

# Weekly economic update

7 – 13 March 2011

The most important events in the global markets last week were the situation in MENA region and conference after ECB meeting. Announcement of possible mediation in Libya and Bernanke's statement that current oil prices do not pose a threat to US economy improved market sentiment after its deterioration at the beginning of the week. Better mood was also backed by good macro data (Chicago PMI, ISM, US labor market). The euro gained versus the dollar, as Bernanke was really dovish during his testimony in Congress and the tone of ECB's communiqué and Trichet during the conference were far more hawkish than expected. Trichet even suggested that a rate hike could occur as early as April. Domestic market was mainly influenced by the MPC decision. The interest rates have been kept on hold as we expected but the market reaction was more modest than we anticipated. The MPC decision and strengthening of euro against main currencies put the zloty under pressure at the end of the week. The market was not affected by the surprising decline of domestic PMI index for manufacturing. As regards the details of the index, the price indices remaining at elevated level raise concern.

Among data released this week the Friday's retail sales and consumer sentiment in the US shall be most important. Moreover, the Bank of England will decide on interest rates. Increasing expectations for ECB rates hike may boost bets that the domestic MPC, which is often emphasising the importance of main central banks decisions, can tighten the monetary policy already in April. This is a potential factor that may strengthen the zloty and raise yields in debt market this week (and month). Besides, NBP will publish its *Inflation Report* on Monday, which can be accompanied by comments of MPC members. An additional stimulus may be data on inflation in the Czech Republic and Hungary due to release on Wednesday and Friday respectively. We are of opinion that the beginning of the week should be rather calm.

## Economic calendar

| Time CET                   | COUNTRY | INDICATOR                                    | PERIOD |      | FORECAST |       | LAST VALUE |
|----------------------------|---------|--|--------|------|----------|-------|------------|
|                            |         |  |        |      | MARKET   | BZWBK |            |
| <b>MONDAY (7 March)</b>    |         |  |        |      |          |       |            |
| 9:00                       | PL      | NBP's Inflation Report                       |        |      |          |       |            |
| 10:30                      | EZ      | Senitx index                                 | Mar    | pts  | 15.5     | -     | 16.7       |
| 11:00                      | PL      | Tender of 51-week T-bills worth PLN0.5-0.9bn |        |      |          |       |            |
| <b>TUESDAY (8 March)</b>   |         |  |        |      |          |       |            |
| 12:00                      | DE      | Industrial orders                            | Jan    | %MoM | 2.2      | -     | -3.4       |
| <b>WEDNESDAY (9 March)</b> |         |  |        |      |          |       |            |
| 11:00                      | PL      | Auction of OK0113 bonds                      |        |      |          |       |            |
| 12:00                      | DE      | Industrial output                            | Jan    | %MoM | 1.7      | -     | -1.5       |
| 16:00                      | US      | Wholesale inventories                        | Jan    | %MoM | 0.9      | -     | 1.0        |
| <b>THURSDAY (10 March)</b> |         |  |        |      |          |       |            |
| 3:00                       | CN      | Trade balance                                | Feb    | %bn  | 4.9      | -     | 6.5        |
| 8:00                       | DE      | Exports                                      | Jan    | %MoM | 0.7      | -     | 0.5        |
| 13:00                      | GB      | BoE decision                                 | -      | %    | 0.5      | -     | 0.5        |
| 14:30                      | US      | Initial jobless claims                       | week   | k    | 373      | -     | 368        |
| 14:30                      | US      | Trade balance                                | Jan    | \$bn | -41.3    | -     | -40.6      |
| <b>FRIDAY (11 March)</b>   |         |  |        |      |          |       |            |
| 3:00                       | CN      | CPI  | Feb    | %YoY | 4.8      | -     | 4.9        |
| 3:00                       | CN      | Industrial output                            | Feb    | %YoY | 13.0     | -     | 13.5       |
| 14:30                      | US      | Retail sales excluding autos                 | Feb    | %MoM | 0.6      | -     | 0.3        |
| 15:55                      | US      | Flash Michigan index                         | Mar    | pts  | 76.8     | -     | 77.5       |

Source: BZ WBK, Bloomberg, Reuters

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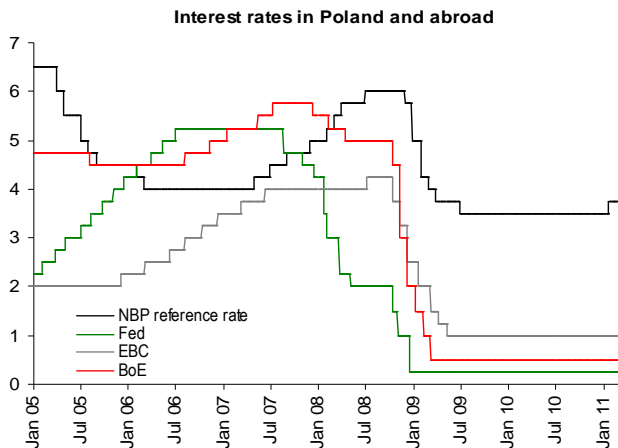
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## What's hot this week – Data abroad



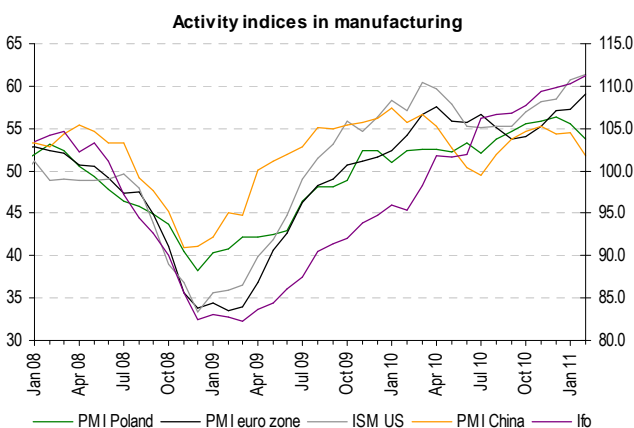
- This week we will not get new domestic data while potentially most important for the markets figures abroad will cumulate towards the end of the week. On Thursday the Bank of England will make decision on interest rates.
- Important domestic event this week will be Monday's publication of the Inflation Report, including details of the projection NBP projection for inflation and GDP as well as results of MPC votes at previous meetings. One may also expect comments from MPC members, which will be interesting particularly in the context of the ECB meeting.
- Among all days of the week the most interesting will be Friday when we will get monthly figures from China, including CPI and industrial output, which will be a hint on the Chinese central bank policy, but key focus of attention will be the US retail sales and Michigan consumer confidence index.

## Economy last week – PMI disappointed, MPC decision in line with expectations

### Inflation and GDP projections in the next *Inflation reports*

|      | GDP growth    |         |         |         |
|------|---------------|---------|---------|---------|
|      | Feb 10        | Jun 10  | Oct 10  | Feb 11  |
| 2011 | 1.8-4.0       | 3.3-5.9 | 3.3-5.5 | 3.3-5.1 |
| 2012 | 1.9-4.3       | 2.2-5.0 | 2.8-5.5 | 2.3-4.8 |
| 2013 | -             | -       | -       | 1.7-4.4 |
|      | CPI inflation |         |         |         |
|      | Feb 10        | Jun 10  | Oct 10  | Feb 11  |
| 2011 | 1.7-3.1       | 2.1-3.3 | 2.5-3.5 | 2.8-3.7 |
| 2012 | 2.6-4.6       | 2.2-3.7 | 2.4-3.7 | 2.2-3.4 |
| 2013 | -             | -       | -       | 2.1-3.7 |

- At its March meeting the MPC left the interest rates unchanged, in line with our expectations.
- In the post-meeting statement it was stressed that CPI rise above the target was related to exogenous factors, but it was noted that there was also rise in core inflation and inflationary expectations.
- The post-meeting statement did not give clear hints on timing of further policy tightening. Over the coming month the uncertainty regarding durability of the strengthening in consumption demand and on investment activity will not decrease while labour market data should show some slowdown in wage growth. We still expect yet three interest rate hikes each by 25bps, next in Q2, possibly already in April, especially with forecasted further rise in CPI inflation and in the context of expected interest rate hike in the euro zone.



- PMI for Polish manufacturing sector in February clearly disappointed, dropping to 53.8 pts and putting our forecast for February industrial output of 11.2%YoY at risk. The second consecutive decline resulted from slower growth of new orders and industrial output. Still, the acceleration of employment growth was a positive factor that helped lower growth of production backlogs. Such data support our forecasts of decline in unemployment rate and rebound in investment. The index of prices of finished products climbed to the highest level since May 2004. The costs of production remained close to January's record.
- GDP figures for 4Q10 proved to be very close to our estimates based on preliminary data for the whole year. GDP grew by 4.4%YoY, slightly less than we expected. CSO did not revise data for previous quarters. The data do not alter our forecasts for GDP this year.

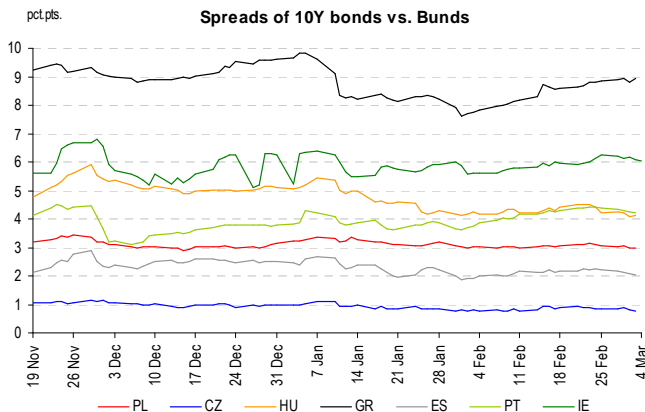
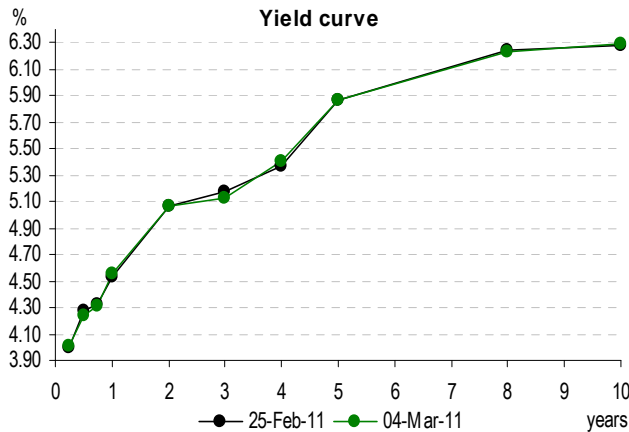
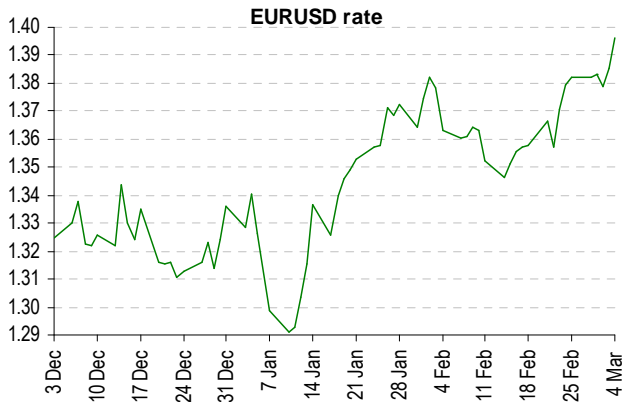
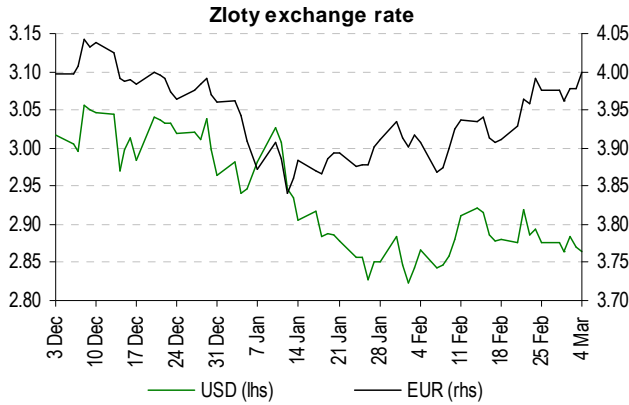
## Quote of the week – Is the MPC statement still valid after the ECB meeting?

### Key element of the MPC communiqué

[Strong increase in consumption] was driven by a rise in employment and accelerated growth in wages in the economy. It was also strengthened by a surge in advance purchases by households in anticipation of VAT rates increases in January 2011. Investment growth, on the other hand, remained low. (...) Yet, the Council decided that the January interest rates increase combined with uncertainty about the sustainability of acceleration in consumer demand and no signs of considerable recovery in investment, as well as sustained moderate wage pressure in the corporate sector and continuing rise in unemployment decrease the risk of inflation remaining above the inflation target in the medium term. Therefore, the Council decided to keep the NBP interest rates unchanged.

During the press conference the NBP Governor Marek Belka emphasised that although the January rate hike was a beginning of a cycle, the frequency of further monetary policy tightening isn't defined yet. The change in ECB's tone makes the rate hike more probable during MPC meeting in April. In this context it's noteworthy to recall the part of the January MPC's minutes. Most MPC members were of opinion that the January rate hike was a beginning of a cycle, but its scale and dynamic would depend on the data. According to certain members, it was difficult to decide whether a further tightening would be necessary and that the monetary policy of the ECB should be taken into account, as ECB 'might start increasing interest rates only in the second half of 2011'. The last part seems to be invalid now.

Market monitor



Potential for zloty appreciation

Over the past week the zloty depreciated versus the euro and due to strong increase of EURUSD gained versus the dollar. The EURPLN increased amid no interest rate hike by the MPC (against some expectations) and considerable appreciation of the euro. Also, regional factor had some impact. The market was disappointed, as there were not too much details regarding fiscal reform plan in Hungary, which lowered its reliability. Rising EURHUF pushed the EURPLN up. This week the developments abroad shall play main role on the PLN's market. We expect the EURPLN not to break the tested resistance level at ca. 3.99 and amid anticipated by us sustaining of positive market sentiment it shall decline towards 3.95. Besides, the market may conclude that higher probability of interest rate hike in the euro zone means higher chances for monetary policy tightening by the MPC, which may be reflected in changes of the zloty. Vital risk factors for that scenario are CPI's data in Czech and Hungary and Friday's meeting of EU leaders.

The EURUSD surged in the past week. The euro was supported by dovish comments of Ben Bernanke that did not exclude third round of QE and far more hawkish than expected communiqué of the ECB. Also President Trichet said on the press conference that an interest rate hike may take place in April and this supported the single currency. On Friday the exchange rate reached next resistance at 1.40, but after data from US labor market the EURUSD lowered to 1.395. This week the EURUSD shall remain in the range of 1.375-1.40. Next resistance is at 1.412.

Domestic yield curve up

Over the past week the domestic yield curve did not change much. First days brought lower rates at the long end as the FinMin announced plans of issuances for March and there will be no auctions of 10Y securities. Short end of the curve was stable before the MPC decision. No interest rate hike triggered yields drop by ca. 4-5bps. In following day the domestic market weakened, following foreign market as expectations for interest rates in the euro zone increased. If this week some comments of MPC members appear regarding last meeting and the *Inflation Report* we expect them to be rather hawkish. That may give potential for higher yields mainly on the short end of the curve.

Yields on the core fixed income markets surged over the past week as market priced in sooner than previously anticipated interest rates' hikes in the euro zone. The yields of the 10Y Bunds advanced by 15bps while Treasuries by 10bps.

Spreads of PIIGS's bonds over 10Y Bunds narrowed over the past week mainly due to visible surge of German yields. The market focused mainly on the developments in the Middle East and the ECB meeting and therefore the situation on the peripheries of European debt market receded into the background. This week there is a meeting of euro zone's leaders scheduled for Friday and that may prompt investors to pay more attention to Southern European countries. Especially, as Greece will offer 6-month T-bill worth €1.25bn while Portugal will try to sell its 2Y bonds worth €700-1000m just after yields of these securities surged to a 10-month high.

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