Bank Zachodni WBK

Weekly economic update

27 June – 3 July 2011

Information from Greece is still the main factor driving the markets and there is nothing to suggest that this situation may change. The previous week showed a rollercoaster of moods in the market and another factor behind it, except the sovereign debt crisis, was another set of disappointing macroeconomic data releases, which suggested the economic slowdown. Despite significant shifts in market moves, the zloty only temporarily (during the long weekend in Poland) broke the range, which we suggested a week ago, and traded between 3.972 and 4.018 against the euro. On the bond market, yields were in the downward trend driven, among others, by information on limited supply of Treasury papers this year.

This week we will see a number of data from abroad (flash HICP in the euro zone, consumer confidence, home price index in the US, among others), but still in terms of international events influencing the Polish market, the voting on reform package in Greece will come to the fore. Assuming that the parliament accepts the proposed solutions, which is necessary for another financial aid from EU and IMF, the appetite for riskier assets should increase. At the same time, however, on the domestic market we will see the publication of long-awaited revision of balance of payments statistics. A few months ago, worries regarding significant revision of current account deficit as a result of reclassifying large "errors and omissions" balance into higher imports, led to weakening of the Polish currency. Therefore, the Wednesday's release may have impact on the zloty. Also, this week data on inflation expectations will be published (another increase) as well as PMI index for June (another fall). We maintain the range of 3.94-4.00 against the euro for this week, assuming approval for reforms in Greek parliament (if no, EURPLN will rise again above 4.0).

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (27 June)					
14:30	US	Consumer spending	May	%MoM	0.1	-	0.4
14:30	US	Personal income	May	%MoM	0.4	-	0.4
14:30	US	Core PCE	May	%MoM	0.2	-	0.2
		TUESDAY (28 June)					
8:00	DE	GfK index	Jul	pts	5.3	-	5.5
10:30	GB	Final GDP	Q1	%QoQ	0.5	-	0.5
15:00	US	S&P/Case-Shiller home price index	Apr	%MoM	-0.2	-	-0.2
16:00	US	Consumer confidence	Jun	pts	60.5	-	60.8
		WEDNESDAY (29 June)					
11:00	EZ	Economic sentiment	Jun	pts	105.0	-	105.5
14:00	**PL**	**Current account***	**Q1**	**€m**	**-**	**-**	**-5.28**
16:00	US	Pending home sales	May	%MoM	2.9	-	-11.6
		THURSDAY (30 June)					
11:00	EZ	Flash HICP	Jun	%YoY	2.8	-	2.7
14:00	**PL**	**Inflation expectations**	**Jun**	**%YoY**	**-**	**-**	**4.3**
14:30	US	Initial jobless claims	week	k	420	-	429
15:45	US	Chicago PMI index	Jun	pts	54.0	-	56.6
		FRIDAY (1 July)					
4:30	CN	PMI – manufacturing	Jun	pts	-	-	51.6
9:00	**PL**	**PMI – manufacturing**	**Jun**	pts	-	**51.8**	**52.6**
9:58	EZ	PMI – manufacturing	Jun	pts	52.0	-	54.6
15:55	US	Michigan index	Jun	pts	71.8	-	71.8
16:00	US	PMI – manufacturing	Jun	pts	51.5	-	53.5

Source: BZ WBK, Parkiet, Reuters *revision of historical data will be also released

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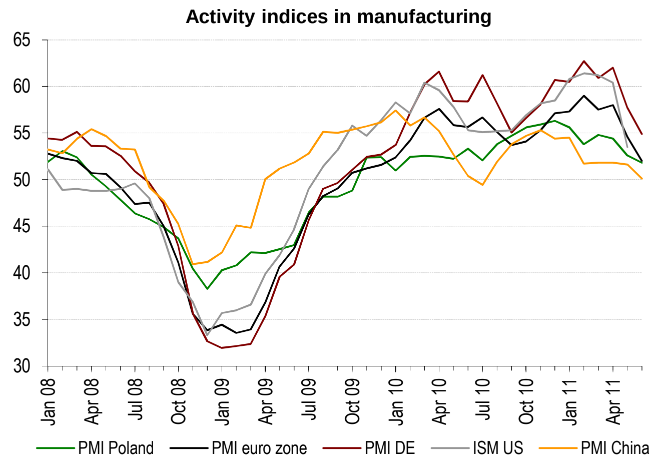
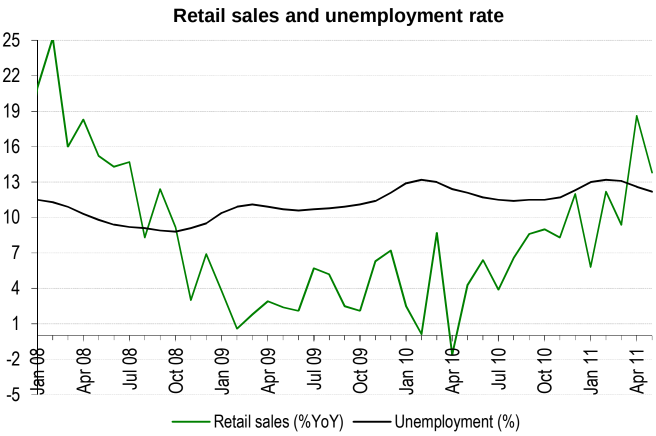
What's hot this week – Greece, balance of payments, inflation expectations, PMI

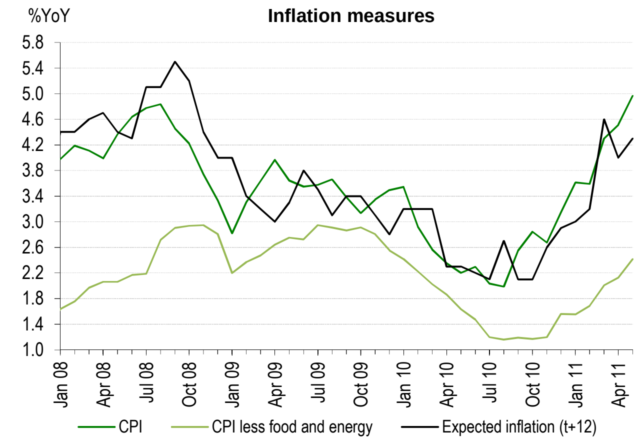


- Except events in Greece, the Polish market will certainly pay attention to quarterly balance of payments data. It is worth to remind that in March the issue of possible significant upward revision of C/A deficit (and quite weird speculation on following GDP downward revision) had contributed to zloty weakening. In our opinion, 1-2% of GDP higher current account deficit may be expected (with no material impact on GDP, which we will know with some delay).
- Flash PMI data for Germany and the euro zone showed significant decrease in activity. The Polish indicator will not be immune to international events, though we forecasts it to fall on a lower scale than in Europe – to 51.8 pct from 52.6 in May.
- The NBP will publish inflation expectations measure for June, which is likely to rise again from 4.3% in May.

Last week in the economy – Strong increase in sales and core inflation



- Retail sales increase by 13.8%YoY was close to our forecast and did not surprise the market either. Just as we expected, the annual pace of growth, after April's surge due to Easter, decelerated to the average from March and April (14%). Data did not change the picture as regards Poles' propensity to consume at quite high level and confirmed our expectations that consumers' demand should be, together with fixed investments, the drivers of GDP growth in coming quarters.
- The unemployment rate declined to 12.2%, slightly less that we and the market expected (12.1%).
- Business confidence index calculated by the CSO showed that the situation in manufacturing in and retail trade deteriorated versus May while conditions in construction output improved.



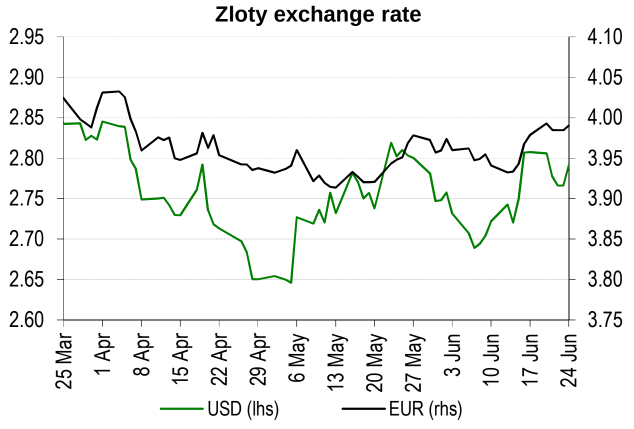
- According to NBP's data the core CPI (inflation excluding food and energy prices) advanced from 2.1%YoY to 2.4%YoY. Other inflationary measures also recorded increases by 0.3-0.5pp and reached from 3.2% to 4.8% in May. The data were in line with our expectations and confirmed that rising upward trend in inflation was not purely driven by supply-side shocks, such as high food and fuel prices globally.
- We expect that in the environment of improving labour market conditions private consumption growth will be maintained at relatively high level and the rising trend in core inflation will be continued. This will support further increase (or at least stabilisation) of inflation expectations at elevated level, which will force the MPC to continue monetary policy tightening.

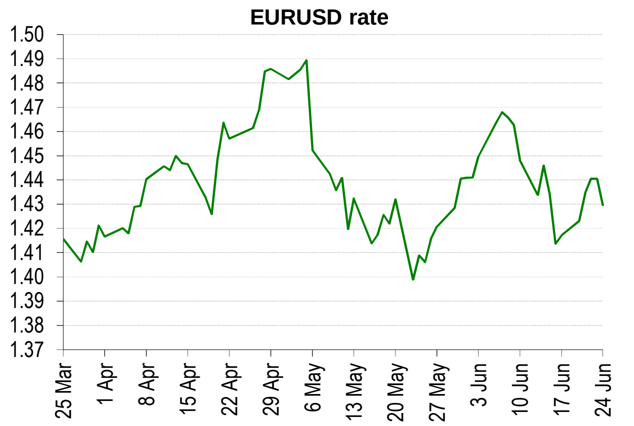
Quote of the week – Small rate increases failed to bring effects

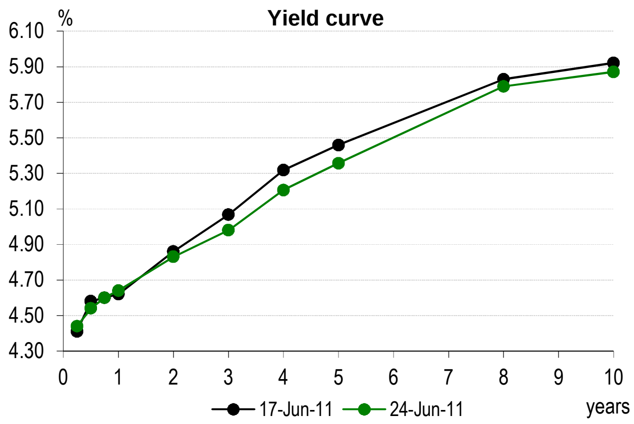
Andrzej Kaźmierczak, MPC member, Bloomberg, 20th June
Small and gradual rate increases have so far failed to bring the desired effects as they neither slowed inflation, nor calmed inflation expectations. In this situation, I'm determined to continue monetary-policy tightening and the May inflation data only strengthened my determination to do so. (…) The Monetary Policy Council may need to continue a restrictive policy during 2012, which may limit economic growth to below 4% next year. Expectations for a neutral bias in monetary policy are premature. (…) There is some light at the end of the tunnel as private investments are growing, including investments financed from loans. This means the interest-rate increases haven't limited corporate demand for loans, which leaves some space for tightening rates.

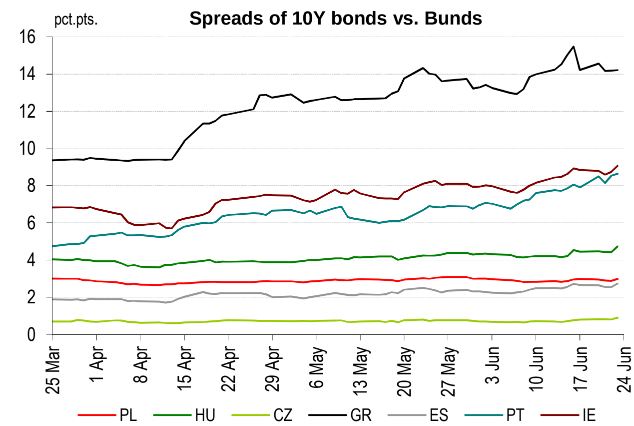
In the interview with Bloomberg, Andrzej Kaźmierczak from the MPC, until recently regarded as one of the opponents of aggressive monetary tightening, stated that "small and gradual rate increases have so far failed to bring the desired effects". Kaźmierczak was definitely impressed (not for the first time) with the CPI inflation figure, as well as inflation expectations. It seems likely that he would probably vote in favour of rate hike already in July. On the other hand, we remember the recent comment by usually hawkish MPC's Bratkowski, who announced no support for hike this year. Overall, we think it will be difficult to gather majority of votes in favour of another rate hike already next month, though later in autumn there will be a majority for such a move.

Market monitor









Zloty in hands of Greeks

▪ Zloty exchange rate remained last week under influence of sentiment abroad. Successful confidence vote for the Greek government was only a temporary support for the market, and in the second half of week the risk aversion surged after weak macro data, concerns about global economic growth, and situation in Greece. Zloty weakening peaked on Thursday, in the absence of local investors, when EURPLN approached 4.02, and CHFPLN 3.40. In sum, zloty only temporarily soared above the fluctuation band against euro predicted by us. Situation this week depends in fact on Greek parliament's decision on the austerity package (vote planned on Tuesday-Wednesday). If, as we assume, bills are passed, we may see a clear decline in risk aversion and rebound in the zloty. In this scenario we maintain a range of EURPLN fluctuations 3.94-4.0. Rejection of reform package would imply further correction and EURPLN above 4.0. Zloty may be also affected by the revision of balance of payments data by the NBP.

▪ EURUSD, as we expected, was rising in the first part of the week. After breaching the resistance 1.44, upward trend stopped, and then a sudden rise in risk aversion after weak PMIs and Fed decision triggered a trend reversal, so the dollar erased all losses incurred earlier in the week (EURUSD down to 1.412). On Thursday there was another partial recovery, after EU declaration of help for Greece. Despite quite large number of data releases this week, investors' attention will focus on Greece. In case of passing the reforms, resistance 1.44 will be tested again.

Possible decline in yields

▪ On the domestic debt market at the start of the last week there was a clear strengthening in reaction to comment of deputy finance minister Dominik Radziwiłł about possible reduction of debt supply in the remaining part of this year thanks to securing large part of borrowing needs. Domestic data on retail sales and unemployment had no significant impact on the market, and Thursday's market holiday effectively reduced investors' activity in the second part of the week. Assuming approval of austerity plan in Greece, a fall in risk aversion may help in yields' decrease at the long end of the curve this week. We do not expect large changes at the short end, although a rise in inflation expectations may boost market's pricing of MPC's rate hikes.

▪ Yields in core debt markets were following changes in risk aversion. Initial rise in yields was cancelled on Thursday after poor macro figures and Fed decision, when world equity markets plummeted. On Thursday Treasuries weakened after better data from the US (10Y yield at 2.9%), but Bund yields remained low (2.84%) due to investors' doubts whether Greek will manage to avoid a default.

▪ Bond spreads of peripheral countries of the euro zone against Bunds increased last week, which was obviously driven by uncertainty regarding fiscal and political situation in Greece. Some recovery was visible at the end of the week, though the market participants are aware that the announced agreement between the EU and Greek government will be effective only if the voting on austerity programme in Greece (as a precondition of financial aid) is successful.

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