

# Weekly economic update

27 November – 3 December 2006

The set of activity indices for October released the last week, that is industrial and construction production and retail sales have noted a strong growth. The results of CSO's business climate survey showed the upkeep of the positive trends in the economy in the next months of Q4. Official data about companies' financial results also bode well for future economic activity, and especially for investment activity. This data showed that a clear trend of growing financial results has been kept, and financial results of exporters are still above the average for all companies. This suggests that there are chances to upkeep the strong exports expansion, which would be positive for the zloty in the medium-term. Generally, data released last week signalled that GDP growth in Q4 should not be much weaker than in the previous quarters – the Ministry of Finance assesses it will be around 5.5%, which is in line with our view. Meanwhile, inflation data released last week (PPI and core inflation measures) showed that the pressure on prices remains limited.

This we will see the next meeting of the MPC and GDP figures for the third quarter. Based on available monthly data, we assess that economic growth amounted to 5.5% in that period, but according to CSO representatives the risk for this forecast is on the upside and GDP growth in Q3 could have been higher. CSO released preliminary LFS survey for Q3 (full results will be published in the next month) and it appears that unit labour cost growth pace accelerated in the whole economy which can raise central bankers' concerns about future pressure on prices. However, we do not expect the concerns to be significant enough so that provoke a rate hike. The MPC will, in our view, want to wait for the next figures.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>TUESDAY (28 November)</b>							
9:00	EMU	Money supply (H)	Oct	%	8.7	-	8.5
13:30	USA	Durable goods orders (H)	Oct	%	-4.0	-	8.3
15:00	USA	Consumer confidence (H)	Nov		106.0	-	105.4
15:00	USA	Home sales (H)	Oct	m	6.15	-	6.18
<b>WEDNESDAY (29 November)</b>							
	<b>POL</b>	<b>MPC meeting - decision (H)</b>		%	<b>4.0</b>	<b>4.0</b>	<b>4.0</b>
13:30	USA	Preliminary GDP (H)	Q3	%	1.8	-	1.8
15:00	USA	New home sales (H)	Oct	m	1.8	-	1.6
<b>THURSDAY (30 November)</b>							
<b>9:00</b>	<b>POL</b>	<b>GDP (H)</b>	<b>Q3</b>	<b>%YoY</b>	<b>5.5</b>	<b>5.5</b>	<b>5.5</b>
10:00	EMU	Economic sentiment (H)		Nov	110.5	-	110.3
10:00	EMU	Revised GDP (H)	Q3	%YoY	2.6	-	2.7
10:00	EMU	Preliminary HICP (H)	Nov	%YoY	1.8	-	1.6
15:00	USA	Chicago PMI (H)	Nov		54.8	-	53.5
<b>FRIDAY (1 December)</b>							
9:00	EMU	Manufacturing PMI (H)	Nov		57.1	-	57.0
15:00	USA	Manufacturing ISM (H)	Nov		51.8	-	51.2

\* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK

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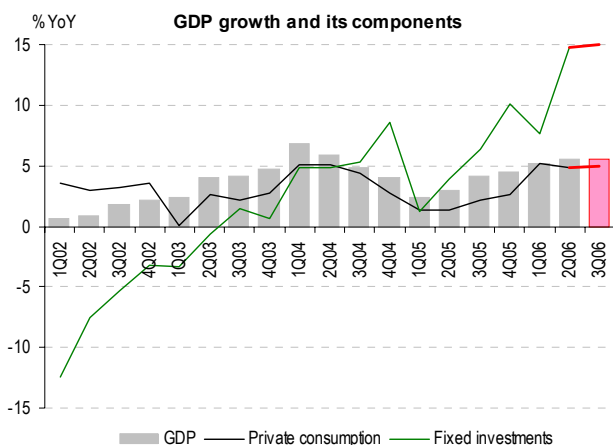
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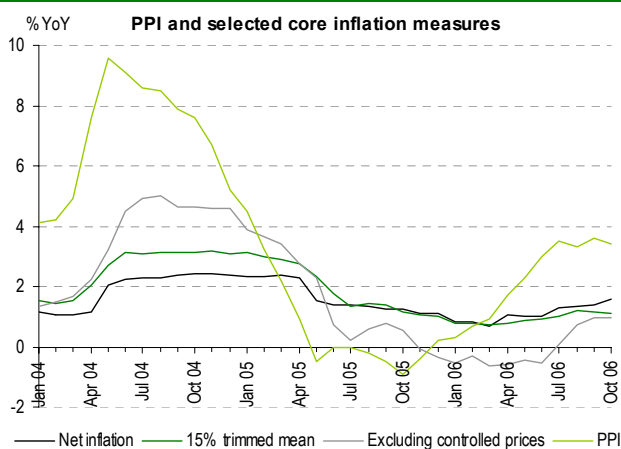
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## What's hot this week – MPC meeting and GDP figures

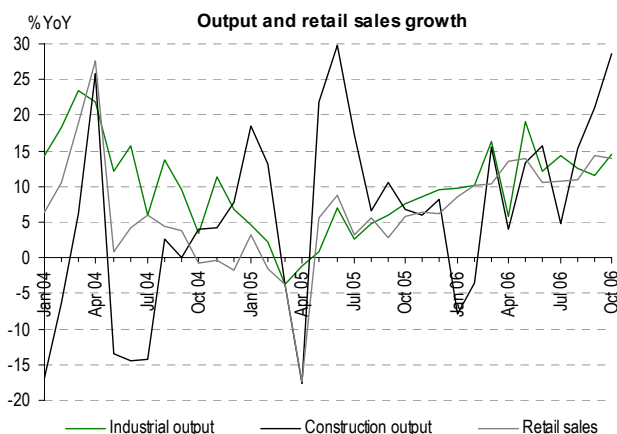


- There will be important events for the Polish market in the incoming week: we will get to know the outcome of the MPC meeting, and the day after the GDP figures for Q3 will be released.
- Before obtaining figures for Q3, MPC is not likely, according to our opinion, to change its view on inflation prospects. The balance of strength within the Council may change only after the MPC receives all the data for Q3 (including LFS) and new inflation projection (due for publication in January).
- We expect that the economic growth in Q3 amounted to 5.5% at least (in line with market consensus) amid private consumption growth of 5%, and investment growth of 15%. Net export contribution to GDP growth was, according to us, slightly negative (ca. -0.5pp).

## Economy last week – Strong economy, benign inflation



- Inflation figures released last week confirmed that despite higher demand, inflationary pressure remains limited.
- NPB figures showed that all core inflation measures fell in October. The most closely observed measure, that is net inflation lowered to 1.3%YoY from 1.4%YoY in September, confirming that the CPI inflation slowdown in October was not only the effect of sharp fall in fuel prices, but also the consequence of the fact that growth rates of other prices are not accelerating substantially, and are even lowering, despite very strong economic growth.
- PPI inflation decelerated as well, from 3.6%YoY to 3.4%YoY, thanks to fall in prices of fuel and other commodities. Prices in manufacturing rose a mere 1.7%YoY, showing that permanent and strong demand growth has no consequences on wholesale prices.



- Industrial output growth amounted to 14.5%YoY in October. In manufacturing output growth was even stronger and exceeded 17%YoY. To a certain extent, high production growth was due to higher number of working days. However, even after excluding this factor, the result was good. Output growth after seasonal adjustments was a healthy 12.5%YoY.
- Construction output rose very rapidly, by 28.8%YoY (28.2% after seasonal adjustments), which was one of the highest results ever. This suggests that strong investment expansion observed in the two first quarters of the year (and probably also in Q3) transferred to Q4.
- Retail sales also noted a strong growth (13.3%YoY in nominal terms and 13.9%YoY in real terms), confirming upward trends in the economy.

## Quote of the week – GDP growth in 3Q not weaker than in 2Q

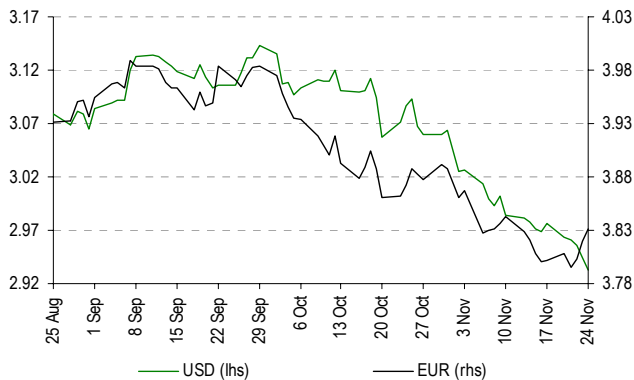
**Janusz Witkowski; CSO's deputy president,**  
PAP, 24 November

*Now we have foreign trade data for the first nine months. They have not worsened the picture of the situation. This is why we can keep our assessment that GDP growth in Q3 will not be worse than in Q2. (...) Economy has started well the fourth quarter. October was another month of strong economic growth. (...) It seems that in the third quarter, investment dynamic was the highest.*

Comments of CSO's deputy president suggest that the risk for our GDP forecast for the third quarter (in line with market consensus) is on the upside, which means that it is unlikely that growth could have been lower than the forecasted 5.5% and it might have been higher. His comments also suggest that according to data for October there are reasons to have an optimistic view on economic growth in the final quarter of the year.

## Market monitor

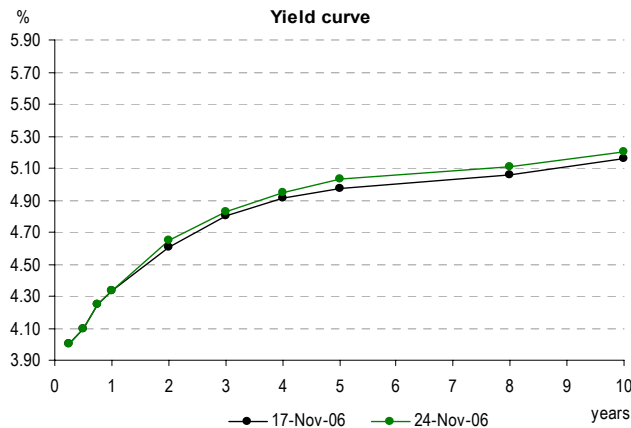
Zloty exchange rate



## Slight correction of the zloty in the mid-week

- In the past week a slight correction occurred after a wave of zloty strengthening in the Polish FX market. It was linked to, among other things, profit taking on emerging markets before the long weekend abroad, the surprising lack of rate hike in Hungary and the lira weakening. The zloty weakened by around 0.7% against the euro but it strengthened against the dollar by 1.4% amid significant weakening of the greenback on the international markets.
- Fundamentals of Polish economy will still be supporting the zloty, though it may be under slight pressure due to the possibility of further profit taking. Sentiment towards the region should remain positive and will be acting against a substantial depreciation. In our view, the EURPLN rate should remain in the 3.75-3.85 range and the USDPLN rate in the 2.93-3.03 range in the coming days.

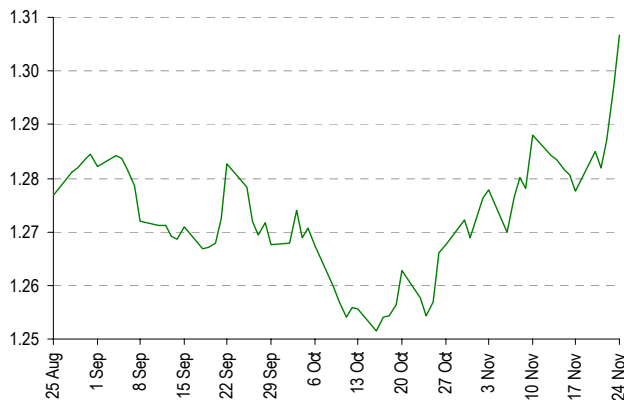
Yield curve



## Slight bonds weakening

- The correction occurred also on the debt market, which gradually weakened during several days of the week. Macroeconomic data that was released and MPC members' declarations did not substantially change expectations concerning moves in monetary policy and did not affect the market. On Friday, core markets provoked a slight bond strengthening, though yields rose during the week by 9-8 bp.
- We still think that it is very likely that the interest rates will remain unchanged in Poland during the next few quarters, though the risk of a slight adjustment of the monetary policy parameters can be boosted by labour market figures. Global slowdown next year will work in the opposite direction. Good GDP figures for Q3 may result in some bonds weakening.

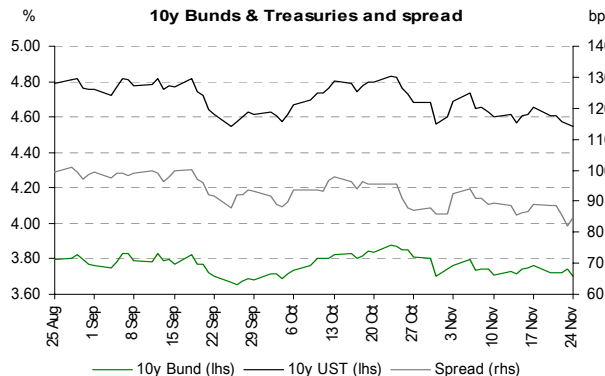
EURUSD rate



## EURUSD above 1.30

- After a slight gain of US dollar in the previous week in the last week foreign investors limited FX positions in the US currency ahead of Thanksgiving Day in US and Japan. Euro strengthened among others after the release of higher than expected Ifo index and lower Michigan index. Yet another news on possible diversification of Chinese currency reserves resulted in EURUSD rate rise up to 1.31, which gives a 2% rise from previous Friday.
- Breaking of the 1.3 level was expected, though it occurred earlier than we predicted. In the nearest days further data from US housing market, economic activity indices, as well as EMU's GDP data in the euro zone are going to be the most important. The liquidity may rise in the international markets and there may be some correction of the EURUSD rate.

10y Bunds &amp; Treasuries and spread



## Strengthening amid low liquidity and strong euro

- Long-term Treasuries' yields were falling during a large part of the week to 4.55% (10Y). It was an effect of, among other things, lower Michigan index. Bunds weakened (high Ifo index), though by the end of the week, there was a substantial strengthening linked to strong euro appreciation amid low liquidity in the market. Yields of 10Y papers fell to 3.7% after a rise to 3.74%.
- During this week many figures will be released in the US. Further weakening of the housing market can upkeep the Treasuries prices at high levels. Durable goods orders data and activity indexes ISM and PMI will also be crucial. Inflation data and money supply as well as revised GDP for the third quarter will be key for the euro zone.

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