Bank Zachodni WBK

Weekly economic update

18 – 24 April 2011

Since the beginning of the week the market sentiment was poor. The risk-averse mood was initially connected with aftershocks in Japan. In the following days a negative pressure on the stock indices was exerted by disappointing quarterly results of US companies, possibility of debt restructuring in Greece as well as by concerns about impact of high oil prices and monetary tightening of main central banks on the global economy. Under these unfavourable conditions, the zloty gained thanks to strong inflation increase in March, which has boosted the market expectations for a rate hike in May.

From the very beginning of the new week there will be publications of data important for both domestic and global markets. We expect the Polish data to confirm positive tendencies in the labour market and economic activity. However, they should not boost expectations for aggressive monetary tightening in May. The most important figures abroad will be April's flash PMI in manufacturing and US housing market data. We think, that there is still a potential for further zloty appreciation and we can see 3.90 versus euro this week. As the time passes, we will see a declining market volatility due to approaching Easter.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 April)					
11:00	**PL**	**Tender of 49-week T-bills worth PLN0.5-1.0bn**					
14:00	**PL**	**Wages in corporate sector**	**Mar**	**%YoY**	**4.3**	**4.4**	**4.1**
14:00	**PL**	**Employment in corporate sector**	**Mar**	**%YoY**	**4.3**	**4.3**	**4.1**
16:00	EZ	Consumer confidence index	Apr	pts	-	-	-10.60
		TUESDAY (19 April)					
4:30	CN	Flash PMI – manufacturing	Apr	pts	-	-	51.8
9:28	DE	Flash PMI – manufacturing	Apr	pts	60.0	-	60.9
9:58	EZ	Flash PMI – manufacturing	Apr	pts	57.0	-	57.5
14:00	**PL**	**Industrial output**	**Mar**	**%YoY**	**9.7**	**9.6**	**10.7**
14:00	**PL**	**Construction output**	**Mar**	**%YoY**	**15.0**	**19.3**	**23.0**
14:00	**PL**	**PPI**	**Mar**	**%YoY**	**8.2**	**9.0**	**7.3**
14:30	US	House starts	Mar	k	525	-	479
14:30	US	Building permits	Mar	k	540	-	530
		WEDNESDAY (20 April)					
10:30	GB	Bank of England minutes					
14:00	**PL**	**Core CPI**	**Mar**	**%YoY**	**1.8***	**2.1**	**1.7**
16:00	US	Home sales	Mar	m	5.0	-	4.88
		THURSDAY (21 April)					
10:00	DE	Ifo index	Apr	pts	110.5	-	111.1
11:00	**PL**	**Tender of 48-week T-bills**					
14:00	**PL**	**Business climate**	**Apr**	**pts**	**-**		
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	393	-	
16:00	US	Leading indicators	Mar	%MoM	0.2	-	0.8
16:00	US	Philly Fed index	Apr	pts	37.0	-	43.4
		FRIDAY (22 April)					
	DE, GB, CH,US	Market holiday					

Source: BZ WBK, Parkiet, Reuters *consensus from *Parkiet* survey before March CPI data

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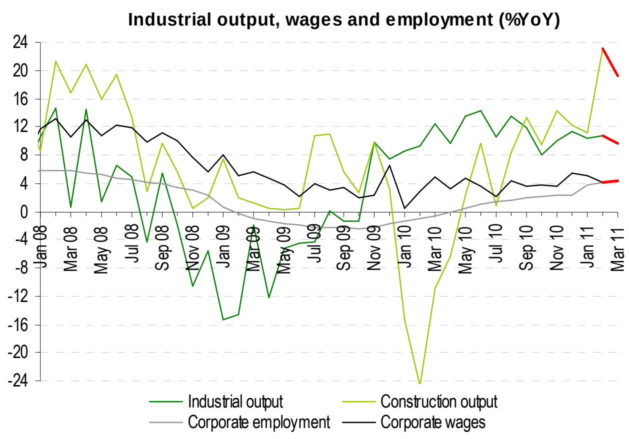
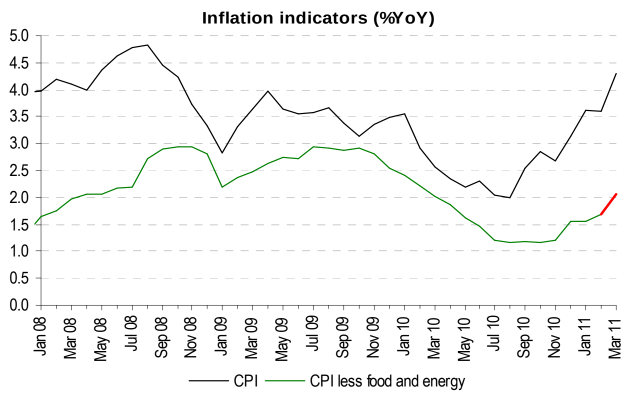
What's hot this week – Important foreign and domestic data

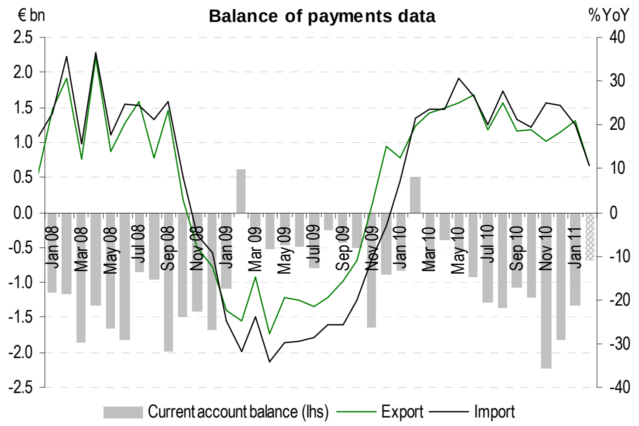


- At the beginning of the week we will see another data important for the monetary policy. We expect it will confirm positive tendencies on the Polish labour market.
- The PMI index for Polish manufacturing increased in March, which is a risk factor for our forecast, indicating a slight decline of annual growth of industrial output. Lower than in February positive base effect will exert pressure on annual growth of construction output. In our view the data will show persistence of positive tendencies in economic activity.
- In our opinion, the general interpretation of this data will be optimistic, although not enough to strengthen the expectations for 50bp interest rates hike in May.

Economy last week – Inflation surprised again



- The consumer prices increased in March well above expectations, by 0.9%MoM and 4.3%YoY. One of the main sources of that surprise was stronger than we anticipated increase in prices of food and beverages (2.1%MoM), in particular nearly 40% surge of sugar prices (we mentioned that risk factor in our latest weekly report). Also prices of clothes and footwear surprised on the upside as their increase was several times higher than usual. Also prices of fuel advanced but the increase was in line with our forecast (3.1%MoM). We expect that the CPI inflation will remain well above 4%YoY until the end of this year.
- According to our estimates core inflation after excluding food and energy prices rose in March by 2.1%YoY (MinFin expects 2%) and may head towards 3% later in the year.



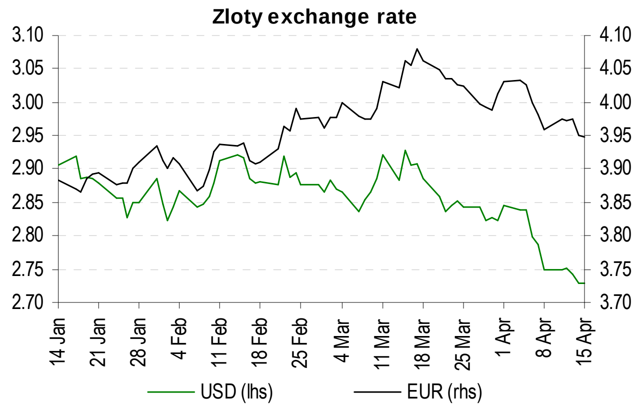
- The February data on balance of payments showed higher than expected current account deficit at €685m. The trade deficit was well below our expectations (€163m), mainly due to very low imports. It is worth to stress that January's data – showing imports that obviously seemed underestimated – was revised well up. The exports decelerated notably to 10%YoY and although it was slightly lower than we expected, we already claimed that growth at 20%YoY is hardly sustainable.
- The M3 money supply advanced in March by 10.8%YoY, well above expectations. A robust growth of loans for companies was recorded, which supports hopes of recovery in investment. Still, the biggest impact on higher money supply was caused by high flow of funds related to payment for BZ WBK stocks.

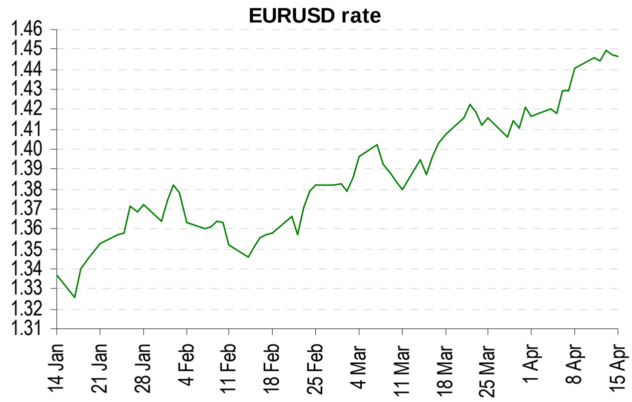
Quote of the week – We have to act

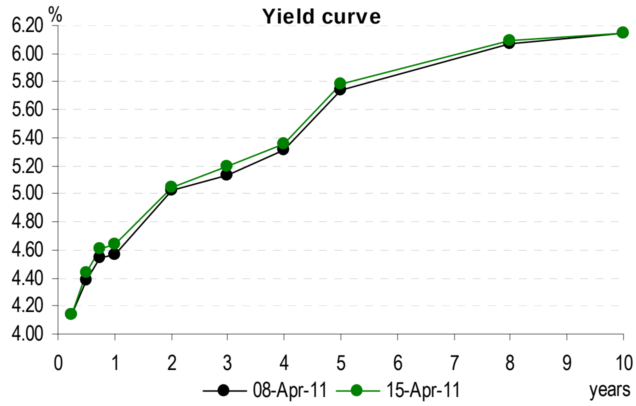
Andrzej Kaźmierczak, MPC member, PAP, 13th April
We are on a monetary tightening path, what does not mean automatism of rate hike when inflation increases.
Anna Zielińska-Głębocka, MPC member, Reuters, 13th April
A rate hike in May is justified.
Andrzej Bratkowski, MPC member, PAP, 14th April
A quick hike by 50bp would be credible for the market. However, I can not exclude, that MPC decides to hike by 25bp.
Marek Belka, NBP governor, Reuters, 14th April
(…) decisions concerning the interest rates are not based on last month's statistical data.
Zyta Gilowska, MPC member, Reuters, 15th April
Decision upon another rate hike is made basing on detailed information, including the core inflation measures. It can not be excluded, that a hike will be delivered in May or June.

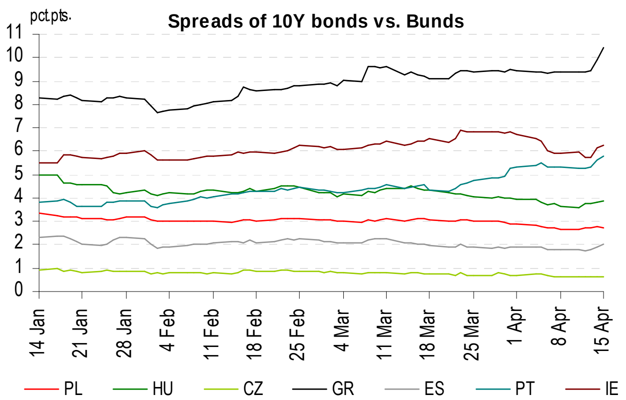
The CPI figures – in the context of recent comments of MPC's Kaźmierczak and Bratkowski – have strengthened the market expectations for rate hikes in May by 50bp. The NBP governor tried to play down such speculation as soon as possible, underlining, that he does not fear an excessive wage growth as the labour supply is increasing. In our view, Mr. Belka will not be eager to back a hike greater than 25bp in May. Prior to MPC sitting many important data are due to release, which can affect the assessment of the situation, but we still think, that a 50bp hike would be a good move, but the Council can lack courage to do it. From the recently published results of vote in March results, it seems that if Mr. Winiecki and Ms. Zielińska-Głębocka vote in line with their recent comments, then one more vote would be needed to deliver a hike in May. The core inflation figures can invigorate Zyta Gilowska to support a hike.

Market monitor









The zloty appreciation will continue

- At the beginning of the previous week the zloty weakened against the euro and the dollar amid declining demand for risky assets. A factor, which made the domestic currency end the week in positive territory, was inflation figures. The expectations for rate hike in May pushed the EURPLN rate to the lowest level since February and the USDPLN rate lowest since December 2009. The only CEE currency, which has weakened was the forint, which was not supported by higher than expected inflation in Hungary. In case of forint the sour global sentiment was prevailing. In line with our expectations, the EURPLN rate dropped to 3.94 level, but failed to break it. In our view the zloty's appreciation potential did not run out of fuel yet. We think, that there is a high probability of EURPLN rate decline. After breaking the still valid support area at ca. 3.94, the rate may head towards 3.90. Resistance is 3.98. On Monday the Hungarian central banks is deciding on interest rates, but more important – if rates remain unchanged, in line with expectations – will be the communiqué, which can affect the market, together with other important publications this week.
- The EURUSD rate was stable throughout the previous week in 1.436-1.452 band. The euro tested the resistance at 1.452, but failed to break it as the dollar was supported by US data on retail sales and against the single currency worked investors' concerns about Greece. The dollar gained after release of US inflation figures, which reached 2.7%YoY, just as in the euro zone. We expect, that the decline in EURUSD, which strengthened last week, will be continued this week, although at a calmer pace. We stick to our forecast, that the 1.452 level will not be broken in the near future.

The data will not increase the expected hike scale

- The March inflation figures caused a flattening of domestic yield curve last week. A strong impulse, about which we wrote in the last report, has pushed the 2Y bonds' yields upwards by almost 10bp. In the following days this move was moderately corrected. The long end remained stable. The FRA rates indicate, that the market is pricing-in a 25bp rate hike in May. In our view the domestic data due to release this week will not be hawkish enough, to increase the expected magnitude of tightening and cause substantial market volatility. We expect, that the imminent Easter will limit the investors' activity and the yields on the domestic debt market will not change substantially this week.
- On the core debt markets the yields dropped throughout the week due to strong demand for safe assets. The yields of 10Y Bunds reverted from peaks set in the last days.
- The previous week brought an increase of spreads between 10Y Bunds and PIIGS countries' bonds. The price of Greek bonds fell most, due to raising concerns, that a debt restructuring will be inevitable in this country. The deteriorated sentiment weighted on Portuguese bonds as well, although the country redeemed its bonds worth €4.2bn maturing this month. The Irish bonds' yields were pushed upwards because of both issue of Greek debt and downgrade by Moody's to the lowest investment grade.

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