Bank Zachodni WBK

Weekly economic update

16 – 22 May 2011

Uncertainty regarding situation in Greece and Portugal, a few disappointing macro figures and quarterly earnings reports as well as decision of the Chinese central bank to increase reserve requirement negatively affected sentiment in the global markets the last week. As a result, the euro lost versus the dollar while currencies in the region weakened against majors. The zloty was positively affected by activity of the BGK in the market and unexpected rate hike by the NBP. Strengthening of expectations for another rate hike already in June caused that the market did not react to slightly higher than predicted CPI figures for April.

This week will be full of domestic macro data, but in our opinion they will not have impact on the market, similar as the CPI data. We expect that the upward tendency in yields will be continued this week. Possible rise in risk aversion connected with situation in Greece may lead to a correction of the last zloty appreciation, especially that this is suggested by technical analysis. The global market will probably focus on the meeting of the euro zone and EU finance ministers, who will debate over the issue of additional aid for Greece. The EURUSD, which is currently close to an important technical level, may be influenced by minutes of the last FOMC meeting. The market may also react to a series of the US macro figures with particular focus on data on the housing market and industrial output.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (16 May)					
11:00	**PL**	**Tender of 45-week T-bills worth PLN0.5-1.0bn**					
11:00	EZ	HICP	Apr	%YoY	2.8	-	2.7
14:00	**PL**	**Exports**	**Mar**	**€m**	**11 581**	**11 578**	**10 309**
14:00	**PL**	**Imports**	**Mar**	**€m**	**12 015**	**12 086**	**10 472**
14:00	**PL**	**Current account**	**Mar**	**€m**	**-1 177**	**-1 177**	**-685**
14:30	US	NY Fed index	May	pts	20.0	-	21.7
		TUESDAY (17 May)					
11:00	DE	ZEW index	May	pts	5.0	-	7.6
14:30	US	House starts	Apr	k	568	-	549
14:30	US	Building permits	Apr	k	580	-	585
15:15	US	Industrial output	Apr	%MoM	0.4	-	0.8
		WEDNESDAY (18 May)					
10:30	GB	BoE minutes					
11:00	**PL**	**PS0416 bond auction**					
14:00	**PL**	**Wages**	**Apr**	**%YoY**	**4.5**	**4.9**	**4.0**
14:00	**PL**	**Employment**	**Apr**	**%YoY**	**4.0**	**4.0**	**4.1**
20:00	US	Fed minutes					
		THURSDAY (19 May)					
14:00	**PL**	**MPC minutes**					
14:30	US	Initial jobless claims	week	k	420	-	434
16:00	US	New home sales	Apr	m	5.24	-	5.1
16:00	US	Philly Fed index	May	pts	20.0	-	18.5
		FRIDAY (20 May)					
14:00	**PL**	**Core CPI**	**Apr**	**%YoY**	**2.1**	**2.0**	**2.0**
14:00	**PL**	**Industrial output**	**Apr**	**%YoY**	**6.6**	**6.2**	**7.0**
14:00	**PL**	**Construction output**	**Apr**	**%YoY**	**19.0**	**15.8**	**24.2**
14:00	**PL**	**PPI**	**Apr**	**%YoY**	**8.6**	**8.4**	**9.3**

Source: BZ WBK, Parkiet, Reuters

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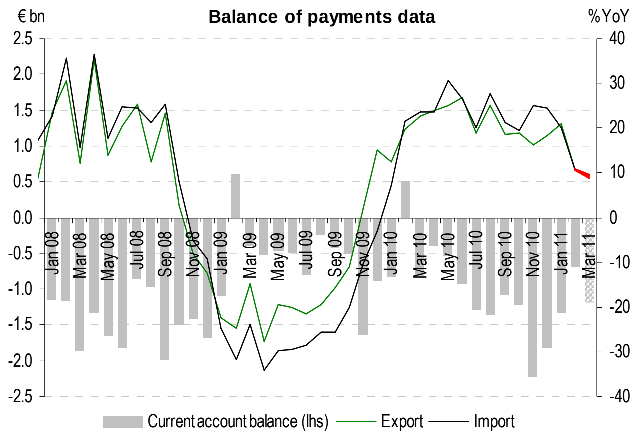
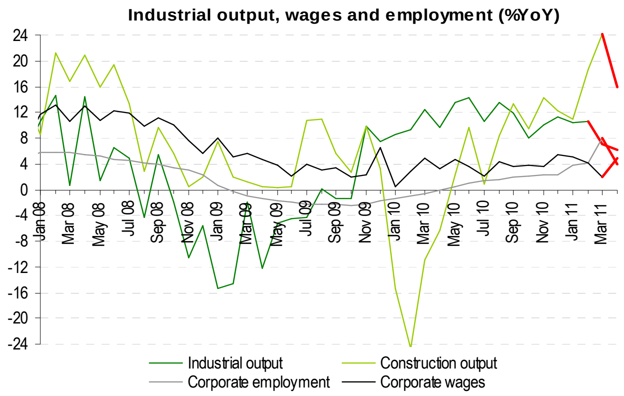
What's hot this week – Important domestic data, large dose of events in the US

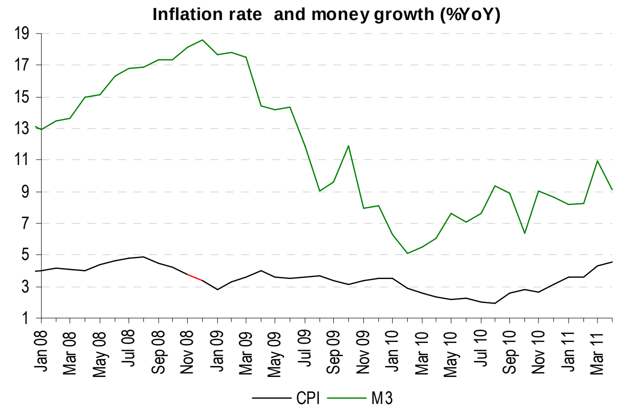


- We expect widening of the current account gap in April, mostly due to seasonal rise in imports, which only partly will be offset by rise in exports. The annual growth rates in exports and imports will decelerate due to high base in 2010. The foreign trade data published by the CSO suggest that exports may be slightly lower than we forecast and imports could be slightly higher.
- Labour market data should confirm continuation of moderate wage growth (with a slight acceleration) and further rise in employment. Since April 2010 a clear creation of jobs started and this will negatively affect the annual pace of employment growth this year. Thus, we forecast some slowdown in employment growth in April this year. In our view, the data will not change prospects for monetary policy and should not have impact on the market.



- As regards data on industrial output for April, we predict that they will show further slowdown in annual growth. To some extent this will be a result of drop in activity related to Easter which will also affect the recent clear correction of the last solid rise in construction output. A possibility of a slowdown in industrial output is also suggested by PMI.
- We forecast, similar as the market, a slight deceleration of PPI inflation due to higher base than a month earlier. Slower monthly rise in producer prices will be a result of the zloty appreciation trend lasting since mid-March.
- All in all, we expect confirmation that industrial output growth stabilised below 10%YoY while inflationary pressure at the producers level remained strong.

Economy last two weeks – Brave decision of the MPC, CPI data not surprising



- Annual CPI inflation in April rose to 4.5%, i.e. slightly stronger than we expected. The reason for deviation of the actual reading from our forecast is stronger than we expected rise in prices of foodstuff and clothing and footwear. All in all, CPI figures for April confirm expected by us scenario of acceleration in inflation until the end of this year. However, we think that the data will not be a sufficient argument to convince majority of MPC members to deliver another rate hike (the third in a row) at its meeting in June.
- In line with expectations, money supply growth in April decelerated quite clearly amid significant reversal of the effect connected with inflow of funds related to payments for BZ WBK shares by Santander. It is worth to note that the data showed further in growth of corporate borrowing, to 6.4% from 4.0% in March.

Quote of the week – Only acceleration or extending the scale of hikes?

Marek Belka, NBP governor, press conference, May 11.

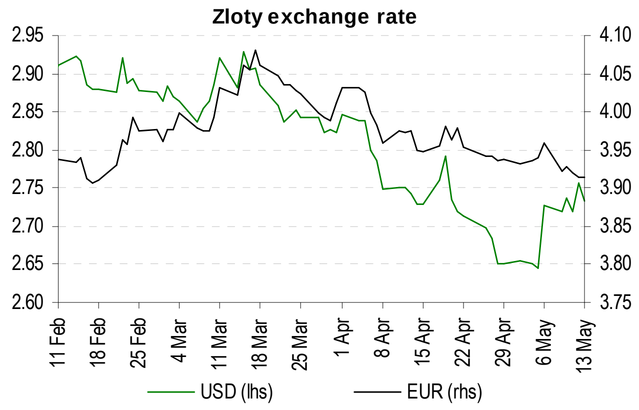
Apart form higher food and energy prices we observed also growth of other goods and services. That was an important factor for at least some part of MPC members, that backed the interest rate hike.

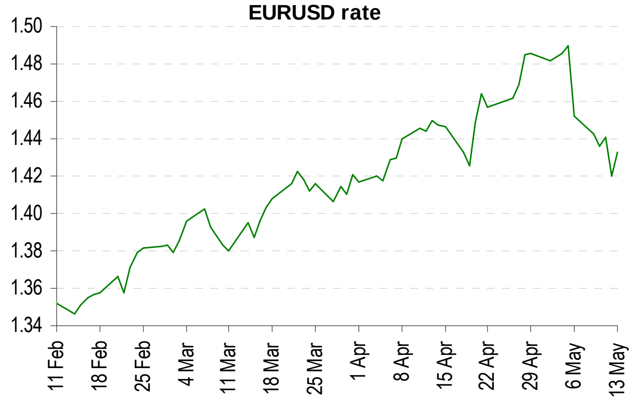
Some market commentators misinterpreted the decision of the FinMin on selling currency on the market and wrongly perceived it changed the MPC's outlook on the interest rates. That happened even despite I clearly underlined on the press conference a few weeks ago that this decision in perceived by us only through the necessity of lowering excess liquidity on the market and cutting costs of sterilization of that excess liquidity.

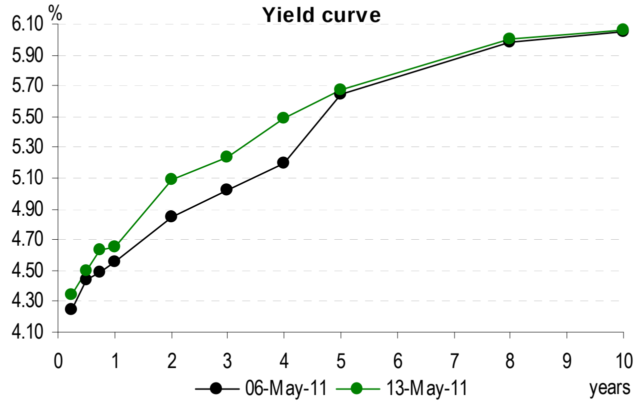
Amid higher market expectations there was some acceleration of monetary policy tightening. It is connected with assessment of the situation by some MPC members for whom certain factors had decisive meaning. I mentioned one, which I see as most important.

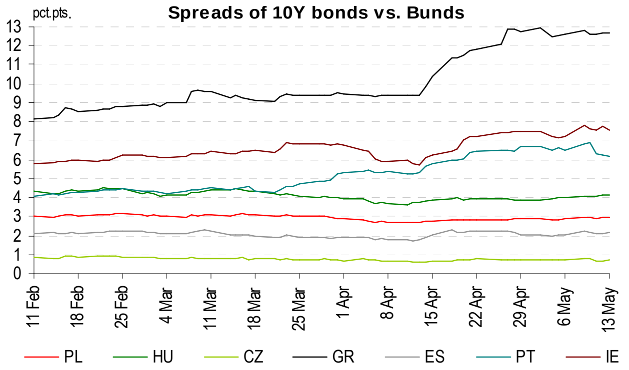
The Monetary Policy Council surprised vast majority of market participants, raising interest rates in May by the second time in a row by 25bps, though the decision is not that surprising, if we take into account the economic situation. The hike would have taken place sooner or later. What about the interest rates in coming months? It is difficult to find an answer to this question in the MPC's statement, just like in the previous month, because the statements are quite similar to each other. So one could say that if the Council raised the interest with a similar message, it may do the same next month. Still, when taking under consideration that latest data on inflation showed only slight increase, core CPI should rise only slightly and wage growth will accelerate not more than to 5%, we expect that next interest rate hike will rather take place in July than in June.

Market monitor









Zloty stronger after the MPC, time for correction

▪ The zloty appreciated versus the euro and was stable versus the dollar over the past week. Amid high risk aversion persisting for the better part of the week the domestic currency was supported by BGK euro's selling and unexpected interest rate hike by the MPC. Consequently, the EURPLN declined temporarily below lower band of suggested by us range (3.90). Friday's data on CPI did not have any clear impact on the market. The Czech's koruna and Hungarian forint depreciated versus the euro amid low demand for risky assets. Falling stock indices in our region put negative pressure on that currencies. The EURPLN rebounded in the past week from the support level at just below 3.89 and technical analysis suggests that the upward correction initiated at the end of the week may be continued this week. The fact that June's interest rate hike is already partly priced in and its is possible that investors will focus on Greece are factors that potentially could support the upward move of the EURPLN.

▪ The EURUSD, after short stabilization the beginning of the week at around suggested by us support at 1.435-1.44 plunged in the following days. The euro was under pressure amid uncertainty regarding the situation in Greece and not clear decision on Finland's decision on help for Portugal. At the end of the week the downward trend was halted after i.e. better than expected GDP data from Germany and France. At the beginning of this week the case of possible next aid for Greece will be discussed by finance ministers of the euro zone (Monday) and whole EU (Tuesday). The EURUSD ended the week close to crucial support level and if it is broken the exchange rate may fall to 1.40. The resistance is at 1.44.

Continuation of upward trend in yields

▪ Yields on the domestic fixed income market were stable amid low investors' activity until the moment of MPC decision announcement. The unexpected interest rate hike pushed the curve up, mainly its short end. That move was further fuelled by correction after latest yields' plunge that occurred in the previous week. The shortest FRA rates also recorded strong increase and presently they partly price in that next interest rate hike will take place already in June. Friday's data on CPI had no market effect. We expect that this week the upward trend of yields may be continued and domestic macro data will not have much impact. The pressure on the middle and long end of the curve will be put by the perspective of 5Y bonds auction.

▪ On the core fixed income markets yields were stabilized after having been falling since mid-April. Yields of 10Y Bunds and Treasuries reached the lower band of horizontal trend in which they stayed since mid-February. So far the potential for a rebound seems to be limited as uncertainty regarding Greece and Portugal remains alive.

▪ Over the past week spreads versus 10Y Bunds narrowed most in case of Portugal bonds. That was due to information from Finland, where the government managed to gather the majority needed to vote for a bailout package for Portugal.

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