

# Weekly economic update

17 - 23 January 2011

Last weeks were marked by improvement in sentiment on the global markets due to positive macro figures from major economies. During the past three weeks the zloty gained to levels soon before the NBP intervention in April 2010. Apart from better moods in the global markets, the local currency was positively affected by a series of comments from the MPC – last week from Bratkowski about possible zloty gain to 3.50 versus the euro at year-end and from Winiecki about a need for rate hikes, and the previous week comments from NBP governor Marek Belka that in order to contain inflation the Council want to start the zloty appreciation through beginning a cycle of interest rate hikes. Such message from the MPC (coupled with next rise in Poland PMI and acceleration in CPI inflation above 3%) pushed yields at short end of the domestic yield curve strongly up. The long end also moved higher amid concerns about the euro zone peripherals and negative reaction to announcement of changes in Polish pension system. This week the key event for the Polish market will be the MPC meeting, but important events include also next data locally and abroad, situation in the euro zone debt markets and earnings reports for Q4.

*Parkiet* daily presented final results of macroeconomic forecasts' competition in 2010. We are pleased to inform that our team took the first place with significant advantage over the other financial institutions. In all categories (inflation, labour market, demand, balance of payments) we were in the top three. We also won the competition for best forecasts in Q4 2010. It is worth to remind that in 2008 we took second place and in 2009 the third one and we are the only institution, which maintained the position on the podium for the three consecutive years.

## Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (17 January)</b>							
	US	Market holiday					
<b>TUESDAY (18 January)</b>							
11:00	DE	ZEW index	Jan	pts	10.0	-	4.3
14:00	PL	Wages	Dec	%YoY	3.9	3.1	3.6
14:00	PL	Employment	Dec	%YoY	2.3	2.3	2.2
14:30	US	NY Fed index	Jan	pts	12.0	-	10.57
<b>WEDNESDAY (19 January)</b>							
	PL	MPC decision		%	3.75	3.50	3.50
14:30	US	Building permits	Dec	k	555	-	530
14:30	US	House starts	Dec	k	554	-	555
<b>THURSDAY (20 January)</b>							
11:00	PL	Bond switching auction					
14:00	PL	MPC minutes					
14:00	PL	Industrial output	Dec	%YoY	11.7	15.1	10.1
14:00	PL	Construction output	Dec	%YoY	13.7	3.7	14.2
14:00	PL	PPI	Dec	%YoY	5.3	5.5	4.6
14:30	US	Initial jobless claims	week	k	425	-	445
16:00	US	Home sales	Dec	m	4.83	-	4.68
16:00	US	Philly Fed index	Jan	pts	25.0	-	24.3
16:00	US	Leading indicators	Dec	%MoM	0.7	-	1.1
<b>FRIDAY (21 January)</b>							
8:00	DE	Ifo index	Jan	pts	110.5	-	109.9
14:00	PL	Business climate	Jan	pts	-	-	-

Source: BZ WBK, Reuters, Parkiet

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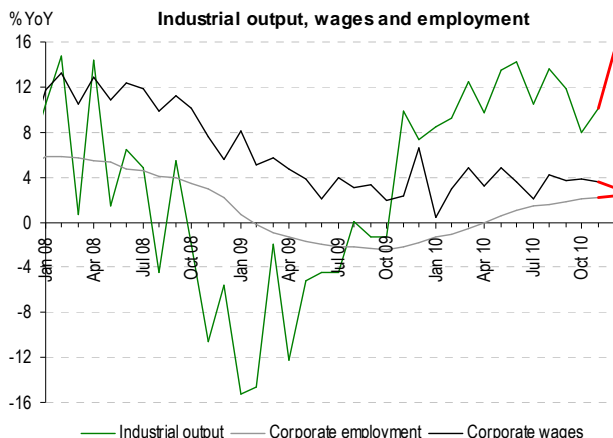
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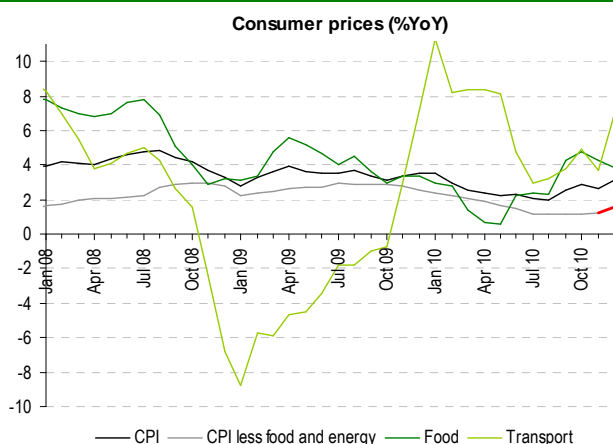
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## What's hot this week – Focus on MPC meeting

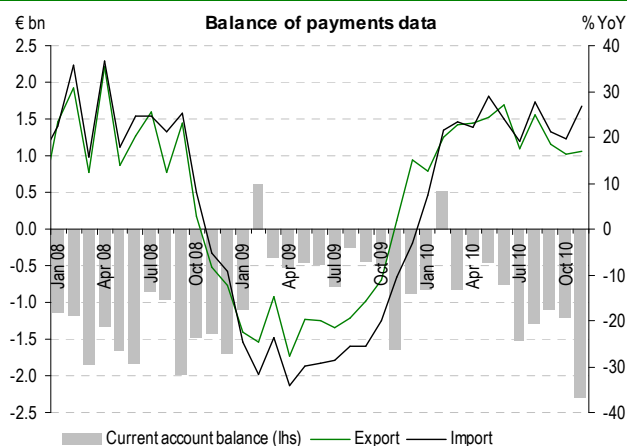


- This week the key event in the Polish market will be the MPC meeting. The Council will not have the full set of monthly indicators for December (data on output, retail sales, PPI will be revealed later). Moreover, only in late January there will be release of tentative GDP figures for 2010 (allowing for estimate of GDP in Q4 alone, including fixed investment while a clear revival in investment activity was seen by some MPC members as a precondition for the first rate hike), only in mid-Feb we will get CPI for January (with effects of VAT hike) and only in late February the new NBP projection will be prepared. However, one cannot exclude the hike will be delivered already in January due to central bankers' concerns about surge in current inflation.
- Apart from the MPC decision, important domestic events this week include labour market statistics and output figures as well as minutes of MPC meeting in December.

## Economy last week – Higher inflation and wider C/A gap



- Annual CPI inflation in December rose to 3.1%YoY from 2.9%YoY in November, in line with market consensus and above our forecast of 3.2%. While annual growth in food prices waned, there was acceleration in growth of energy costs and transport prices. There was also stronger rise in prices of other CPI categories - even stronger than we expected, which increased out estimate of net inflation to 1.6% from 1.5% estimated earlier vs. 1.2% in November.
- The data confirm the upward trend in inflation, which will be continued in the next months.
- MPC members has not commented CPI figures due to a blackout period a week before the meeting this week, but already earlier they nervously reaction to the FinMin's estimate showing CPI inflation exceeded 3% in December. Official CPI figures are a support for hawks in discussion about interest rate hike in January.



- C/A deficit in November was €2.3bn, doubling from October and clearly beating market consensus of €1.35bn and our forecast of €1.8bn. This was the widest monthly C/A gap since January 2000 (in the whole period for which the NBP published data in the current methodology).
- The main reason for the surprise was large rise in trade deficit resulting from weaker than expected performance of exports and stronger than predicted increase in imports. Large deficit on income account (again over €1bn) and deficit on transfers account were broadly in line with expectations.
- Weaker exports results may be related to some weakening in rise of external demand while robust rise in imports suggest strengthening of domestic demand (one cannot exclude this is connected with revival in investment activity which we have been expecting for some time).

## Quote of the week – 2011 will be a year of interest rate hikes

### Andrzej Bratkowski, MPC member, Reuters, 11 Jan

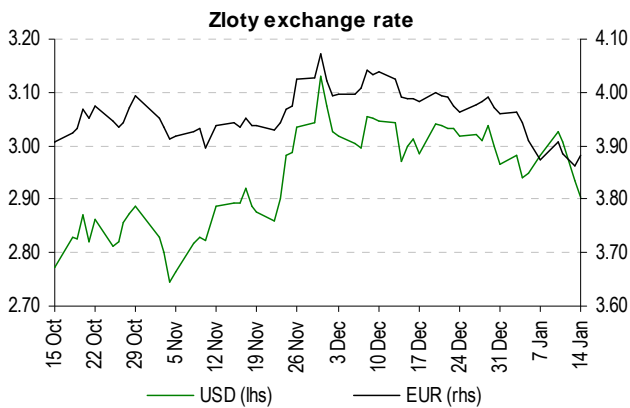
2011 will be a year of interest rate hikes but there is no need for dramatic tightening of monetary policy. Hikes should be moderate, gradual and adjusted to growth and zloty appreciation. (...) With strong zloty appreciation, the scale of hikes could be at 50 basis points this year. At the same time it seems that the whole tightening cycle could be of about 100-150 basis points. (...) The zloty could gain through 2011 even to 3.5 at the end of the year. Such a level could actually slow economic growth down slightly but it [the zloty level] would not pose any bigger threat. It would be optimal if the zloty traded at around 3.70-3.80 [to the euro].

### Jan Winiecki, MPC member, Reuters, 12 Jan

I think that Poland is in a good situation, a relatively good situation. Inflation is rising slowly. But it is rising and this should be reflected in the council's decisions.

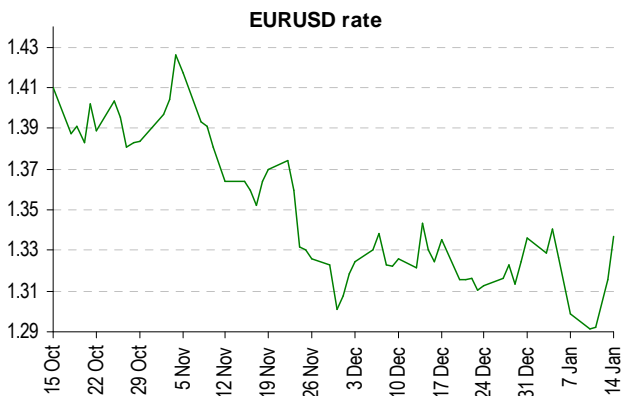
The market perceived comments from Bratkowski as quite dovish (focusing on the fact he indicated the total scale of rate hikes this year could only 50bps), despite he stated the first hike should take place already in January and this was another signal from the MPC (following recent comments from Belka, Winiecki and Chojna-Duch), increasing likelihood of the first hike in March at the latest. However, if the zloty actually gained to 3.50 to the euro, as indicated by Bratkowski, the scale of rate hike this year could actually be lower. At the moment such appreciation of the zloty is not our baseline scenario, so we expect the total scale of rate hikes this year will be 100bps. Whether the first hike will take place in March or as soon as in January may depend on labour market data due on Tuesday and the zloty performance in the next days.

Market monitor

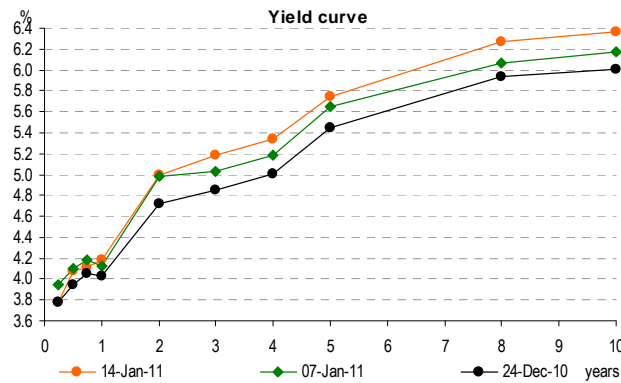


Zloty stronger after MPC members comments

▪ The deterioration of market sentiment at the beginning of the week after rumours that Germany pushes on Portugal to accept help from the IMF/EU weakened the zloty. The EURPLN increased to 3.91 while the USDPLN reached nearly 3.04. The comment from Andrzej Bratkowski, suggesting that the zloty may appreciate considerably, and additional hawkish comment from Jan Winięcki triggered visible appreciation of the domestic currency. The EURPLN declined below levels when the NBP was intervening on the market in April 2010. At the end of the week the zloty depreciated versus the euro and gained versus the dollar amid surge of the EURUSD. This week the zloty performance will depend on the decision of the MPC. The market expects the interest rate hike, and if that does not happen, the EURPLN may reach 3.90-3.92 and the USDPLN 2.95.

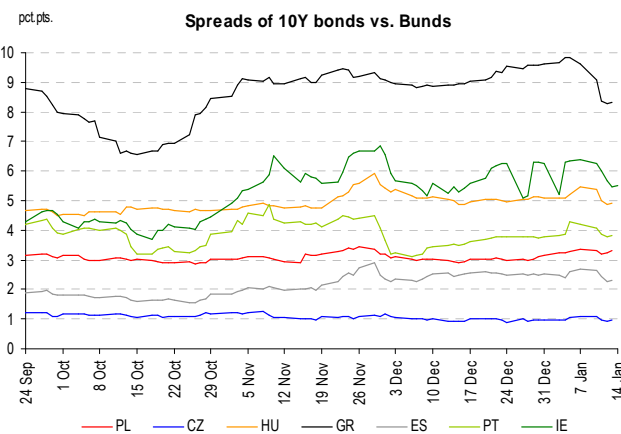


▪ The EURUSD started the week below Friday's closing level due to higher risk aversion. Later in the week, the euro performed pretty good. First, it was positively affected by information that Japan will purchase bonds issued by the EFSF. Besides, the single currency was supported by good results of bond auctions held in Portugal, Spain and Italy. Even stronger rise in EURUSD took place after the ECB meeting, as its governor suggested that in the short term there are upside risks to inflation. This fuelled expectations for the interest rates hikes in the euro zone. The EURUSD reached to crucial resistance level at ca. 1.343 and we expect that it will not be broken (but if it happens, the next resistance is at 1.36). The first support is at around 1.32 and the next one at 1.31.



Steepening of the domestic yield curve

▪ On the domestic fixed income market the yield curve steepened. The yields of short-term bonds declined after the comment from Elżbieta Chojna-Duch (though it was rather hawkish regarding her usually dovish attitude). Higher yields in the middle and at the long end of the curve originated from changes on the foreign markets. The rising yields of 10Y Bunds pushed up yields of domestic long term bonds. The increase in yields in the middle of the curve was moderate. Additionally, the decision on the OFE still puts negative pressure on the Polish debt. CPI figures were in line with expectations and thus they did not have impact on the market. This week the most important event on the domestic fixed income market will be the Wednesday's decision of the MPC on the interest rates. In the past few days the market started to price in hikes in January and leaving the interest rates unchanged may trigger visible downward correction of yields. Some potential for higher volatility may be also on Thursday, as data on industrial output will be released. They may be a clue on the pace and scale of monetary policy tightening in Poland.



▪ On the core debt markets yields increased amid rising appetite for risky assets due to good results of Portuguese, Spanish and Italian bond auctions.

▪ The spreads versus 10Y Bunds plunged due to positive results of bond auctions carried in Portugal, Spain and Italy. The perception of that results by the market was optimistic, despite the awareness that this does not mean that the debt crisis in the euro area is over.

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