Bank Zachodni WBK

Weekly economic update

11 – 17 April 2011

Last week the optimistic mood was prevailing. A support for rising stock indices and CEE currencies was delivered by data from Germany, indicating a further robust growth of the biggest euro zone economy. The Portuguese application to the EU for financial aid has diminished an important uncertainty factor. The MPC, as well as the ECB hiked the interest rates, in line with expectations. The MPC released relatively hawkish communiqué, which supported the Polish currency, while the ECB confirmed, that it will "monitor very closely" the inflation. The ECB's decision did not affect the EURUSD rate substantially and its gains at the end of the week are an effect of no agreement on the US budget.

This week a monthly balance of payments data will be released, which will gain much investors' attention due to uncertainty concerning the errors and omissions figure. The March inflation figures will be of similar importance. If the reading is above the consensus, then – taking into account the recent comment of MPC's Kaźmierczak – a shift of market expectations about the next rate hike towards May should be anticipated. The global sentiment will be influenced by the data from the US (trade balance, retail sales) and China (GDP, CPI). The Fed will probably highlight a continuation of US economy recovery in its Beige Book, which can support the dollar.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 April)					
11:00	**PL**	**Tender of 50-weeks T-bills worth PLN0.3-0.6bn**					
		TUESDAY (12 April)					
11:00	DE	ZEW index	Apr	pts	12.0	-	14.1
14:30	US	Import prices	Mar	%MoM	1.7	-	1.4
14:30	US	Trade balance	Feb	$bn	-45.0	-	-46.3
		WEDNESDAY (13 April)					
11:00	EZ	Industrial output	Feb	%MoM	0.6	-	0.3
14:00	**PL**	**CPI**	**Mar**	**%YoY**	**3.9**	**3.9**	**3.6**
14:00	**PL**	**Exports**	**Feb**	**€m**	**10 775**	**10 711**	**10 201**
14:00	**PL**	**Imports**	**Feb**	**€m**	**11 008**	**11 572**	**9 926**
14:00	**PL**	**Current account**	**Feb**	**€m**	**-468**	**-571**	**-930**
14:30	US	Retail sales excluding autos	Mar	%MoM	0.6	-	0.7
20:00	US	Fed's Beige Book					
		THURSDAY (14 April)					
14:00	**PL**	**Money Supply**	**Mar**	**%YoY**	**8.4**	**8.4**	**8.3**
14:30	US	Initial jobless claims	week	k	380	-	382
		FRIDAY (15 April)					
4:00	CN	CPI	Mar	%YoY	5.2	-	4.9
4:00	CN	GDP	Q1	%YoY	9.5	-	9.8
11:00	EZ	Final HICP	Mar	%YoY	2.6	-	2.4
11:00	EZ	Trade balance	Feb	€bn	-4.6	-	-14.8
14:30	US	Core CPI	Mar	%MoM	0.2	-	0.2
14:30	US	NY Fed index	Apr	pts	17.5	-	17.5
15:15	US	Industrial output	Mar	%MoM	0.5	-	0.0
15:15	US	Capacity utilisation rate	Mar	%	77.1	-	77.0
15:55	US	Flash Michigan	Apr	pts	68.3	-	67.5

Source: BZ WBK, Reuters

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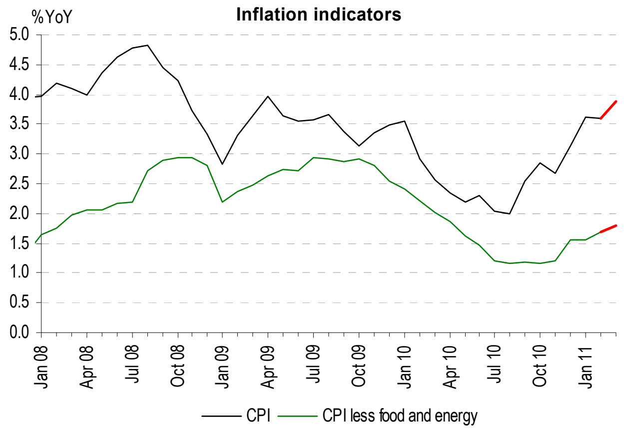
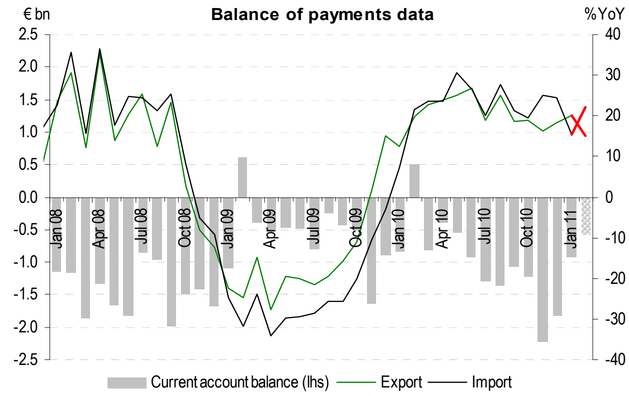
What's hot this week – Market sensitive data on CPI and balance of payments



▪ We expect, that in March the annual inflation has reached its highest level since April 2009. Stil, food and fuel prices are the main driver of increase. It is noteworthy to pay special attention to rapid rise of sugar, which took place recently. Also the FAO index, showing that the yearly dynamics of global food prices advanced in March (even a slight zloty appreciation against the dollar did not offset this effect in case of zloty-denominated prices) justifies the forecast of accelerating food prices on yearly basis. However, in our opinion, the core inflation climbed as well (to 1.8% from 1.7% in February), confirming the rising demand pressure on prices, which is to be continued.

▪ Similarly as the market, we expect a slight growth of money supply due to accelerating dynamics of deposits and credits.



▪ The February retail sales figures support our forecast of a substantial advance of annual dynamics of imports. A factor supporting the relatively high growth in exports is data about robust industrial production growth in February and persisting favourable business climate in Germany.

▪ The expectations of lower current account deficit, apart from trade tendencies, are supported by forecasts indicating lower negative balance of incomes and strong inflow of funds related to transfers from the EU. Due to uncertainty regarding possible revisions in balance of payments, it should be anticipated, that the Wednesday's data release will gain much attention and can affect the zloty in case of substantial deviation from the consensus.

Economy last week – Interest rates higher just as expected

Important fragments from the MPC statement
Surge in commodity prices has contributed to the rise in inflation across the World.
(...) At the same time, core inflation increased further, while inflation expectations rose markedly. The heightened level of inflation is connected primarily with increases in the prices of agricultural commodities and crude oil in the global markets, which have not been offset by changes in the zloty exchange rate, and additionally with a rise in most VAT rates at the beginning of 2011.
Strong retail sales growth in February reduces the risk of household consumption growth (...) Recent data show that the risk of a slowdown of economic activity in Poland has decreased. In the assessment of the Council, continuing economic recovery in Poland and further employment growth may gradually increase wage and inflationary pressures in the medium term. At the same time, a rise in inflation expectations combined with a surge in commodity prices across the world create the risk that heightened inflation will persist. To reduce the risk of inflation running above the inflation target in the medium term the Council decided to raise the NBP interest rates, continuing the monetary policy tightening cycle. At the same time, the Council will continue to analyse possible signals of increased inflationary pressures.

▪ As expected, the MPC hiked the rates by 25bps.

▪ Statement indicating a better assessment of the Council as regards the economic outlook in Poland was quite important, as the earlier comments of some MPC members suggested, that the uncertainty about the economic growth deterred them from supporting the hikes. Moreover, it was noted in the communiqué that the core inflation and households' inflation expectations picked up. The role of the latter factor in the current communiqué increased noticeably as compared to previous months.

▪ Our view considering the scale of further MPC actions remains unchanged (we anticipate two further hikes by 25bps). We do not expect a next hike already in May, but it cannot be excluded, that the interest rate will be increased to the anticipated by us target level of 4.5% earlier than we previously expected.

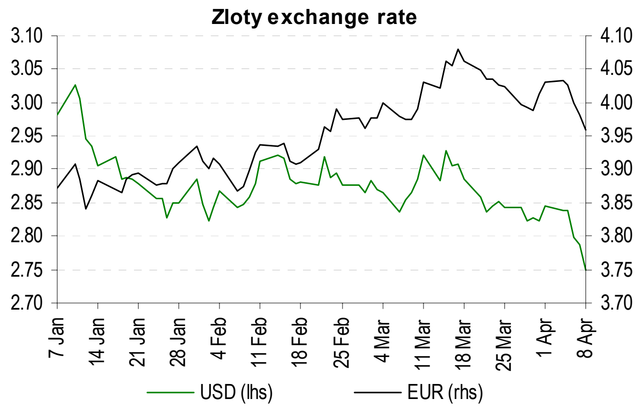
Quote of the week – The inflation problem has become serious

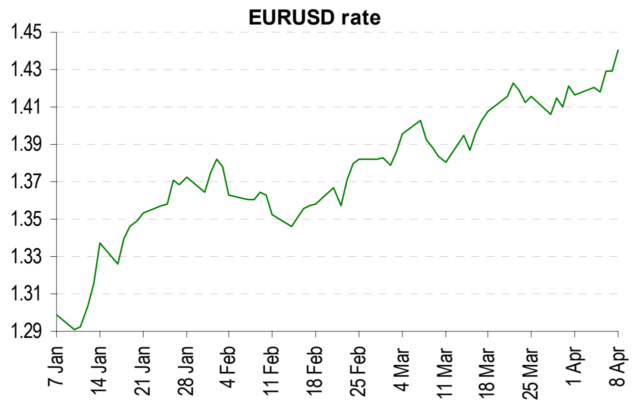
Marek Belka, NBP governor, Reuters, MPC press conference, 5th April I cannot say, that we are approaching the end of policy tightening process (…) how far do we go in the hiking cycle – our assessment of economic situation in the country and abroad will decide upon that.

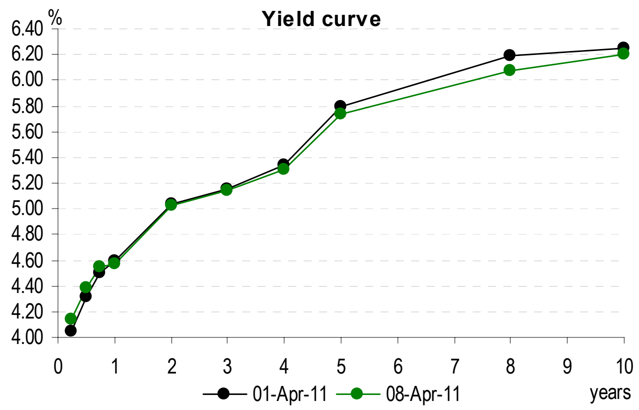
Andrzej Kaźmierczak, MPC member, Bloomberg, 8th April
If the inflation reaches 4%, it will be a threatening sign. (…) As long as we are below 4% border, we have a moment to unwind and further tightening will not be necessary. (…) If it exceeds this level, the further hikes are inevitable. It is possible, that we have to consider, if more aggressive actions are necessary, especially if the inflation expectations persist. (…) The inflation problem has become serious.

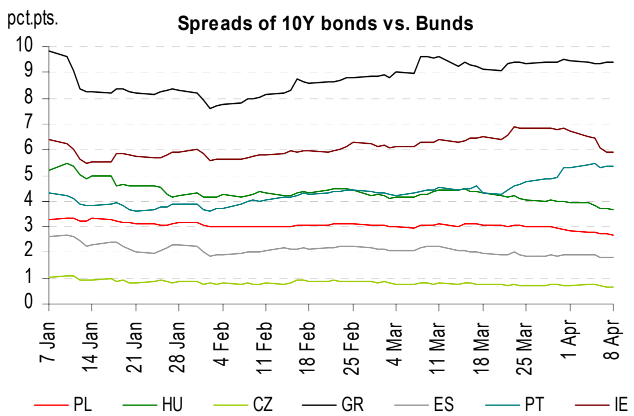
The MPC statement and comments by NBP Governor Marek Belka at the press conference give no clear hints concerning the timing of further interest rates hikes. Clearly, more important for the assessment of further hikes magnitude was a statement of one of the doves within the MPC, Andrzej Kaźmierczak. He repeated his concern about the possibility of yearly inflation exceeding 4%. He indicated that possibility earlier on 10th March, before the February CPI figures. At that time, the data surprised on the downside considerably. Now it is expected, that the prices will accelerate to almost 4% YoY in March and if the scenario of inflation developing above this threshold comes true (only one domestic financial institution forecasts CPI reaching 4%), than the expectations for May rate hike will increase substantially.

Market monitor









Data will decide on EURPLN direction

▪ During the last week the zloty substantially gained against the euro and the dollar. The zloty was supported by positive mood, which was prevailing on the market throughout the whole week, inter alia thanks to Portuguese application to the EU for financial aid. The domestic currency appreciation was supported also by the hawkish MPC statement. The uncertainty about the possible revision of Polish balance of payments data and further privatisation plans were overshadowed. At the end of the week, the EURPLN rate has reached its lowest level since the end of February 2011 and the USDPLN since November 2010. The appreciation trend of the zloty supported the other CEE currencies – the forint was the strongest against the euro since May 2010. We expect that this week the EURPLN rate will reach 3.94, which will be the first serious support. The Wednesday's data will decide if it is broken.

▪ After the close of domestic session last Friday the euro recovered against the dollar. After a short stabilisation at the start of the week the euro gained on expectations for ECB rates hike and Portuguese application for bailout. The ECB's decision itself did not affect the exchange rate, but the uncertainty, which emerged due to an ability of US government to reach an agreement on the budget issue, pushed the EURUSD rate to 1.442, the highest level since January 2010. Technical analysis suggests that the upward trend may be continued till 1.446. First attempt to realise gains can emerge near to this level. The additional resistance is a psychological level of 1.45, while the first support is 1.42. An important factor for the rate is release of Fed's Beige Book, where a considerable improvement of US economic situation will be outlined, which can strengthen the expectations for rate hikes in the US.

A strong impulse is needed to push the yields up

▪ The domestic yield curve flattened last week due to a considerable decline of yields at the longer end and – to a lesser extent – at the middle due to strong demand for securities from this segment of the curve. It can be explained by lack of tender of these bonds in April. The two-year bonds were relatively stable throughout the week and did not react to surprisingly hawkish MPC statement. On the other hand, the FRA and IRS rates increased and now the market, despite the April hike, still prices-in, that the rate will be raised by ca. 100bps till year-end. This week the March CPI figures are due to release. After the MPC communiqué and Kaźmierczak's comment the inflation has to reach 4% to cause the yields increase.

▪ On the core debt markets the yields increased amid persisting risk appetite. Another factor, which pushed the yields upward, was lack of agreement between the Republicans and Democrats on the issue of US budget. The yields of 10-year Bunds have advanced to their highest level since August 2009.

▪ Last week the outgoing PM of Portugal, Jose Socrates, asked the EU for financial aid, as this country was not able to deal with the debt problem on its own. The market anticipated such decision for some time, so it did not increase market volatility. Moreover, the market awaits the release of conditions for the financial aid. The spread of 10-year bonds of euro zone's peripheral countries against the Bunds dropped due to declining yields of those securities. The Irish debt gained mostly and the most significant yield decline emerged after release of information about Portugal asking for help.

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