Bank Zachodni WBK

Weekly economic update

8 – 14 October 2007

The inflation forecast released by the Ministry of Finance was surprisingly high. In the last months our estimates were more accurate. However, if this forecast fulfils this might change the view of some MPC members on the path of the interest rates in the next months, which would be the more important, as the recent comments of some of the Council members may indicate that they may be willing to postpone the decision to raise rate for later moment or pursue monetary tightening to smaller extent than it is currently expected. We keep our opinion that the next interest rate hike will occur in November.

In the last days the domestic financial market was stable throughout most of the time. Zloty fluctuated in a narrow range against the euro and slightly weakened versus the dollar. There was slight yield curve steepening in the debt market. The market players awaited the meeting of the European Central Bank, which as expected left rates unchanged. However, the tone of the ECB's statement was slightly changed to less hawkish one, which was connected with the turmoil in the international financial markets. Non-farm payrolls data in the US exceeded the expectations and figures for the previous months were upwardly revised, which lowered fears over a recession in the United States.

The start of the week may be quite calm with regards to the market holiday in the United States. In the later course of the week investors will concentrate on the FOMC minutes from the September meeting, at which Fed cut rates by 50 bp noting risks for economic growth. This release may shed some light on the way of reasoning and argumentation of Federal Reserve decision makers. The US retail sales data and the Michigan index will show the influence of the slowdown in the US housing market and of the situation in the financial markets on the moods and actions of consumers. If data are sound, they may revive the inflationary fears. These events may have influence on the development of the situation in the Polish market. We do not expect this week brings any breaking news, which would substantially affect the zloty and bonds. Sentiment in the bond market may be reflected in the results of the 10Y bond auction.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (8 October)					
9:00	**PL**	**Tender of PLN500m 52-week treasury bills**					
	US	Market holiday					
		TUESDAY (9 October)					
18:00	US	FOMC minutes					
		WEDNESDAY (10 October)					
9:00	**PL**	**Tender of DS1017 10-year bonds worth PLN1.5-2.5bn**					
16:00	US	Wholesale inventories	Aug	%	0.3	-	0.2
		THURSDAY (11 October)					
9:00	EMU	GDP	Q2	YoY%	-	-	3.2
12:30	US	Import price	Sep	%	0.7	-	-0.3
12:30	US	Trade balance	Aug	$ bn	-59.0	-	-59.25
		FRIDAY (12 October)					
12:00	**PL**	**Money supply M3**	**Sep**	**%YoY**		**15.0**	**15.6**
12:30	US	PPI	Sep	MoM%	0.4	-	-1,4
12:30	US	Retail sales	Sep	MoM%	0.3	-	0,3
14:00	US	Preliminary Michigan index	Oct	pts	84	-	83,4

Source: Reuters

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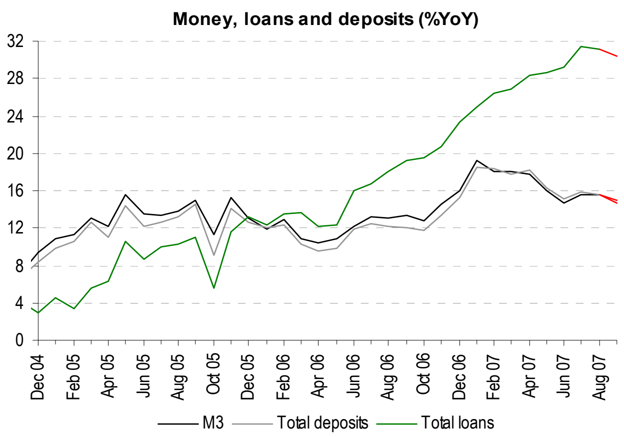
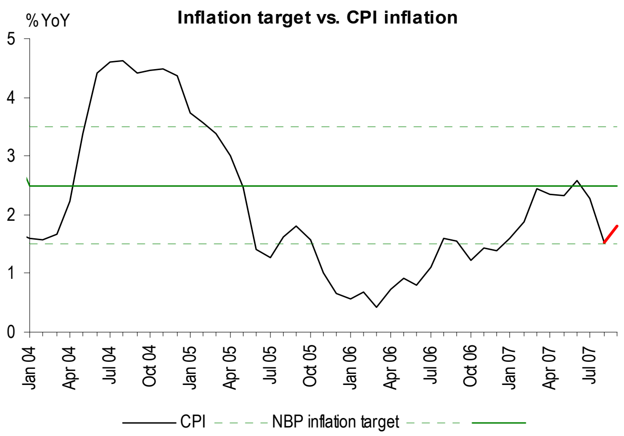
What's hot this week – FOMC minutes will show details of interest rate cut in the US

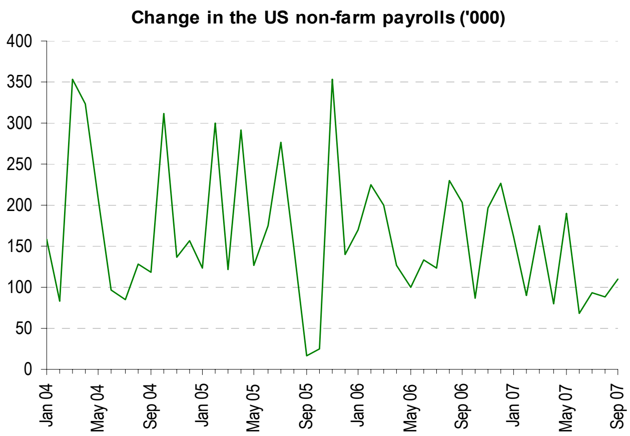


- The start of the week should be quite calm taking into account the market holiday in the United States.
- The market players are going to focus on the FOMC *minutes* of the September meeting, which may show details of the factors that determined the quite surprising decision to cut interest rates by 50 bp.
- In the domestic stage the 10Y auction will be the most important event. At the end of the week the monetary statistics are going to be released for September. We expect that the money supply growth remained at high level (15.0%YoY) amid strong loans growth by ca. 30% (for households ca. 40% and businesses ca. 22%).
- Data from the US such as retail sales may be more important, as they may show whether weakening of US consumer moods turns to weaker consumption.

Economy last week – Quite high CPI forecast of MinFin, dovish tone of the ECB



- According to Ministry of Finance's estimates the CPI index in September grew by 2%YoY against 1.5%YoY in August amid 0.5%MoM prices growth.
- It is quite high number, as our estimates points to a prices growth of 1.8%YoY and some forecasts are even lower.
- Although no details were given concerning ministry's forecast, we may presume that the rise in inflation can result from the price hikes on the food market.
- It is worth mentioning that in the past two months the Ministry of Finance's forecasts were less accurate than ours. If their prediction fulfils this time, the CPI data for September would probably reverse the positive impact of low August's data, what could have negative impact on the assessment of inflation perspectives by the MPC members.



- ECB left the main refinance rate at 4.0% and removed the expression from its statement saying that the monetary policy was on the accommodative side. The bank reiterated the prices stability was still the major concern, though more data would be needed before the next decision changing rates. According to the ECB there are upside risks to inflation and downside risks for to economic growth. President Trichet said that appropriate measures should be taken in order to support the markets in their normal functioning. In our view the rates will be raised only next year, though this may depend on the development of economic situation in the United States.
- US non-farm payrolls rose more than expected, while data for the past months were significantly upwardly revised, which might have lowered fears over US recession.

Quote of the week – Possible lower scale of monetary policy tightening?

Marian Noga, MPC, Thomson Financial, Reuters, 1 Oct

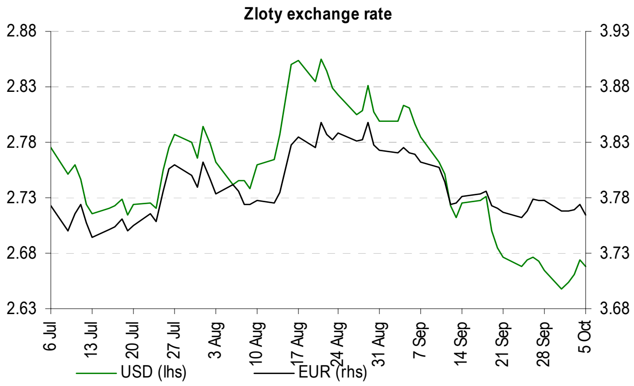
We should see one more hike in interest rates this year. If it turns out that inflation is only just above the target [at he end of year], it may turn out that one more rate hike will be enough next year and we would end the tightening cycle in March. If it is nearer 3 pct, we will probably need two more rises next year [also till March]. If everything goes right, first interest rate cut may be applied at he end of 2008.

Mirosław Pietrewicz, MPC, Reuters, 1 Oct

These optimistic forecasts [October inflation projection] may result in that we would be forced not to change monetary policy parameters till the middle of 2008.

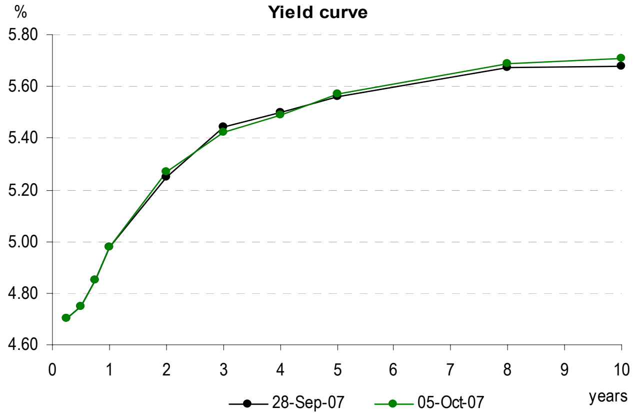
More MPC member allow a possibility for no rate hike this year or limiting the overall scale of rate hikes. Lower path of inflation in October projection as compared to July one may support such scenario. The inflation in August might have confused some MPC members. It seems however, that lower inflation is perceived by the majority of the Council members as a temporary phenomenon, while the risk of influence of global economic slowdown to Polish economy in the result of the financial market crisis, as rather limited. In this situation the labour market data and comments of Andrzeja Wojtyna, Andrzej Sławiński and Jan Czekaj, who determined this year's rate hikes, on these issues will be crucial.

Market monitor



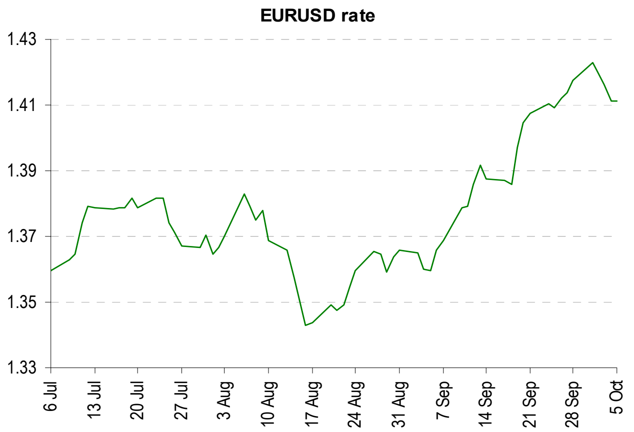
EURPLN in narrow range

- In last week there were no spectacular changes on the domestic currencies market. Zloty slightly appreciated versus euro, although EURPLN rate oscillated in very narrow range of 3.76-3.78. However, it weakened against the dollar. Such zloty's behaviour was caused by change in the EURUSD relation.
- In the forthcoming days Polish FX market should be quite stable. There are no important releases planned for this week, which should support small moves in the market. Zloty will stay under the influence of the sentiment in the international markets, though they shouldn't experience any sudden changes as well. We keep the expected range for the EURPLN rate at 3.73-3.83 and for the USDPLN rate at 2.62-2.72.



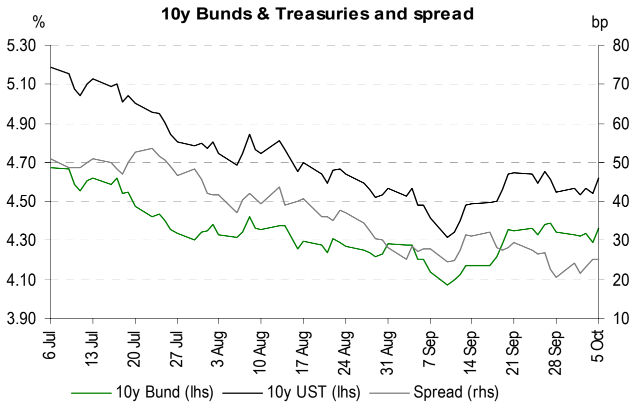
Yield curve slightly steepens

- The domestic debt market was very calm last week. The short end of the yield curve slightly strengthened after the assessments of central bankers and in spite of the Ministry of Finance high inflation forecast. The longer end slightly weakened despite quite stable yields in the core markets. This is resulted in a slight steeping of the yield curve.
- Like on the exchange rate market lack of crucial releases on the domestic stage will cause that the situation on the international markets will be more important for the Polsih market. Long-term-bonds auction will show the market moods. The players will await inflation data and labour market statistics, which are going to be published at the beginning of the next week.



Slight dollar's recovery

- After the period of dollar's weakening against the euro to the record low levels in the previous week, the greenback slightly recovered mainly as a result of technical correction. Moreover, euro zone politician's assessments about too big strength of the single currency to some extent might have had an impact on this situation. Although the ECB's communiqué was little "hawkish" it didn't weaken euro for long as the strong non-farm payrolls did.
- The beginning of the week on the foreign markets may be calm, because of the market holiday in the USA. In later part of the week FOMC *minutes* and trade balance will be important. Retail sales and Michigan index will indicate the influence of weakening on the housing market and turmoil in the financial markets on consumer's behaviours and sentiment.



US Treasuries weaken on non-farm payrolls

- Long-term Treasuries in the US increased in the last few days mainly on the better than expected US labour market data. With regards to German bonds this effect was balanced by earlier quite "dovish" ECB's statement. Yield of 10-year Treasuries rose during the week to 4.59% from 4.55% on previous Friday and the yield of 10-year Bunds remained at 4.34%.
- In the next few days the FOMC *minutes* from September meeting will have crucial influence on the core debt markets. US PPI and Michigan index can be also essential. They can contribute to a slight rise in yields at the longer end. The context of inflationary risks will be highly important amid expectations for further rate cut expectations.

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