Bank Zachodni WBK

Weekly economic update

20 - 26 December 2010

Last week, though it was full of key data in Poland and abroad, and other economic events, brought neither breakthrough in the assessment of the economic situation in Poland and in the world nor in the market. Optimism in the global markets seen at the start of the week following no interest rate hike in China, later in the week gave way to increased caution of investors after disappointing assessment of economic situation made by the Fed, as well as after decisions of rating agencies (S&P has reduced outlook for Belgium, while Moody's downgraded Ireland and placed Spain on the watch list). As a result, at the start of the week stock prices and the EURUSD were rising, and the zloty strengthened, but later there was a correction in equity markets, decline in EURUSD, and the zloty stabilized in a narrow range just above 3.98 versus the euro. Domestic data showed an unexpected drop in CPI inflation in November, which weakened expectations for monetary tightening by the MPC, and slightly strengthened the domestic interest rate market. Minutes of the November MPC meeting showed that the motions to raise rates by 50 bp and 25 bp were submitted, but this information was ignored by the market. Also weaker than expected data on wages and good results of output in industry and construction had no effect on the market.

This week's agenda of events potentially important for the market is somewhat lighter, but it includes some key factors. Wednesday and Thursday will be particularly important, although the closer Christmas, the lower will be market activity. Amid reduced liquidity, any surprising news may trigger a rise in market volatility.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 December)					
8:00	DE	PPI	Nov	%YoY	4.5	-	4.3
		TUESDAY (21 December)					
8:00	DE	GfK index	Jan	pts	5.8	-	5.5
14:00	**PL**	**Core CPI**	**Nov**	**%YoY**	**1.2**	**1.3**	**1.2**
		WEDNESDAY (22 December)					
	PL	**MPC decision**		**%**	**3.50**	**3.50**	**3.50**
14:00	**PL**	**Business confidence**	**Dec**		**-**	**-**	**-**
14:30	US	Final GDP	Q3	%QoQ	2.6	-	2.5
14:30	US	Core PCE	Q3	%QoQ	0.8	-	0.8
14:30	US	Home sales	Nov	%MoM	4.63	-	-0.7
		THURSDAY (23 December)					
10:00	**PL**	Retail sales	Nov	%YoY	**9.0**	**9.2**	**8.9**
10:00	**PL**	Unemployment rate	Nov	%YoY	**-**	**11.7**	**11.5**
14:30	US	Initial jobless claims	week	k	420	-	420
14:30	US	Durable goods orders	Nov	%MoM	0.4	-	-3.4
14:30	US	Personal income	Nov	%MoM	0.3	-	0.5
14:30	US	Consumption	Nov	%MoM	0.4	-	0.4
14:30	US	Core PCE	Nov	%MoM	0.1	-	0.0
15:55	US	Final Michigan	Dec	pts	72.5	-	74.2
16:00	US	New homes sales	Nov	pts	300	-	283
		FRIDAY (24 December)					
	DE	Market holiday					
	US	Market holiday					

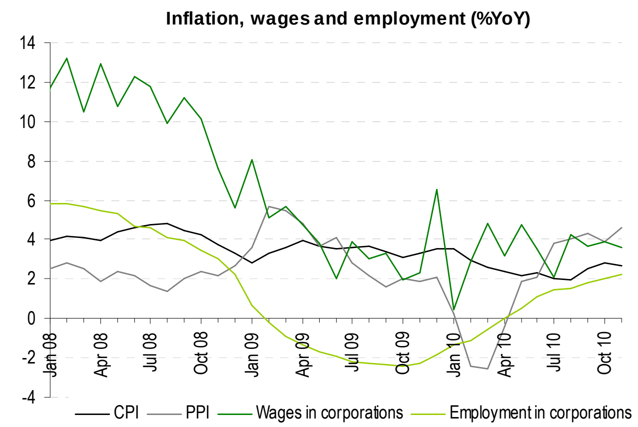
Source: BZ WBK, Reuters, Parkiet

Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Marcin Sulewski (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

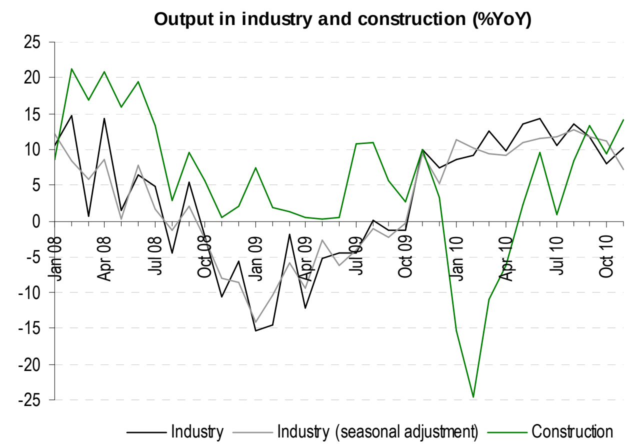
What's hot this week – Fewer data and MPC decision before Christmas

- This week's agenda of events potentially important for the market is somewhat lighter, but it includes some key factors. Wednesday and Thursday will be particularly important, although the closer Christmas, the lower will be market activity. Amid reduced liquidity, any surprising news may trigger a rise in market volatility.
- The most recent economic data and comments from MPC members reinforced our view that interest rates will remain unchanged this year. The tone of the MPC statement and post-meeting comments of its members may be important for the assessment of moment when the rate hikes may start next year.
- We predict slight acceleration in retail sales growth thanks to improvement of households' financial situation and some impact of expected hikes in taxes and prices in the new year. Expected rise in registered unemployment rate was caused by a seasonal effect.

Economy last week – Low inflation and good output data



- CPI inflation unexpectedly fell in November to 2.7% from 2.8%. As compared to previous month, prices inched up by merely 0.1%, amid rise in food prices by 0.2%. Inflation rate remains above the central bank's target, but pressure of the exogenous factors appears to be weaker than we had assumed, and demand-side price pressure remains muted. Nevertheless, we predict a rise in CPI above 3% in December and ca. 3.5% in Q1 2011.
- PPI inflation accelerated in November to 4.6%, mainly due to higher growth in manufacturing prices, which signals building inflationary pressure.
- Employment in corporate sector rose in November by 2.2%YoY, while wage growth slowed to 3.6%YoY. The data confirmed that wage pressure remains limited, despite continuation in the improvement of labour demand.



- Annual production growth in industry and construction returned in November to double-digit levels (10.1% and 14.2%YoY respectively). It confirms that GDP growth in the fourth quarter was at least as high as in the third. At the same time, there is some slowdown in industrial production growth versus three first quarters, and strengthening of construction output growth. Moderate slowdown of external demand growth will be negatively affecting Polish industry, while construction output will be supported by a revival in private investment amid still high pace of realisation of infrastructure projects.
- Current account in October was close to expectations. Annual export growth is slowly being constrained by the effect of growing base from the last year, and in next months and quarters this will be also affected by weakening economic growth abroad.

Quote of the week – MPC still divided on interest rates

Elżbieta Chojna-Duch, MPC member, Reuters, 14 Dec

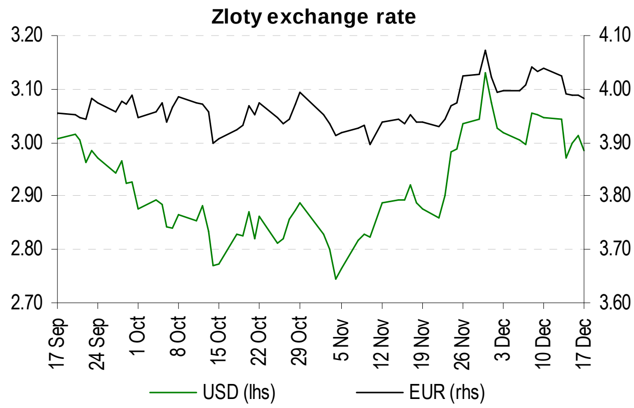
If core inflation kicks in, and economic growth next year remains high and there is no surprises in euro area's peripheral countries, then there will be a need to hike interest rates. For now, the balance of risks is neutral, and this is very important.

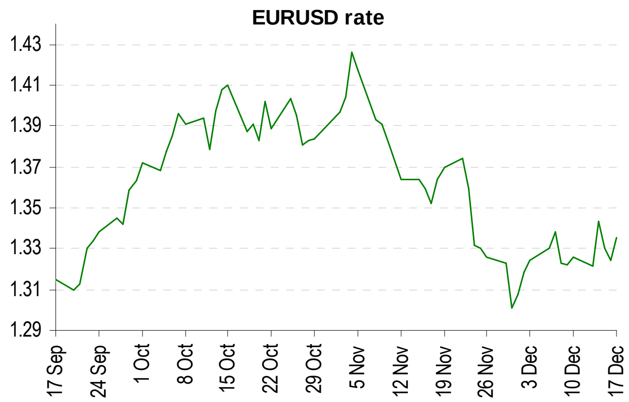
Andrzej Rzońca, MPC member, PAP, 14 Dec

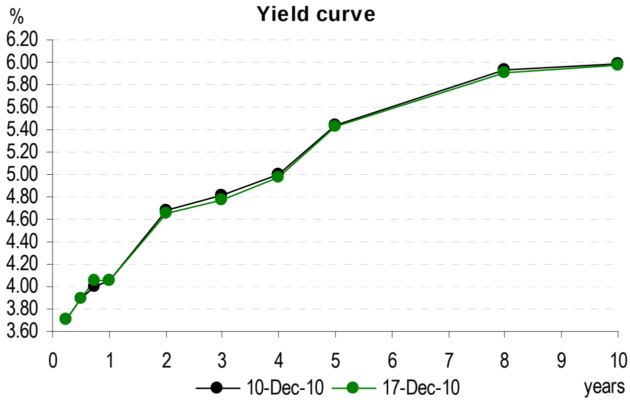
Amid speeding economy the lack of interest rate hikes, aiming at stabilising nominal exchange rate, would lead to sequence of events, which in the extreme case was observed in Baltic states before the crisis. (...) I do not think that stronger than before financial discipline in firms was a permanent change. It seems more likely that companies were strictly controlling costs due to high uncertainty during the financial crisis.

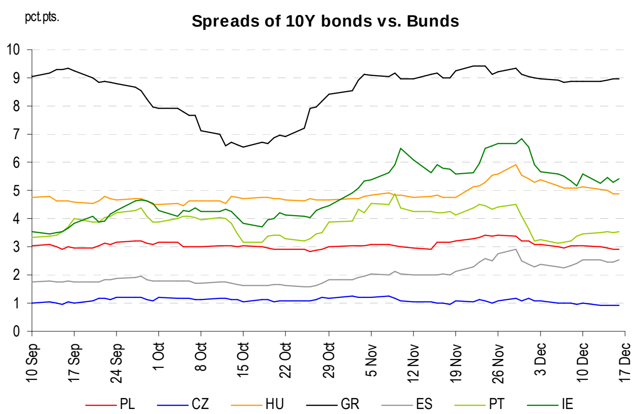
New comments of MPC members did not change our assessment of monetary policy prospects. Elżbieta Chojna-Duch maintains her view that the balance of risks for inflation is even, and the need for rate hikes will appear only when core inflation rises, GDP growth remains high, and situation in euro zone's peripheries will settle down. In turn, according to hawkish Andrzej Rzońca interest rate hikes are needed right now, and efforts to stabilise the exchange rate with interest rate policy (lack of rate hikes to avoid zloty strengthening) may produce fatal results. In Rzońca's view, risks for inflation include possible relaxation of wage discipline in companies, fast credit rise, and lower than in normal circumstances fall in natural interest rate, among others due to a rise in fiscal deficit.

Market monitor









Stabilization after visible appreciation

▪ The optimism that emerged at the beginning of the past week after Friday's decision of the Chinese central bank on leaving the interest rates unchanged pushed the EURPLN down to 3.99 from just above 4.02. Later in the week the horizontal trend prevailed on the market, the exchange rate only temporarily declined below 3.98. In case of the USDPLN, after the drop to 2.95 at the beginning of the week, recovery to above 3.0 occurred later in the week. The CPI data did not influence the zloty, that was under clear influence of swings of global market sentiment, the volatility was limited. This week no major changes shall occur on the EURPLN and USDPLN market. We expect that the EURPLN will rebound slightly from the support level at 3.98 and the USDPLN will be stable at around 3.0 with higher chances for hovering above that level.

▪ On the wave of optimism that emerged after the decision of China central bank, the EURUSD surged from 1.32 at the beginning of the week to nearly 1.35 on Tuesday. Following sessions were pretty calm and until the end of the week the EURUSD remained in the range 1.32-1.34, swinging just as the market sentiment. As the end of the week approached, the euro was under negative pressure, because on the EU summit there were no new decisions made – apart those planned before – to improve the situation on the European debt market. Additional impulse for investors to focus on that issue were decisions of rating agencies (possible downgrade of Spanish rating and Irish rating cut by Moody's). We expect that the exchange rate will be stable, though there may be pressure on the euro due to European debt problems.

Domestic debt stable, higher yields in core markets

▪ Domestic yield curve did not change much over the past week, as low liquidity and occasional activity of investors prevailed. The impact of CPI data was marginal, somewhat bigger downward move was recorded on short term IRS and FRA rates. Also the fact that the MPC voted not only on 50bps interest rates hikes, but also on 25bps hike was ignored by the market. We do not expect that any major changes will occur, though possible another surprise in the MPC communiqué or on the press conference may, due to low liquidity, trigger higher volatility.

▪ On the core debt markets yields increased considerably in the past week. That was caused by optimistic data from the US (on retail sales, industrial output, NY Fed and Philly Fed indexes, from labour and real estate market), that limited demand for safe assets.

▪ The beginning of the past week was pretty stable, as investors awaited the comment after Fed's meeting. Later in the week, due to the prospect of beginning of the EU summit, European debt problems started to play more visible role. The biggest rise of spread versus 10Y Bunds was recorded in case of Portugal, that in market's opinion is still first candidate for using external help. At the other extreme were spreads of Hungarian bonds, where recovery occurred after major sell-out due to local government actions.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl