	US	Final GDP	Q1	%QoQ	1.9	-	3.1

Source: BZ WBK, Parkiet, Reuters

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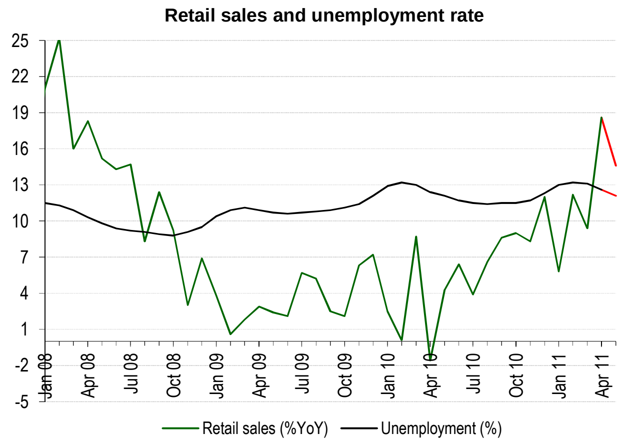
What's hot this week – Marco data from Poland and abroad, Fed's decision and Greek problems

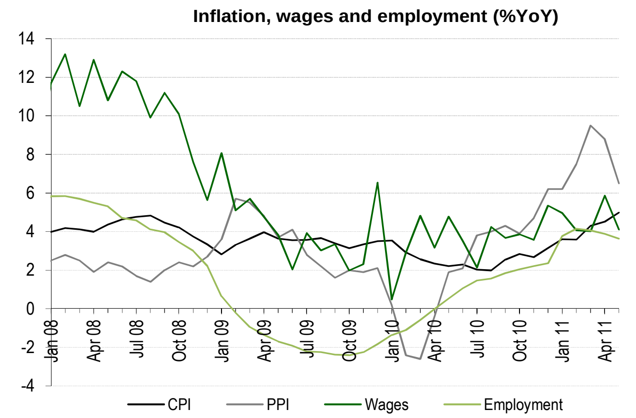


▪ After unusually weak retail sales growth in March and Easter-related acceleration in April, we think that in May the annual sales growth approached the average for two previous months, and was above 14%. Nominal sales growth was positively affected by a clear rise in prices.

▪ We expect a continuation of seasonal drop in registered unemployment rate in May (to 12.1%). Latest Labour Ministry's forecast shows a decline in jobless rate to 12.2% in May, while earlier deputy labour minister Czesława Ostrowska have hinted that a decline may amount to 0.5-1.0 pp (from April's 12.6%).

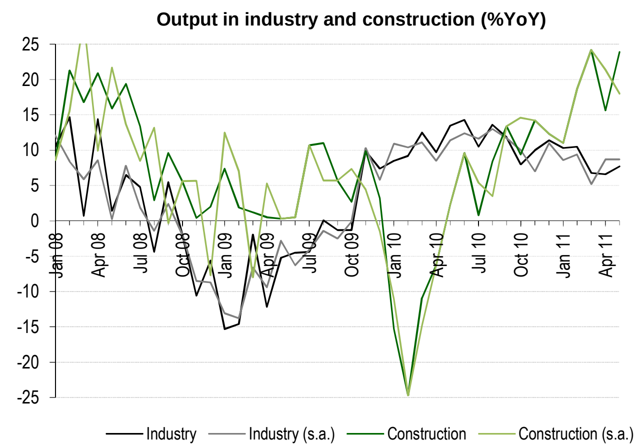
▪ After CPI data release, we have increased estimate of core inflation excluding food and energy prices from 2.3% to 2.4%YoY. The data will confirm that exogenous inflationary impulses are spreading to other price categories.

Last week in the economy – Inflation up, wages down



▪ CPI inflation proved to be surprisingly high in May, rising to 5.0%YoY from 4.5% in April. Monthly rise in prices was 0.6%, versus 0.3% expected by us. What is important, even though the biggest impulse came from food prices, a price rise was quite broad-based, signaling a strengthening of inflationary pressures in the economy.

▪ Data from the labour market in corporate sector were a negative surprise, and have shown a halt in positive changes in the labour market in May. Nevertheless, we think this may be a temporary pause, rather than a signal of reversal. We predict a continuation of moderately fast employment growth later this year, accompanying investment revival, and a clear acceleration in wage growth in corporate sector.



▪ Data on industrial output were roughly in line with forecasts (7.7%YoY rise), and construction output surprised on the upside, growing by 23.9%YoY. This confirms that GDP growth in Q2 is likely to stay above 4%. PPI inflation was lower than forecast, yet remains at elevated level, creating a risk of passing through high producer costs on retail prices.

▪ Balance of payments data for April surprised, showing stronger than expected exports and imports, amid current account deficit close to market consensus. Solid rise in foreign trade volumes could have resulted from a delay of some transactions from March, which in turn was particularly weak.

▪ As regards money supply data, one should note a rapid growth in loans for companies, which may confirm an ongoing investment revival.

Quote of the week – The Council will not panic

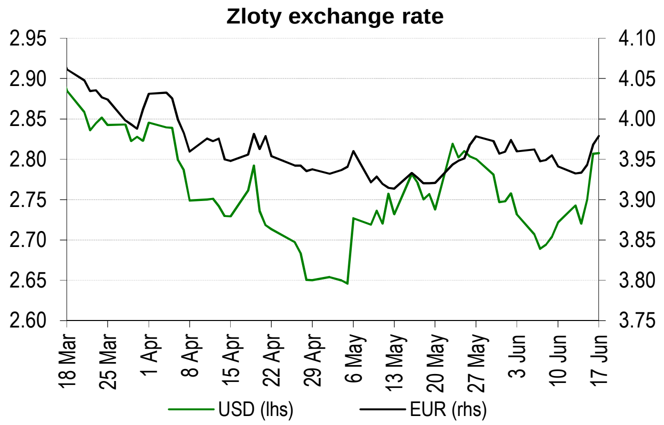
Marek Belka, NBP governor, Reuters, 15th June
The (Monetary Policy) Council will certainly not panic now. It won't start behaving in a manner inappropriate for the economy.

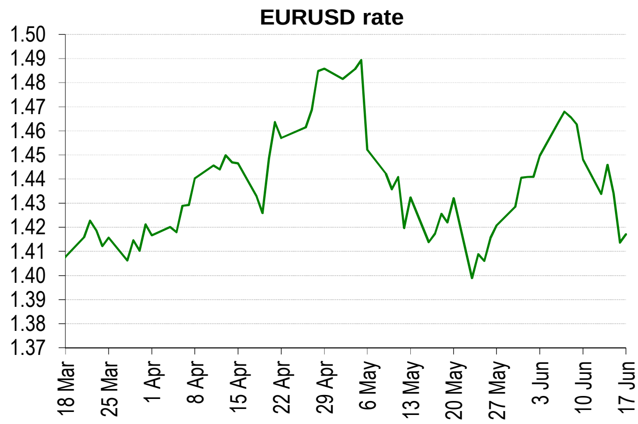
Andrzej Bratkowski, MPC member, Bloomberg, 16th June
We have got room to wait for the effects of four rate hikes and I don't expect anything that could force me to vote for a fifth one before the end of this year. If we keep on raising rates as long as inflation exceeds the target, we would overshoot. A maximum of four quarters should be enough to see the inflation rate returning to a decent level

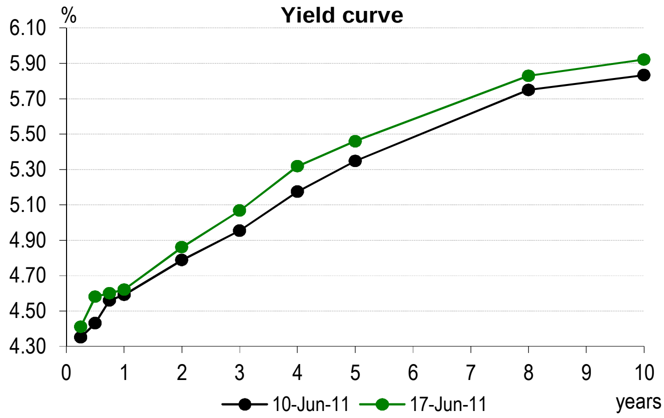
Elżbieta Chojna-Duch, MPC member, Reuters, 15th June
Talking about potential further interest rate hikes is premature. After analyzing situation in July and August, the MPC will make decisions taking into account outlook for inflation's return to the target.

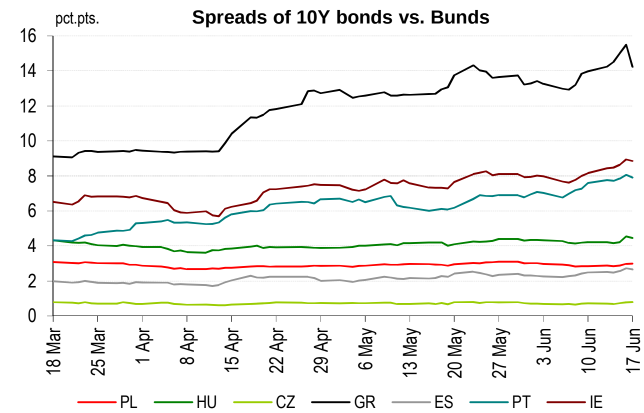
Immediately after surprising data on May's CPI, there appeared comments of the MPC members calming down market expectations for a rate hike at the nearest MPC meeting. Comments of the "dovish" Chojna-Duch were nothing surprising, similarly as those of the NBP president. Nevertheless, even Andrzej Bratkowski, perceived as a "hawk", presented a very "dovish" view. Although after the CPI data one could have stated that outlook for inflation's return to the target has deteriorated (which was indicated in the latest MPC statement as a condition for further monetary tightening), after a series of comments of the Council members and next data it seems clear that there will be no interest rate hike in July. We do not change our forecast, assuming the next rate hike in the autumn.

Market monitor









Possible slight appreciation of zloty

▪ Just as we expected, last week the zloty depreciated, although more markedly due to unexpected increase of risk aversion. The peak of this move took place on Wednesday, when the domestic currency weakened by 0.04PLN versus the euro and by 0.08PLN by the dollar, the EURPLN and USDPLN rates climbed to their highest levels since end-May. As we anticipated, the domestic data did not have a considerable impact on the zloty. Only after CPI figures the EURPLN rate dropped by 0.01PLN, but this move proved to be only temporary. The ERPLN rate did not approach the psychological level of 4.0 and slid to 3.97 due to improving market sentiment. We expect that the potential to further zloty depreciation is currently limited. The domestic currency may be underpinned by improved global market sentiment and more probable increase of EURUSD rate. In our view this week the EURPLN will stay in 3.94-4.00 range and the data due to release will not affect the market.

▪ The EURUSD rate rebounded at the beginning of the week from the support area at 1.435-1.440. The concerns about Greece, which were bolstered due to impasse about participation of private investors in bailout, have pulled the rate to its lowest level since end-May. The raft of positive US data and the announcement by German chancellor and French president that they agreed on the participation of private investors in Greek bailout has calmed the sentiment, which helped the euro to pare some of its losses. The rate rebounded from a major support at 1.400-1.405 and in our view at the beginning of week the euro can continue to pare the losses from the last two weeks. Resistance is at 1.44.

Fall in yields after a market weakening

▪ The past week brought weakening of the domestic fixed income market. The biggest move occurred on Wednesday when first the worries over Greece cumulated, and second, the higher than expected data on CPI was released. The short end of the curve was most affected by the inflation data and that decided on flattening of the domestic yield curve. Clear improvement of the global market sentiment on Friday may support long term bonds at the beginning of the week. Additionally, the information from the domestic FinMin that 70% of borrowing need is already covered may support long end of the curve. The potential for strengthening may be limited by possible increase of yields on the core fixed income markets. The weakening from the past week may be also utilized to purchase 2Y bonds, especially after dovish signals from the MPC.

▪ Sudden increase of risk aversion that occurred in mid-week pushed investors towards safe heaven what dragged yields of long term German and US bonds to the lowest level since January 2010 and December 2011 respectively. Friday's improvement of the market sentiment encouraged investors to sell Bunds and Treasuries.

▪ On the peripheries of the euro zone spreads of Greek and Irish bonds' yields versus Bunds were rising for the better part of the week. Smaller depreciation of bonds was seen in case of Portugal, Spain and Italy. The Friday's announcement by German chancellor and French president on voluntary participation of private investors triggered visible strengthening on the euro zone's peripheries what was accompanied by rising yields of Bunds.

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