

Eyeopener – Returning fears about euro zone

17 May 2010

- **Returning fears about fiscal problems of the euro area – common currency under pressure, EURUSD below 1.23**
- **Good macro data from the US helped the dollar, but did not stop decline in stock markets**
- **Higher risk aversion weakened the zloty, but domestic bonds little changed**
- **Today, T-bills auction and balance of payments data in Poland, few publications in the US**
- **During the week, large number of key data releases in Poland and abroad, however markets will focus on situation in credit markets**

Friday brought intensification of concerns over the debt problem in the euro zone. The market is concerned not only about the effectiveness of actions leading to prevent spreading of problems of Greece on other countries, but also about the influence of the planned fiscal consolidation on economic growth prospects and even on possibility of euro zone disintegration. Consequently, the single European currency weakened on Friday to the lowest level since the collapse of Lehman Brothers in September 2008. At the end of the Polish session the EURUSD rate was slightly above the daily minimum at 1.242. During the weekend and today in the morning the sell-off of the euro was continued and the rate fell below 1.23. Concerns over the euro zone negatively affected the behaviour of world stock markets and behaviour of emerging market currencies, also in our region. The zloty clearly depreciated against the major currencies. At the end of the session the EURPLN rate was at 4.013, and the USDPLN rate was at 3.228 against 3.958 and 3.156 at the opening. Today in the morning the zloty weakened to 4.03 vs. the euro and 3.28 vs. the dollar.

Increase of risk aversion during the Friday session was limited by inflow of quite good macroeconomic data from the US, though at the same time this negatively affected the euro vs. the dollar. US retail sales rose in April by 0.4%MoM against expected 0.2%. Retail sales after excluding car sales also rose by 0.4%, in line with market expectations. Industrial output in the US rose in April by 0.8%, against 0.7% expected. The capacity utilisation in the US companies was at 73.7% in April vs. 73.1% in March, in line with expectations. The consumer sentiment Michigan index rose in May to 73.3 from 72.2 in April, which was below expectations at 73.5.

Higher risk aversion strengthened debt markets. At the end of the day yields of 10Y Treasuries and Bunds were 3.45% and 2.86% respectively.

In the domestic debt market there was steepening of the yield curve. At the short-end yields dropped by 2bps and longer dated bonds increased 3bps. Domestic inflation figures had no impact on the market. CPI inflation in April fell to 2.4%YoY and was slightly above expectations. The most surprising element (again) was substantial increase in prices of clothes and footwear, but it seems

that it was rather temporary phenomenon. As expected, significant rise in fuel prices took place, but in other categories there was stabilisation of prices with no demand-side pressure. CPI inflation excluding food and fuel prices fell below 2% in April. The data did not change inflation outlook for the following months. Money supply growth accelerated to 6%YoY, however was weaker than expected (our forecast 6.2% and market consensus 6.7%). Total loans, after eliminating effect of exchange rate fluctuation, fell by 0.5%MoM, amid rise in households' credit and continuation of decline in loans to corporate sector.

MPC member Andrzej Kaźmierczak said on Friday that the zloty exchange rate should be a key factor for decisions of the Council. In his opinion one cannot allow the EURPLN to approach 3.60, as this would harm the economy. According to him, currently there is no reason for change in informal monetary policy bias.

This week we will get many domestic macro figures. Today the balance of payments for March will be released. We expect a deepening of the C/A gap to €555m amid a significant rise in trade volume. We predict acceleration of exports to ca. 29%YoY and imports to ca. 31%, which would imply a rise in trade deficit. At the same time, we expect improvement in services balance and deterioration in transfers account versus February. For labour market data due for release on Wednesday we predict a slowdown in wage growth in April to 4.1% amid a stabilisation of wage growth in manufacturing and slight acceleration in construction. Lower number of working days may have negative effect on monthly change in salaries. We expect a slight monthly increase in employment and a smaller scale of its decline in year-on-year terms. For output figures to be published on Thursday we expect that industrial production slightly decelerated in April to ca. 11%YoY. This was confirmed by a fall in PMI output component (yet remaining above 50 pts.) and the fact that data for March were affected by higher number of working days. We also expect further bottoming-out in construction sector after delays caused by severe weather conditions at the start of the year. Construction output is predicted to fall by 3.6%YoY. According to our predictions, PPI growth increased in April to -1.5%YoY, mainly due to higher price growth in manufacturing. After publication of CPI data we expect a fall in core inflation after excluding food and energy prices to 1.8-1.9%YoY. In the course of the week we will also get many important data from abroad. Today there will be the New York index and the US report on capital flows.

This week begins with a rise in risk aversion (strong drop in stock markets in Asia, sell-off of the euro). Even if the macro figures due for release this week surprise on the upside, optimism of investors will be constrained by renewed wave of concerns about further developments in the European economy.

ECONOMIC ANALYSIS

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F/X rates (today's opening)

EURUSD	1.2284	CADPLN	3.1597
USDPLN	3.2815	DKKPLN	0.5418
EURPLN	4.0340	NOKPLN	0.5226
CHFPLN	2.8772	SEKPLN	0.4202
JPYPLN*	3.5637	CZKPLN	0.1579
GBPPLN	4.7109	HUFPLN	1.4468

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.9475	4.0320	3.9575	4.0130	3.9852
USDPLN	3.1398	3.2421	3.1543	3.2280	3.186
EURUSD	1.2422	1.2575	1.2548	1.2427	-

T-bonds

TERM	Yield (%)	Change (bp)	Last auction	Average yield
2Y	4.37	-2	5.05	4.802
5Y	5.14	-1	12.05	5.144
10Y	5.65	3	14.04	5.586

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	3.99	-1	0.74	-6	1.08	-4
2Y	4.42	-2	1.12	0	1.24	-2
3Y	4.72	-2	1.59	-2	1.54	-3
4Y	4.96	-1	2.04	-3	1.87	-3
5Y	5.11	-1	2.42	-5	2.17	-4
8Y	5.41	0	3.18	-3	2.85	-5
10Y	5.50	1	3.47	-3	3.13	-5

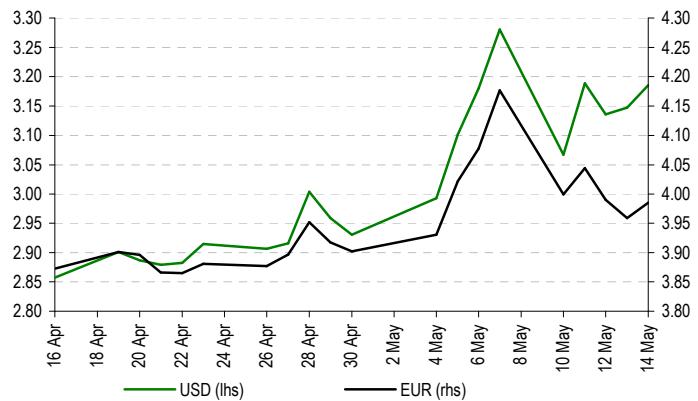
WIBOR rates

TERM	%	Daily change (bp)
O/N	3.29	8
T/N	3.37	5
SW	3.40	0
2W	3.44	0
1M	3.61	0
3M	3.85	0
6M	4.00	-2
9M	4.18	-1
1Y	4.26	-1

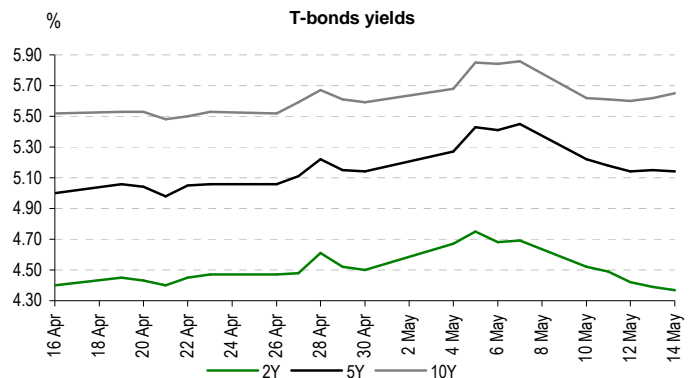
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	3.61	3
3X6	3.86	0
6X9	3.99	-2
9X12	4.22	3
3X9	4.04	-1
6X12	4.19	0

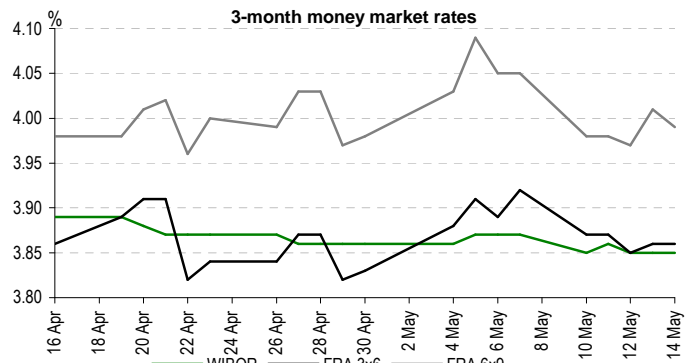
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



* for 100 JPY
Source: Reuters

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