

Weekly economic update

9 – 15 May 2011

Only at the beginning of the last week the market sentiment was moderately positive. In the following days the risk aversion was prevailing. Investors were disappointed by quarterly results of companies (e.g. European banks) and a number of macro data (PMI and ISM indexes in services, industrial orders in Germany). Less hawkish than expected tone of ECB's communiqué triggered a substantial drop in EURUSD. In face of declining demand for risky assets the stock indices went down. The downward correction occurred on the commodity market as well. The stock markets pared some losses after better than expected US non-farm payrolls report released on Friday. The domestic currency was not neutral to the global market events and weakened against major currencies, especially against the dollar.

This week the most important events for the domestic market will be the Wednesday's MPC decision and Friday's CPI figures for April. Our forecast and market consensus indicate that the Council is to keep interest rates on hold, thus the content of post-meeting statement will be crucial for the zloty and domestic bonds. We anticipate a slight sharpening of its tone due to substantial acceleration of CPI inflation in March and still high level of households' inflation expectations. Such a tone of the statement would support our forecast of a rate hike in June. Another factor cementing expectations for monetary tightening at the MPC meeting in June will be – anticipated by us – slight acceleration of CPI inflation in April. Until the announcement of the MPC decision we expect a stabilisation of domestic debt market, especially at the shorter end. The zloty may gain amid expectations for exchange of the euro by the FinMin through the state-owned BGK bank. The most important figures abroad are due for release in the second part of the week. They include Chinese CPI and US retail sales, inflation and consumer confidence.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (9 May)							
8:00	DE	Exports	Mar	%MoM	0.8	-	2.7
10:30	EZ	Sentix index	May	pts	12.0	-	14.2
11:00	PL	Tender of 46-week T-bills worth PLN0.4-0.6bn					
TUESDAY (10 May)							
14:30	US	Import prices	Apr	%MoM	1.8	-	2.7
16:00	US	Wholesale inventories	Mar	%MoM	1.0	-	1.0
WEDNESDAY (11 May)							
	PL	MPC decision		%	4.0	4.0	4.0
4:00	CN	CPI	Apr	%YoY	5.2	-	5.4
4:00	CN	Industrial output	Apr	%YoY	14.7	-	14.8
14:30	US	Trade balance	Mar	\$bn	-47.0	-	-45.8
THURSDAY (12 May)							
11:00	EZ	Industrial output	Mar	%MoM	0.3	-	0.4
14:30	US	PPI	Apr	%MoM	0.6	-	0.7
14:30	US	Initial jobless claims	week	k	430	-	474
14:30	US	Retail sales excluding autos	Apr	%MoM	0.6	-	0.8
FRIDAY (13 May)							
11:00	EZ	Flash GDP	Q1	%QoQ	0.6	-	0.3
14:00	PL	CPI	Apr	%YoY	4.4	4.4	4.3
14:00	PL	Money supply M3	Apr	%YoY	9.1	9.8	10.8
14:30	US	Core CPI	Apr	%MoM	0.2	-	0.1
15:55	US	Flash Michigan index	May	pts	70.0	-	69.8

Source: BZ WBK, Parkiet, Reuters

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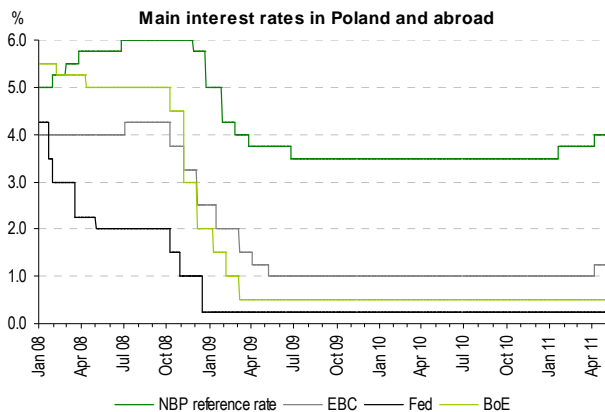
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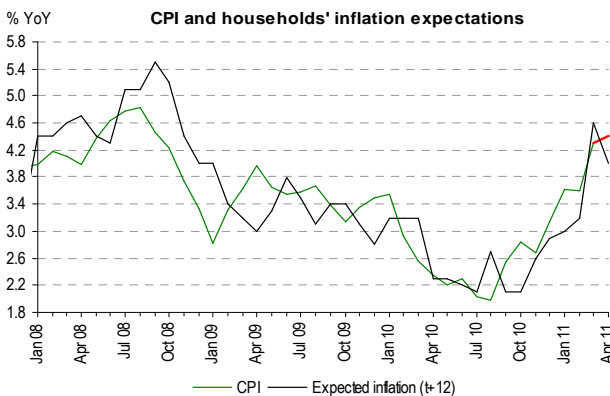
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What's hot this week – MPC meeting and CPI figures



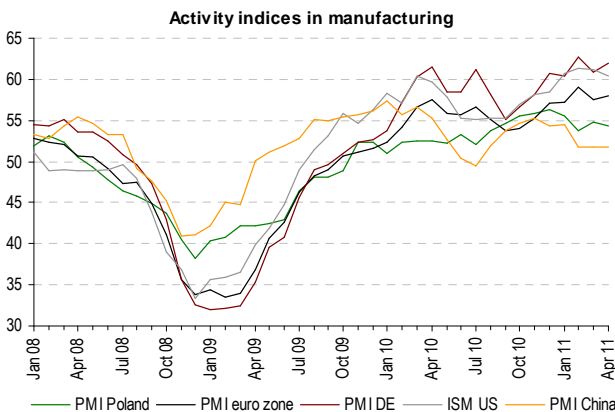
■ The most important event for the domestic market this week will be the MPC meeting. The surprisingly high CPI inflation reading in March triggered a few hawkish comments from MPC members (Zielińska-Głębocka, Bratkowski and even usually dovish Kaźmierczak). However, in the following days message from the MPC softened. The factors, which could reduce the willingness of MPC members for a quick hike (already in May) include: agreement of the NBP and the Ministry of Finance concerning the exchange of euro funds on the market (the importance of this issue was confirmed by comment from Adam Glapiński - see the *Quote of the week* section below) and less hawkish than expected tone of press conference after the ECB meeting last week, which weakened expectations for the next rate hike in the euro zone.



■ After the MPC meeting, the market will await the Friday's CPI inflation figures. We expect a slight acceleration of yearly CPI dynamics, mainly due to advancing food prices and low last year's base. In our view the other categories' yearly dynamics should stay at levels similar to those observed in March.

■ We expect the data to confirm that the inflationary pressure remains strong, which justifies the necessity for further monetary tightening. The still high level of households' inflation expectations (although they dropped to 4.0% from 4.6% in March) poses a threat of second round effects occurrence (about which we wrote in detail in our last MACROscope monthly report in April).

Economy last two weeks – Stronger than expected retail sales, disappointing PMI



■ Poland's PMI manufacturing for April proved weaker than expected, dropping to 54.4. Pace of output growth stabilised. For the first time in 7 months production backlogs dropped, which was to some extent a result of investment aimed at increasing production capacity. Enterprises also continued to increase employment, although at slightly slower pace than in March. Detailed indices support our expectations for continuation of employment growth and revival in investment activity. However, a negative element of the PMI survey were sub-indices indicating strong inflationary pressure.

■ Data on retail sales and unemployment confirmed quite positive situation in Polish economy in Q1. The consumers' demand recovered pretty fast from a temporary slowdown triggered by VAT hike and is growing quite quickly, while the number of unemployed declines.

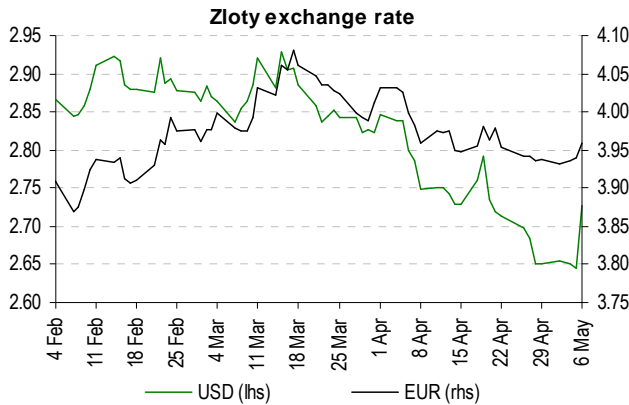
Quote of the week – The strong zloty is the best way to curb inflation

Adam Glapiński, MPC member, Reuters, 27th April

However, we can have hope that the euro exchange by the Ministry will persistently and moderately strengthen the zloty. It is not about rapid changes, but about compensating for the oscillations. (...) nothing has a stronger impact on inflation than zloty appreciation. (...). If (the zloty appreciates), it will prevent the MPC from hiking the interest rates in some cycles, but we should not stick to it too much.

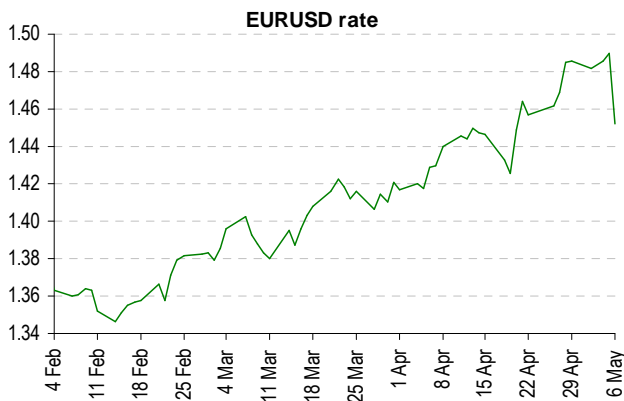
Adam Glapiński, who voted against rate hike by 25bp in March, was the only MPC member who commented on the NBP and MinFin's joint decision on exchange of foreign currency in the market. His comment indicates that the outlook for sale of the euro in the market and thus gaining an anti-inflationary impulse thanks to the strong zloty could have affected also other MPC members, who were not convinced about the necessity of further monetary tightening. In our view the configuration of votes during the meeting this week can be similar as in March, when only radical hawks (Bratkowski, Rzońca) and Hausner voted for a hike.

Market monitor

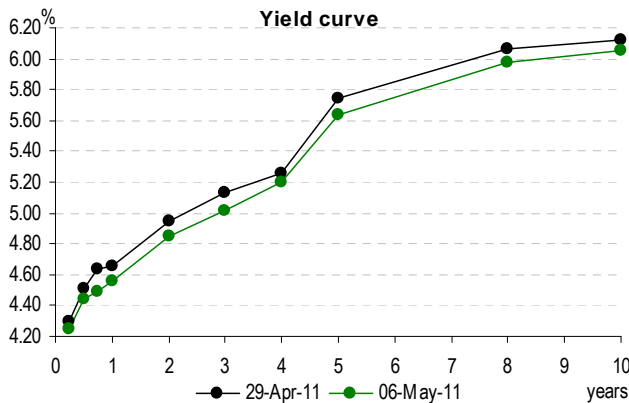


Zloty strengthening thanks to BGK

▪ Prior to the long weekend the EURPLN broke the 3.94 level, but last week the zloty weakened against the euro and more substantially against the dollar. The negative pressure on the domestic currency was exerted by persisting risk aversion, which emerged after disappointing companies' results and weak macro data. A strong depreciation against the dollar is an effect of slump of EURUSD rate due to less hawkish than expected ECB. On Friday the zloty pared some losses and on the market rumours emerged that BGK had sold the euro. Since the beginning of the week the forint weakened as well, although it managed to pare some losses against the euro at the end of the week. The Czech koruna was relatively stable throughout the week. This week the communiqué after MPC will be important for the zloty, as it – in spite of no hike in May – will sustain the expectations for rate hikes in the further part of the year and will lead to decline of EURPLN rate together with expectations for further attempts to strengthen the zloty by BGK. We expect the rate to stay in 3.90-3.98 band.

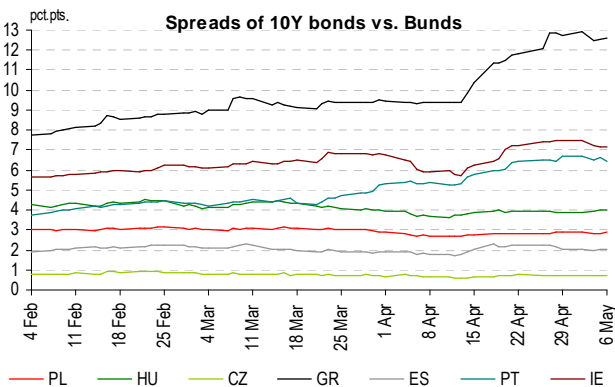


▪ The EURUSD rate increased in the week prior to ECB sitting and hovered below 1.49 for the first part of last week while awaiting the post-meeting press conference. The expectations for wording signalling the rate hike in June have successfully limited the potential for rate decline due to persisting risk aversion. As the conference began, a rapid euro depreciation occurred, the EURUSD rate dropped from ca. 1.482 to 1.45 due to deteriorating expectations for rate hike in June. Another downward impulse was provided by the US labour market figures, but turned out to be only temporary. In due course, at the end of the week the rate fell below 1.45 and, in spite of later rebound, we still see a potential for further drops. First support is 1.435-1.44 area, which – in our view – will not be broken.



Stabilisation of yields prior to the MPC meeting

▪ The long weekend has effectively limited the activity on debt market in Poland. Last week the yields dropped on the whole length of the curve. On the middle and long end this was caused initially by quite successful bonds swap auction and in case of 2Y bonds the drop was caused by less hawkish than expected ECB governor, which can limit to some extent the MPC's willingness to rates hike in the nearest future. On Friday the move was continued on the whole length of the curve. The market expectations concerning soon hikes deteriorated substantially, so a slight sharpening of post-meeting MPC communiqué tone can move the yields slightly upward, especially the FRA rates. In case of bonds the reaction to the communiqué can be limited by the swap auction and the anticipation for the Friday's inflation figures, which will not affect the market substantially in our view.



▪ On the core debt market the yields recorded drops, mainly in case of Treasuries. This was caused by persisting for the whole week risk aversion on the global market. In case of Bunds the drop was slight, at the beginning of the week it was limited by the news about successful end of negotiations on the financial aid for Portugal. In the following days the yields dropped after ECB post-meeting conference.

▪ The spreads of euro zone peripheries' bonds against the 10Y Bunds narrowed, especially in case of Ireland, which recorded a substantial decrease of bonds' yields (by 35bp). The changes were slight in case of other countries, the yields of Portuguese bonds dropped only by a couple of bps.

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