

# Weekly economic update

21 – 27 March 2011

Uncertainty associated with the effects of the earthquake in Japan was the main focus of investors last week. Even the unexpected decision of the euro zone leaders on expanding the capital of EFSF and lengthening the loan to Greece, with simultaneous reduction of its interest, has not stopped the stock market indices from falling sharply. The zloty was affected by a strong correction, which was not halted by the macro data. Weaker expectations for interest rate hikes and in particular a surge of risk aversion pushed EURPLN temporarily to 4.12. At the end of the week the moods improved amid hopes for resolving the nuclear crisis in Japan and due to the G7 intervention to weaken the yen. On the other hand, a new negative factor has appeared due to worsening turmoil in the Middle East and the UN Council's resolution, which allows military intervention in Libya. In response, Libya has announced a ceasefire, which has supported the market mood. At the start of this week we will see publication of balance of payments data for January, which was re-scheduled by the NBP. Seasonal increase in the unemployment rate should be ignored by the market, while a rebound in retail sales, in the context of the recent hawkish PPI data that increased slightly hopes for the April rate hike, could potentially support the zloty. Abroad, there will be publications of flash manufacturing PMI indices in China, Germany and the euro area, as well as the final data on US GDP in Q4 2010, but we think they will be overshadowed by expectations for further developments in Japan and Libya. In our opinion, the zloty may gain slightly amid the ceasefire in Libya, and the domestic yield curve may become slightly flatter as a result of profit taking at the short end.

## Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST VALUE
				MARKET	BZWBK		
<b>MONDAY (21 March)</b>							
11:00	PL	Tender of 51-week T-bills worth PLN0.7-1.2bn					
14:00	PL	Current account	Jan	€m	-1380	-1395	-1573
14:00	PL	Exports	Jan	€m	10063	10305	9771
14:00	PL	Imports	Jan	€m	10651	10850	10877
15:00	US	Home sales	Feb	m	5.2	-	5.36
<b>TUESDAY (22 March)</b>							
14:00	PL	Core CPI	Feb	%YoY	2.0	1.9*	1.7*
<b>WEDNESDAY (23 March)</b>							
10:00	PL	Retail sales	Feb	%YoY	7.3	6.9	5.8
10:00	PL	Unemployment rate	Feb	%	13.2	13.2	13.0
10:00	PL	Business climate	Mar	pts	-	-	-
11:00	EZ	Industrial orders	Jan	%MoM	1.8	-	2.1
15:00	US	New home sales	Feb	k	290	-	280
16:00	EZ	Consumer confidence index	Mar	pts	-	-	-9.9
<b>THURSDAY (24 March)</b>							
3:30	CN	Flash PMI – manufacturing	Mar	pts	-	-	51.7
9:28	DE	Flash PMI – manufacturing	Mar	pts	62.0	-	62.7
9:58	EZ	Flash PMI – manufacturing	Mar	pts	58.2	-	59.0
13:30	US	Initial jobless claims	week	k	392	-	385
<b>FRIDAY (25 March)</b>							
10:00	DE	Ifo index	Mar	pts	110.5	-	111.2
13:30	US	Final GDP	Q4	%QoQ	3.0	-	2.6
14:55	US	Michigan index	Mar	pts	76.5	-	77.5

Source: BZ WBK, Bloomberg, Parkiet, Reuters \* BZ WBK estimates after data on February's CPI based on new weights

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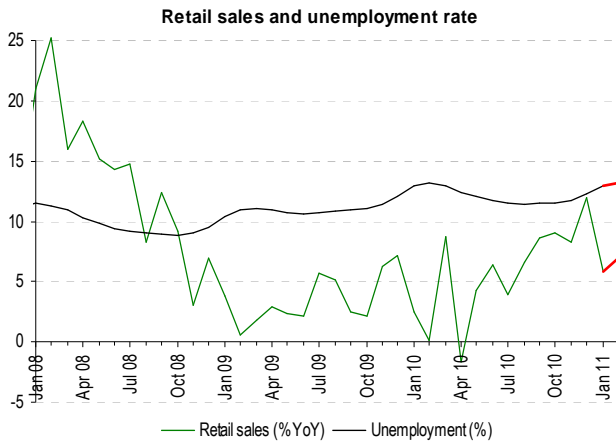
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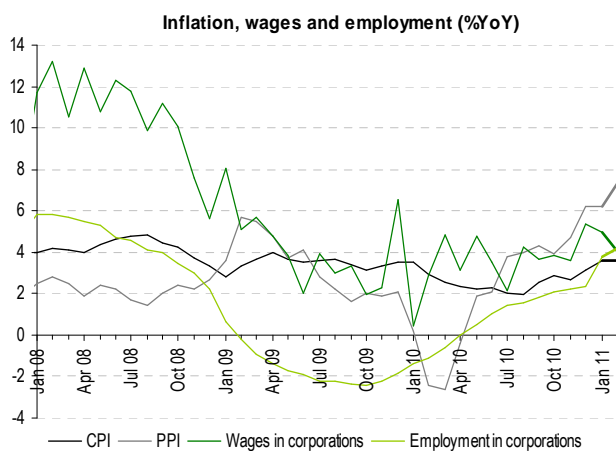
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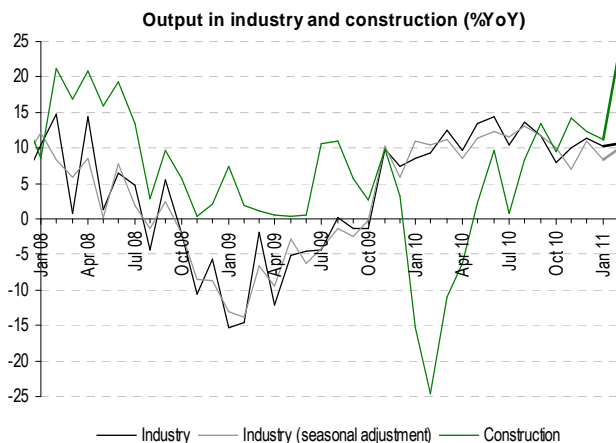
**Marcin Luzziński**

**What's hot this week** – Next dose of domestic data

- In the context of recent surprising foreign trade data abroad, the domestic balance of payments for January seems to be interesting. After a seasonal drop of trade turnover in January we expect a rebound in February, but data released by the CSO indicated risk to our forecast showing slower pace of trade growth, particularly weaker imports. If this is seen also in NBP data (lower trade deficit), it may provide some support for the zloty.
- We expect that retail sales data for February will show that the effect of shift in demand from early 2011 to last months of 2010 is slowly fading. The annual growth in February will be also under positive influence of lower base than in January. We forecast further, slight rise in the registered unemployment rate, mostly due to seasonal factors, as in the two previous months.

**Economy last week** – Dovish CPI and wages, hawkish output and PPI

- In contrast to anticipated acceleration of inflation in February the CPI remained unchanged versus level seen in January. Additionally, the January's data was visibly revised down (basing on new weights in consumer basket) to 3.6% from 3.8%YoY. On the monthly basis the CPI advanced by 1.2% in January (no revision) and 0.2% in February (slightly less than expected).
- In February average wage growth in the corporate sector decelerated to 4.1%YoY from 5.0%YoY in January and 5.4%YoY in December. The average employment in the enterprise sector advanced in February by 4.1%YoY, in line with our forecast and slightly above market consensus. The continuation of employment growth amid rising inflation will support growing wage pressure later in the year.



- The PPI accelerated in February to 7.3%YoY, the highest level since October 2004, from 6.2% in January. The data suggests that the cost pressure put on the producers does not only gain steam but is also spreading. That may finally put bigger upward pressure on prices of consumer goods and services.
- The industrial output advanced by 10.7%YoY, slightly less than we expected (11.2%) and well above market consensus (9.9%). The data confirmed our presumption that a strong plunge in Polish manufacturing PMI index was not a good hint on what was going on in the domestic industry in February. Construction and assembly sector also recorded a very good result in February, as the output growth accelerated to 23%YoY (the highest since April 2007) from 11.2% in January. Strong rebound in that sector fuels our hopes for visible recovery of investments in Q1 2011.

**Quote of the week** – Recent data do not change situation**Adam Glapiński, MPC member, Reuters, 17 March**

The recent data does not change the overall [economic] outlook and our stance in monetary policy (...) We want to avoid second round effects. I still think that interest rate hike in April is possible, but not certain. (...) I do not exclude supporting the motion for interest rate hike in April.

**Andrzej Kaźmierczak, MPC member, PAP, 17 March**

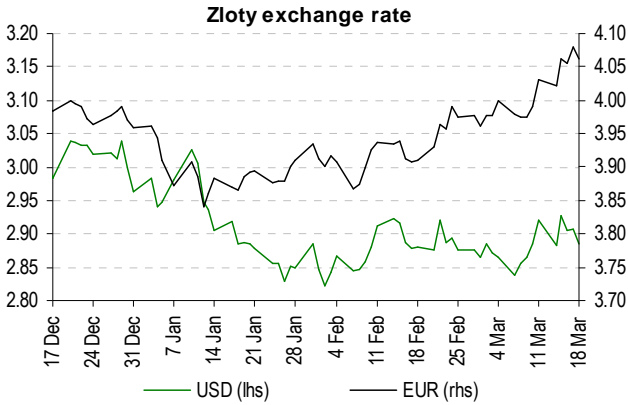
If the CPI inflation is still persistently above the upper end of the allowed range, then an interest rate hike in Q2 would be undoubtedly justified. As regards April, it is hard to say whether a rate hike is undisputedly necessary, but one cannot exclude it.

**Andrzej Bratkowski, MPC member, PAP, 18 March**

Such high inflation means that inflation expectations increase. People expect that prices will still be high. I think that in such situation the central bank cannot wait calmly until the exogenous factors pushing inflation up disappear.

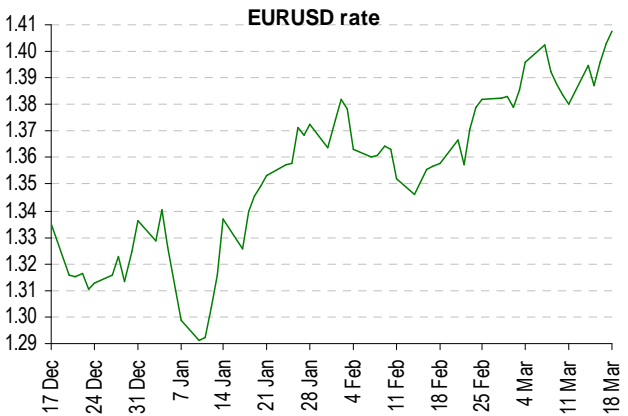
Although among domestic macro data published last week only output and PPI figures were hawkish, while CPI and wages were clearly dovish, they were followed by comments from MPC members suggesting they see a need for further monetary policy tightening. Adam Glapiński, regarded as a dove, again stressed a need for the more hikes, possibly already in April. Also usually clearly dovish Andrzej Kaźmierczak sounded quite hawkish. Looking at recent comments of central bankers, the issue of heightened volatility in the global markets receded in the background (despite the volatility intensified), so one may expect that even with currently increased risk aversion, a rate hike may be supported by those MPC members, who wanted to avoid changes in monetary policy parameters during turmoil in the markets.

**Market monitor**

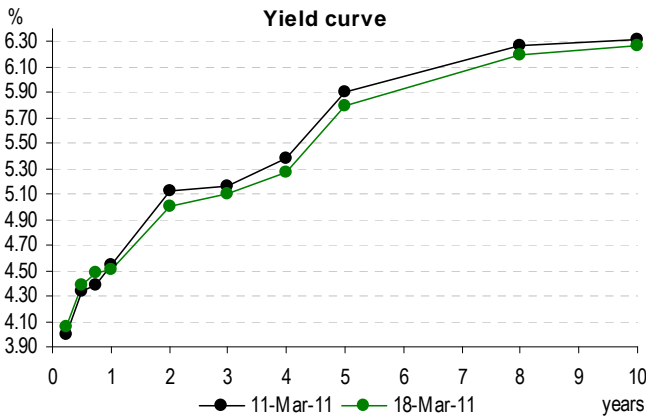


**Small room for zloty appreciation**

▪ The past week brought considerable depreciation of the zloty. High level of risk aversion due to situation in Japan and unrest in Libya and also dovish data on CPI and wages pushed the EURPLN temporarily even to 4.12. The forint and Czech's koruna also depreciated versus the euro but the zloty lost most. The increase of the USDPLN was clearly smaller due to rising EURUSD. At the end of the week the EURPLN retreated from the highest level since July 2010 reached earlier due improvement of the market sentiment and hawkish data on PPI. The exchange rate rebounded from vital resistance at 4.12 and we do not find a reason for another wave of zloty's considerable depreciation this week. The domestic currency may be supported, at least at the beginning of the week, by the ceasefire in Libya. The case of Japan is still alive. We expect that this week the exchange rate will stay in the range of 4.03-4.10.

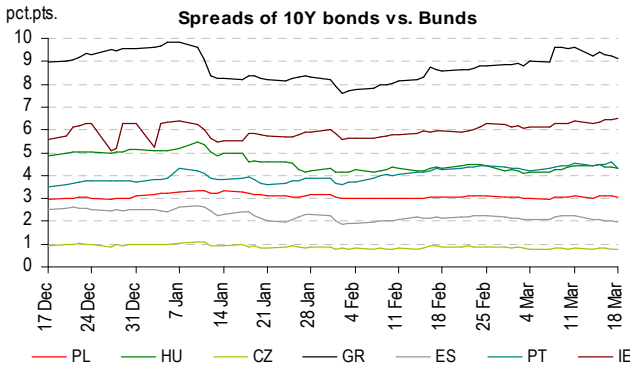


▪ Despite persisting since the beginning of the week high level of risk aversion the euro appreciated versus the dollar over the past week. The single currency resisted decline of stock indices and was supported by surprising decisions made at the meeting of the euro zone's leaders last weekend (the effective capital of the EFSF was extended from 250 to €440bn, lowering by 1pp the interest of Greek loan and extending the payback period to 7.5 years). In the following day the euro was gaining on improvement of market mood due to positive interpretation of the US data and ceasefire in Libya. At the end of the week the EURUSD reached the highest level since November 2010 and was testing the resistance at 1.413. We think that there are small chances of breaking it. The support is at 1.40, next resistance at 1.428.



**Scope for yields rise at the short end**

▪ On the domestic debt market the yield curve has become steeper. This was triggered by dovish data on inflation and wages, which in the market opinion reduced chances for interest rate hike in April. The biggest drop in yields took place at the short end, but also the rest of the yield curve was clearly affected by dovish data. FRA rates also recorded a decline, but some of this move was reversed after the PPI data, to which bond market did not respond. This week, we will see next domestic data. Currently, the expectations for interest rate hike in April are weaker than before publication of last week's data, and the potential impact of data to be released this week does not seem large. We believe that at the short end of the curve they may be a slight increase in yields as a result of profit taking. In other segments of the curve, we expect stabilisation.



▪ Yields on the core debt markets have fluctuated along with the market mood. Strong demand for safe assets that appeared at the start of the week caused a sharp decline in yields, while the next days saw a slight rebound amid a decrease in risk aversion.

▪ Bond spreads have fallen markedly in PIIGS countries during the past week. This was the result of decisions taken at the weekend summit of euro zone countries and already on Monday yields of bonds of euro area peripheral countries recorded a strong decline. On subsequent days, the changes were limited. The smallest gain from positive changes in the functioning of EFSF affected Portugal, which invariably is considered to be the next country that will need external assistance.

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