Bank Zachodni WBK

Weekly economic update

14 - 20 February 2011

Stock markets in the past week were broadly stable, but there was some deterioration in sentiment on the global markets due to persisting tensions in Egypt and investors' impatience regarding solution to debt problems in Europe. As a result, after brief appreciation at the beginning of the week, the zloty was gradually weakening in the next days and EURUSD dropped below important support at 1.36. Domestic yield curve steepened with yields at the short end lower after quite dovish comments from MPC's Glapiński and rise in yields at the long end amid weakening in the core debt markets. This week we will get large dose of important data locally and abroad. In our view, domestic data will have hawkish flavour, which would be negative for the short end of the yield curve and positive for the zloty. However, events abroad will also be crucial.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (14 February)					
	CN	Trade balance	Jan	$bn	10.3	-	13.1
11:00	**PL**	**Tender of 50-week T-bills worth PLN1-1.5bn**					
11:00	EZ	Industrial output	Dec	%MoM	0.0	-	1.2
14:00	**PL**	**Money supply**	**Jan**	**%YoY**	**9.3**	**9.6**	**8.6**
		TUESDAY (15 February)					
3:00	CN	CPI	Jan	%YoY	5.5	-	4.6
11:00	DE	ZEW index	Feb	pts	20.0	-	15.4
11:00	EZ	Flash GDP	Q4	%QoQ	0.4	-	0.3
14:00	**PL**	**CPI**	**Jan**	**%YoY**	**3.4**	**3.5**	**3.1**
14:30	US	NY Fed index	Feb	pts	13.0	-	11.92
14:30	US	Retail sales excluding autos	Jan	%MoM	0.6	-	0.5
14:30	US	Import prices	Jan	%MoM	0.8	-	1.1
		WEDNESDAY (16 February)					
14:00	**PL**	**Wages**	**Jan**	**%YoY**	**5.1**	**5.1**	**5.4**
14:00	**PL**	**Employment**	**Jan**	**%YoY**	**2.6**	**2.8**	**2.4**
14:30	US	Building permits	Jan	k	570	-	630
14:30	US	House starts	Jan	k	540	-	530
15:15	US	Capacity utilization rate	Jan	%	76.3	-	76.0
15:15	US	Industrial output	Jan	%MoM	0.5	-	0.8
20:00	US	Fed minutes					
		THURSDAY (17 February)					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	401	-	383
14:30	US	Core CPI	Jan	%MoM	0.1	-	0.1
16:00	US	Philly Fed index	Feb	pts	20.2	-	19.3
16:00	US	Leading indicators	Jan	%MoM	0.4	-	1.0
		FRIDAY (18 January)					
14:00	**PL**	**Industrial output**	**Jan**	**%YoY**	**10.0**	**10.5**	**11.5**
14:00	**PL**	**Construction output**	**Jan**	**%YoY**	**21.8**	**22.8**	**12.3**
14:00	**PL**	**PPI**	**Jan**	**%YoY**	**6.3**	**6.0**	**6.1**

Source: BZ WBK, Bloomberg, Parkiet, Reuters

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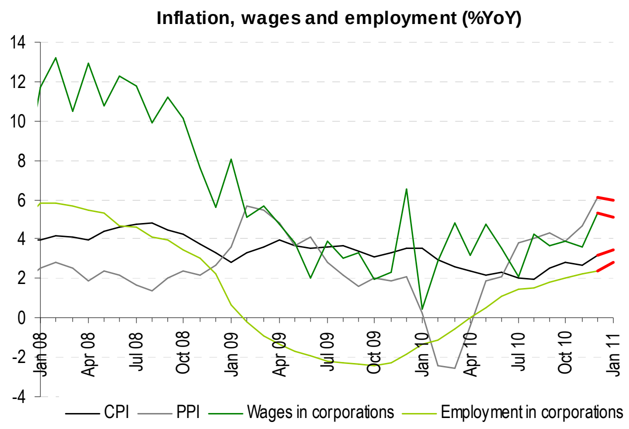
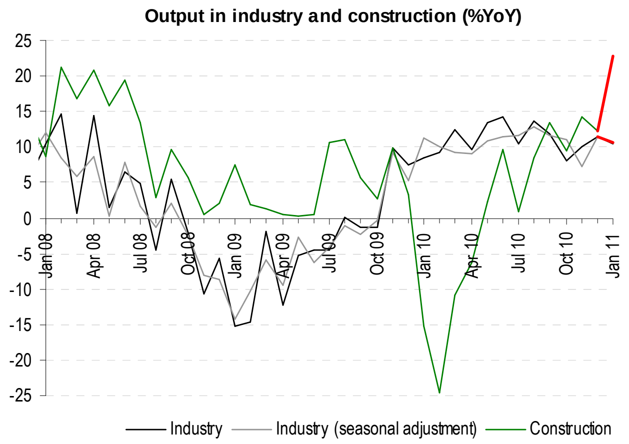
What's hot this week – Large dose of data locally and abroad

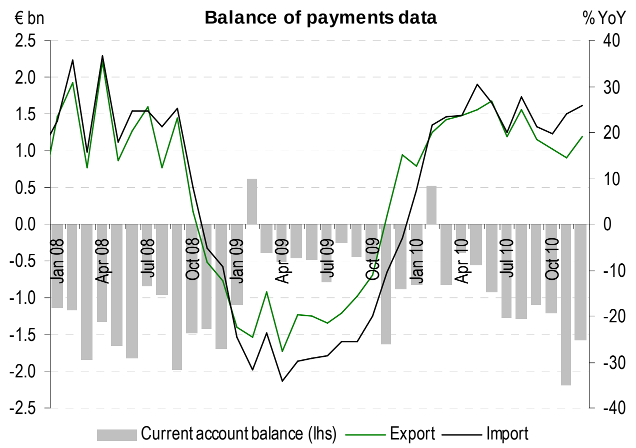


- Among a large portion of the domestic data, which are to be released this week, the CPI seems to be the crucial indicator, as it will have – in our opinion – the strongest influence on the market expectations concerning the prospects for the monetary policy and therefore the strongest impact on the market interest rates and the zloty.
- A next significant increase of consumer inflation is widely expected. In our opinion it will be stronger than the market expects and the inflation will rise due to the dynamics of the most CPI categories. This development might increase the market expectations for the second interest rate hike at the next MPC meeting and the total scale of interest rate hikes this year.
- As for the PPI we forecast a slight decrease, but it won't alter the conclusion supported by the PMI study that the inflationary pressure at the producer level is very strong.



- Apart from inflation figures, a very important hint on the inflation outlook and further MPC decisions will be data from the labour market. Wages in corporate sector will be particularly important. After their growth unexpectedly topped 5%YoY in December, several MPC members said it will be one of the most closely watched indicators. In our view, wages in January rose again by over 5%YoY, which may reinforce the hawkish tone of the inflationary data. Data on employment will be distorted by the effect of the annual change in the sample of companies employing more than 9 people.
- As regards production data, our forecasts are above market consensus, but in case of industrial production there is some downward risk related to lower than expected PMI index. Sharp improvement in construction output growth will be largely affected by a low base effect.

Economy last week – Balance of payments close to expectations



- The C/A gap in December was lower than a month earlier, but higher than a year ago, leading to widening of the 12-month cumulative C/A gap in relation to GDP to 3.3% from 3.1% after November and 2.1% in 2009. Value of the current account gap in euro terms almost doubled in 2010 as compared to 2009, reaching €11.6bn.
- We predict that the tendency of widening in C/A gap will be continued due to faster rise in important than in exports with slightly weakening rise in external demand and accelerating domestic demand.
- In December 2010 exports and imports were very close to our estimates as reaching respectively €9.8bn (+19.0%YoY) and €10.9bn (+26.0%YoY), while we expected €9.7bn and €10.8bn. Total value of exports in 2010 was the highest in Poland's history.

Quote of the week – There is no need for hysterical actions in monetary policy

Adam Glapiński, członek RPP; Reuters, 10 lutego

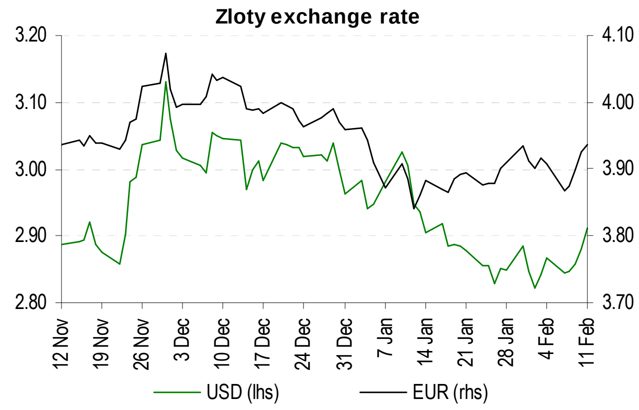
In the most likely scenario, from the current point of view, one small correction in late Q3 or in Q4 is likely. There is no need for hysterical actions in monetary policy. There is no need for sudden and sharp tightening. Rate hike in January was supposed to anchor inflationary expectations, but the decision could be made in March. We may calmly watch the situation. Comments of some NBP representatives were supposed to trigger the zloty strengthening, but currently it seems that this possibility has exhausted. I agree with the governor Belka that the zloty still has potential to appreciate, that it is undervalued.

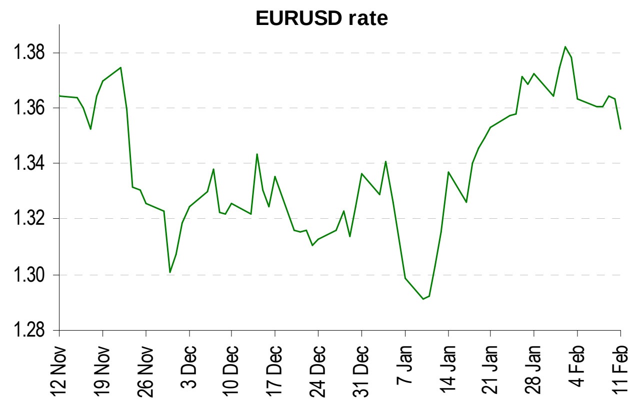
Jan Winiecki, MPC member; Reuters, 11 February

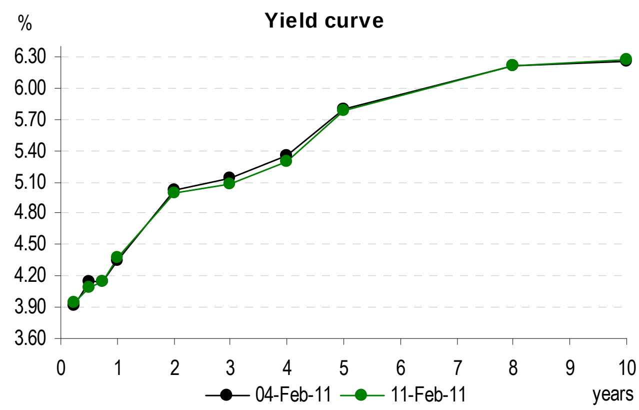
In do believe that given both external and reinforcing internal inflationary factors, we should expect some changes towards higher rates.

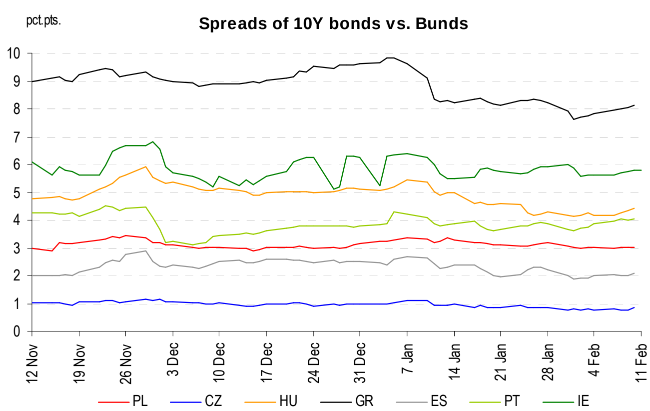
Last week, MPC member Andrzej Kaźmierczak, quite surprisingly stated that "in the financial markets there is belief" that reaching 7% by yields of 10Y bonds means that "the country is close to default". In our view, the nominal level of long-term interest rates (not compared with the level of inflation, GDP growth, etc.) does not inform about the country's solvency. For the assessment of monetary policy outlook more useful were comments of A. Glapiński and J. Winiecki. The former said that "from the current point of view", next rate hike is needed only in Q3 or Q4. However, in out view, his opinion may be changed by hawkish data. Winiecki's comment was more hawkish. We still think that there will be majority of votes for the rate hike in Q2.

Market monitor









High volatility of the EURPLN

▪ Last Friday, after close of the domestic session the EURPLN plunged below the support level at 3.89. On Monday that momentum was continued and exchange rate reached next support at 3.84. Yet the same day the correction of that move occurred towards 3.88. In following days the zloty was under the negative pressure of deteriorating market sentiment. Additionally, lower than expected CPI in Czech Republic (which diminished expectations for prompt rate hikes in this country) depreciated the zloty. Along with the Czech crown and the zloty also the forint weakened and lost most in our region. At the end of the week the EURPLN was at ca. 3.92 as the zloty was supported by Friday's comment of MPC's Jan Winiecki. If the exchange rate stays above the upward trend line (ca. 3.92) then further increase towards 3.95 is possible. But if Tuesday's data on CPI confirm our expectations, then the EURPLN may decline to ca. 3.89, but the scale of that possible move will also depend on the tone MPC memers' comments after the data release.

▪ On Monday the EURUSD rebounded from the support at 1.35 and in following days the euro, fuelled by hawkish comment of the ECB member and expectations for high growth of the global economy, gained versus the dollar. The EURUSD rebounded from the resistance at 1.375 on Wednesday. Next, due to higher risk aversion and good data for the dollar the EURUSD broke the support at 1.36 and headed towards next support at 1.35. We expect it will not be broken and the exchange rate will rebound towards 1.36. Still, in case of breaking, the next support is the area above 1.34.

Short end of the curve awaits the data

▪ Domestic yield curve became steeper last week. Yields at the short end, after stabilization at the start of the week, rose slightly before the auction of 2-year bonds, and then fell after dovish comments by Adam Glapiński. At the long end yields increased slightly, following German Bunds. This week the market's attention will focus on Tuesday's publication of the CPI data, and later on Wednesday's labour market figures. Our inflation forecast is above market consensus and the combination of reading in line with our expectations and a big sale of 2Y bonds at the latest auction may result in growing yields at the short end of the curve. Changes at the long end will be influenced by developments in the global market. Potential factors affecting the domestic long-term bonds include Wednesday's bond switching auction in Portugal and Thursday's bond auction in Spain.

▪ Yields of 10-year Bunds and Treasuries ended the week above the levels recorded at last Friday's close. This was mainly due to a marked increase at the start of the week amid rising hopes for faster growth in the global economy. The increase in risk aversion brought yields down at the end of the week.

▪ On the peripheral debt market, amid relatively stable yields of German bonds, spreads versus the 10Y Bunds widened. That was mainly due to increasing yields of the PIIGS' bonds. Since the beginning of the year investors hoped that decisions regarding solving the European debt problem will be taken soon, while the EU summit will be held in March. The negative pressure on the prices was due to disappointment of no new information on that issue.

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