Bank Zachodni WBK

# Weekly economic update

## 6 – 12 August 2007

**Last week the moods on the financial markets were swinging like a rollercoaster. At the start of the week we were facing a rebound after significant weakening experienced in the previous week, but on Wednesday another wave of flee from risky assets took place, which was in line with our view presented a week ago. The last days of the week again saw some rebound and the domestic currency gained slightly in value over the whole week. Nevertheless, the zloty remains vulnerable to still existing concerns about situation on the US credit market and possible waves of risk aversion connected with it. Therefore, for this week we maintain the same range of currency fluctuations that we had adopted last week, i.e. 3.77-3.87 for EURPLN and 2.74-2.84 for USDPLN. At the same time we still believe that the zloty will be on average weaker in August than it was in July.**

**There was little activity on the domestic debt market last week. The biggest changes took place in 2Y segment, which was perceived by investors as relatively less attractive than papers with longer maturities. In effect, yield curve flattened. The release of Ministry of Finance's inflation forecast at 2.4%YoY had no impact on the market, although it was above most of earlier released market predictions, including ours, at 2.3%. Our lower prediction results mainly from assumption about deeper seasonal decline in food prices. Official data about July's inflation will be announced on 14 August. In the nearest week the main event for the local market will be publication of data about average monthly wage in Q2. According to our forecast, the data should show high enough pay rise that amid decline in labour productivity it would imply acceleration in growth of unit labour costs to almost 5%YoY. It would be another signal for the MPC confirming threats for medium-term inflation perspectives connected with situation on the labour market.**

### Economic calendar

| Time GMT | COUNTRY | INDICATOR | PERIOD | | FORECAST | | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | | | | MARKET | BZWBK | |
| | | **MONDAY (6 August)** | | | | | |
| **9:00** | **PL** | **Tender of 52-week bonds** | | | | | |
| | | **TUESDAY (7 August)** | | | | | |
| 12:30 | US | Unit labour costs | Q2 | %QoQ | 2.1 | - | 1.8 |
| 12:30 | US | Labour productivity | Q2 | %QoQ | 2.0 | - | 1.0 |
| 18:15 | US | FOMC decision on rates | - | % | 5.25 | 5.25 | 5.25 |
| | | **WEDNESDAY (8 August)** | | | | | |
| **9:00** | **PL** | **Auction of 10Y floating rate bonds and 12-year CPI-linked bonds** | | | | | |
| 14:00 | US | Wholesale inventories | Jun | %MoM | 0.4 | - | 0.5 |
| | | **THURSDAY (9 August)** | | | | | |
| **12:00** | **POL** | **Average monthly wage in the economy** | **Q2** | **%YoY** | **-** | **7.7** | **7.1** |
| | | **FRIDAY (10 August)** | | | | | |
| 12:30 | US | Import prices | Jul | %MoM | 0.9 | - | 1.0 |
| 18:00 | US | Federal budget | Jul | $bn | -32.4 | - | -33.16 |

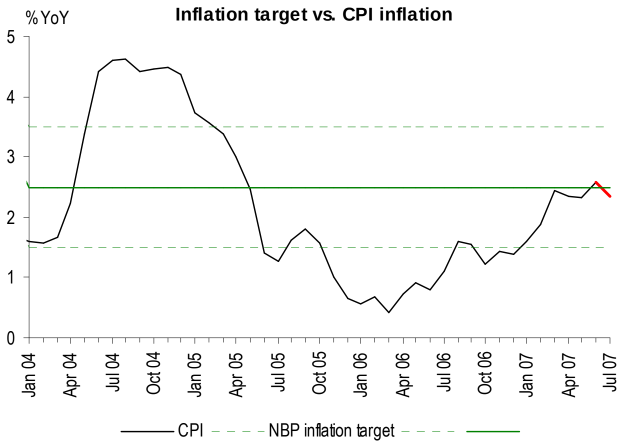
*Source: Reuters*


**Maciej Reluga** Chief economist (+48 22) 586 8363
**Piotr Bielski** (+48 22) 586 8333
**Piotr Bujak** (+48 22) 586 8341
**Cezary Chrapek** (+48 22) 586 8342 e-mail: ekonomia@bzwbk.pl

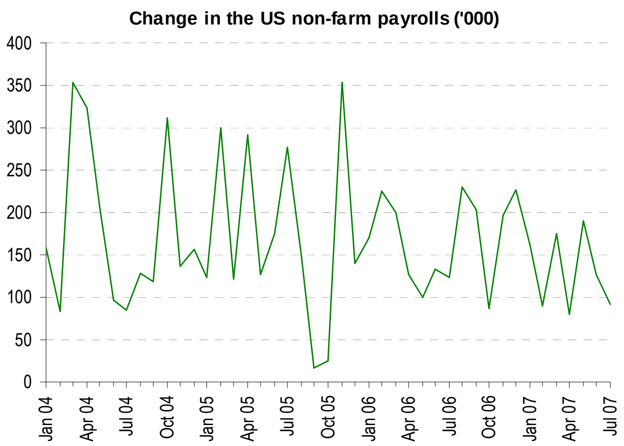
## **What's hot this week –** Data on wages in Q2 and FOMC meeting


- This week we will get data on average wage in the whole economy for 2Q07.
- On the basis of earlier released data for the enterprise sector, we forecast that wage growth in the whole economy accelerated to 7.7%YoY in 2Q07 from 7.1%YoY in 1Q07. Taking into account that for 2Q07 we also predict acceleration in employment growth and lower rise in value added, growth rate of unit labour costs accelerated to nearly 5%YoY in 2Q07. Confirmation of these predictions in the data would be an argument for a rate hike in August.
- This week, amid lack of major data release from the euro zone and light data calendar in the US, all eyes will be on the FOMC meeting. The key factor will be official statement of the Fed, as it is widely expected that rates will remain unchanged.

## **Economy last week –** FinMin's inflation forecast, ECB meeting and US payrolls data




- As usual at the beginning of a month, the Ministry of Finance released inflation estimate for the previous month. According to the ministry, CPI inflation in July dropped 2.4%YoY with 0.2%MoM fall in prices. The ministry expects that in August inflation will fall further to below 2%YoY.
- Our forecast of CPI inflation in July stands at 2.3%YoY with an assumption that food prices fell by around 1.5%MoM and transport prices slightly increased.
- Although our inflation forecasts for the last two months were more accurate than FinMin's estimates, historically good record of FinMin's forecasts accuracy is likely to affect the market expectations and the consensus is likely to be at 2.4%YoY.
- From the MPC's point of view, stabilisation of inflation close to the target for a few months is helpful in anchoring inflation expectations.




- Among many data releases last week, the key one was release of US non-farm payrolls. The data showed that employment in July increase 92k against the revised 126k in June. The market had expected slight decline to 130k from 132k before the revision. The unemployment rate in July increased to 4.6% against market expectations pointing to stabilisation at 4.5%.
- Other events, including meetings of the ECB and the Bank of England, were overshadowed by the US payrolls. As expected, both the central banks kept interest rates on hold. Also in line with expectations, the ECB President Jean Claude Trichet confirmed in his comments, by using a sentence about a need for "vigilance", which heralded previous rate hikes, that the market should expect another monetary tightening in the euro zone in September.

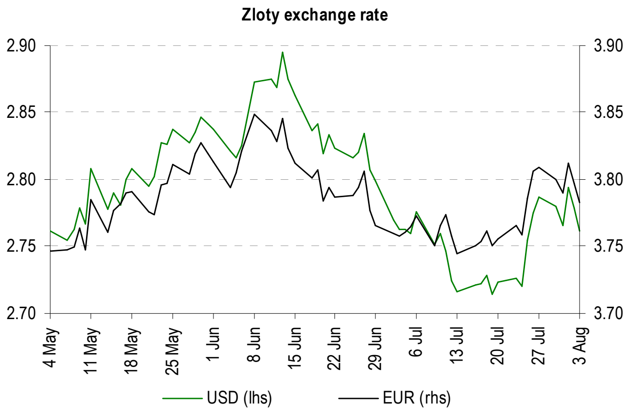
## **Quote of the week –** Doubtful lack of a need to hike rates

**Jan Czekaj, MPC member; Gazeta Prawna, 31 July**

*One cannot state that something lacked [to hike rates]. Some role was played by tactical reasons. We did not want to fuel expectations for next hikes, raising rates month by month. (…) I doubt whether there will be no need for further hikes (…) If firms are rising wages and prices, we will have to react with rates. Increase in ULC does not have to automatically lead to price increases. Firms have limited ability to increase prices, for instance due to competition of imported goods, especially with strong zloty. (…) Besides, we would not like to act too strong to avoid too large fluctuations of output and inflation.*

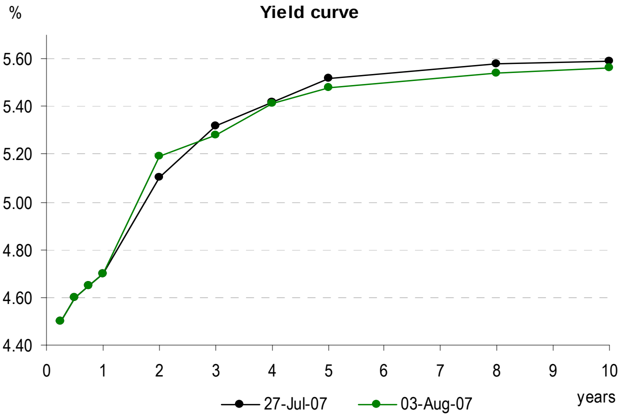
Comments from Jan Czekaj for *Gazeta Prawna* daily indicate that he is not going to be passive to a threat of possible pass-through from higher ULC to prices, but he is not convinced whether such a threat would materialise. Also, he would like to avoid excessive tightening of monetary policy. At the same time, MPC member expressed his doubts whether rate hikes delivered so far will be sufficient and suggested that no rate hike in July was only due to tactical reasons. All in all, Czekaj's comments seem to confirm our view that he will vote for a rate hike in August and this will determine decision of the whole Council.

## Market monitor



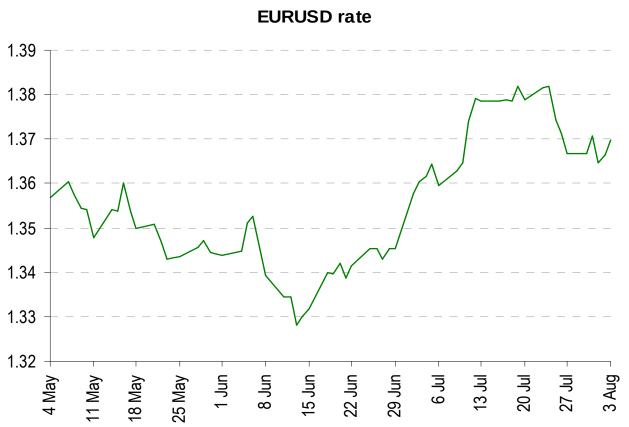

### Swinging moods for the zloty

- The last week on the local foreign exchange market was under influence of changing moods towards the zloty. On Monday, the Polish currency continued a correction after earlier weakening, it stabilised on Tuesday, but already on Wednesday another depreciation of the zloty took place, which was in line with our view presented last week. Later during the week the zloty has been appreciating.
- Although, taking into account the week as a whole, the zloty saw some appreciation against the major currencies, it still remains vulnerable to news from global markets, (the US credit market) and a possibility of further increase in risk aversion. That is why, we maintain the trading range for the zloty, which we assumed a week ago, at 3.77-3.87 for the EURPLN rate and 2.74-2.84 for the USDPLN.



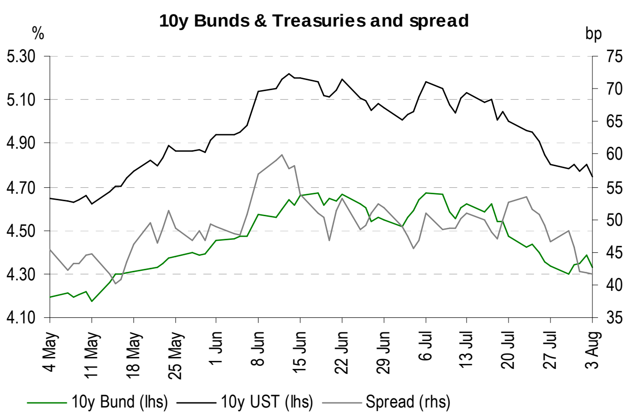

### Bonds between the devil and the deep blue sea

- Yields of domestic bonds with longer maturity did not change much in the last couple of days, as the influence of the situation in core markets was offset by spread changes driven by changes in risk appetite of global investors. The two-year papers substantially weakened, as they were perceived as less attractive. Additionally, the result of two-year bond auction were not so optimistic, as the Ministry of Finance did not manage to sell the offered amount of papers.
- The upcoming week will see the important information as regards wages in the whole economy in Q2, which will be closely watched by the MPC and thus by the bond market. As usual, core markets will be important for Polish bonds, especially given the Fed meeting scheduled for Wednesday.




### Dollar erases a part of earlier gains

- Amid certain calming down moods in the global markets and purchases of more risky assets, there was high capital outflow from the United States and the greenback depreciated. As the periods of the higher risk appetite alternated with risk aversion throughout the week the US currency lost only a part of that what it gained previously. The scale of dollar's depreciation increased after the release of much weaker than expected data on non-farm payrolls in the United States.
- Next week the Fed meeting is going to be of key importance for the US currency. If US central bank expresses its fears over the prospects of the economy this will be negative news for the dollar, though consequent rise of risk aversion would act in the opposite direction.




### Further strengthening in the core debt markets

- In the past week, the core debt markets continued to strengthen, which was earlier experienced with regards to higher interest in safe-haven assets amid concerns over situation in the US credit market and whole US economy. At the end of the week, yields of 10Y Treasuries declined to 4.74% against 4.80% a week before, while during the week it was even temporarily close to 4.70%. The confirmation of the expectations for interest rate hikes in the euro zone (next move in September) by the ECB's Governor transitory weakened Bunds (to 4.38%), though at the end of the week they strengthened to 4.33% vs. 4.34% on previous Friday.
- This week the Fed meeting is going to be the major factor influencing the core debt markets.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl