Bank Zachodni WBK

Weekly economic update

22 – 28 October 2007

The week will start with analysis of tentative election results and their possible impact on the economy in the next years. It is hard to say to what extent rising support for PO in recent opinion polls affected the zloty rate, and to what extent its appreciation resulted from reviving expectations for swift rate hikes (and their bigger total size), however one cannot rule out that after election we will see a correction on the FX market (amid profit taking after recent gains, or because of the rule 'buy rumours, sell facts'). Nevertheless, soon the analysts and investors will have to turn back to analysis of economic data, as new publications will take place already on Monday: the Central Statistical Office will release revised quarterly GDP figures for 2006 and first two quarters of 2007, while NBP will announce core inflation numbers. Main core inflation measures are likely to remain low (according to our estimate, net inflation remained at August's level, i.e. 1.2%), which should be a support for bond market, together with Tuesday's retail sales data. As in the case of output data, we expect to see lower growth in retail sales than predicted by median market consensus, partly because of lower rise in wages and employment. However, it will be still a solid rise close to 15%YoY. Registered unemployment rate is expected to reach 11.7%. On Thursday, minutes of September's MPC meeting will be released. Perhaps it will allow to understand more clearly how surprisingly low CPI affected the Council members' views, however its impact on the market should be limited. Among data releases abroad due this week, one should pay special attention to data from US housing market and German Ifo index.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 October)					
9:00	**PL**	**Auction of PLN500m of 52-wekk Treasury Bills**					
9:00	**PL**	**Revised quarterly GDP data (Q1 2006 - Q2 2007)**					
12:00	**PL**	**Net inflation**	**Sep**	**%YoY**	**1.2**	**1.2**	**1.2**
		TUESDAY (23 October)					
	PL	**Business climate**	**Oct**				
8:00	**PL**	**Retail sales**	**Sep**	**%YoY**	**16.7**	**14.5**	**17.0**
8:00	**PL**	**Rate of unemployment**	**Sep**	**%**	**11.7**	**11.7**	**12.0**
		WEDNESDAY (24 October)					
9:00	**PL**	**Switch auction**					
8:00	EMU	Preliminary PMI – manufacturing sector	Oct	pts	53.1	-	53.2
8:00	EMU	Preliminary PMI – services sector	Oct	pts	54.7	-	54.2
14:00	US	Home sales	Sep	m	5.3	-	5.5
		THURSDAY (25 October)					
12:00	**PL**	**MPC Minutes**	**Sep**				
8:00	GER	Ifo index	Oct	pts	109.0	-	110.0
12:30	US	Durable goods orders	Oct	%	1.5	-	-4.9
12:30	US	New jobless claims				-	337
14:00	US	New home sales	Sep	m	0.783	-	0.795
		FRIDAY (26 October)					
8:00	EMU	Money supply	Oct	%YoY	11.4	-	11.6
14:00	US	Final Michigan	Oct	pts	82.5	-	83.4

Source: Reuters, Parkiet, BZ WBK

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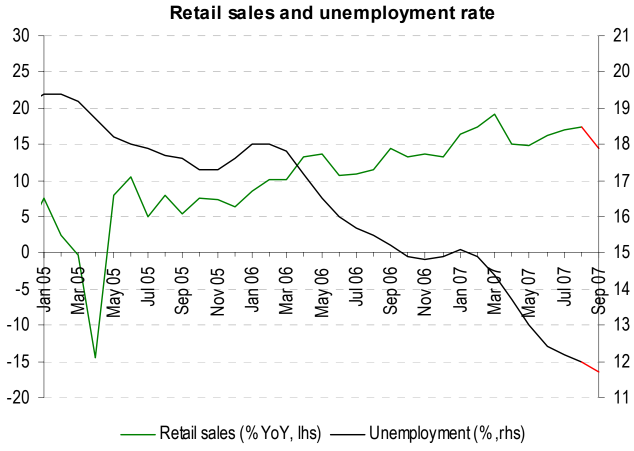
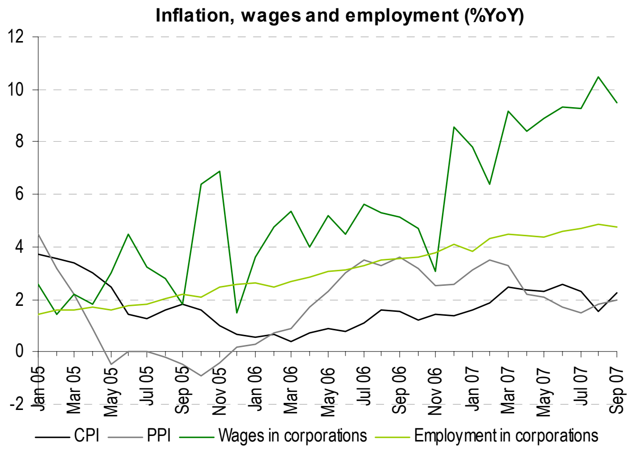
What's hot this week – Election results and new data at the heart of attention

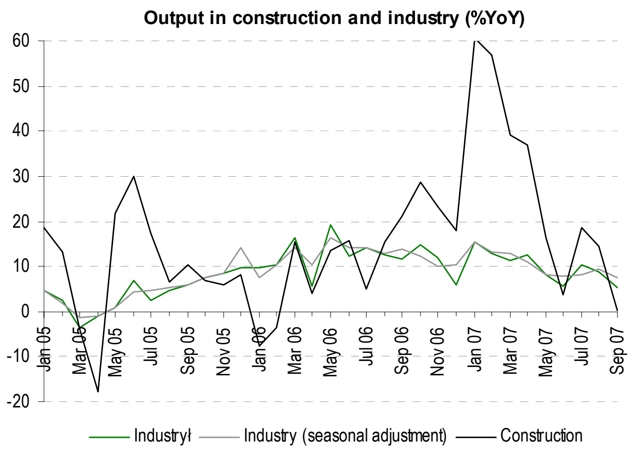


- At the start of the week the focus of attention will be on the analysis of tentative election results and their possible impact on government shape and economic policy in the next years.
- There will be also new data releases. On Monday, core inflation data will be announced, which probably remained quite low in September despite CPI rise. Also, revised quarterly GDP figures will be published for 2006 and two first quarters of 2007.
- Retail sales data, due on Tuesday, will be interesting – whether they will show lower rate of growth like output in industry and construction did (our forecast 14.5%), or maintain rapid growth, as market predicts. Unemployment rate will fall below 12% for the first time since 1999.
- Minutes of MPC September's meeting should not have big impact on the market, as it was the case in previous months.

Economy last week – Higher CPI, but wages and output below expectations



- After surprisingly low inflation in August, CPI index surprised on the upside, growing 2.3%YoY and 0.8%MoM. The main reason was a surge in food prices, while net inflation remained according to our estimate unchanged, at 1.2%.
- Prices in industry have been growing moderately – PPI growth accelerated to 2%YoY, roughly in line with forecasts.
- Wage growth in enterprises sector decelerated in September from 10.5% to 9.5%YoY, while employment growth slowed down from 4.8% to 4.7%YoY. Such results are still supportive for maintaining solid private consumption growth and imply quite high increase in labour costs. On the other hand, growth in wages and employment is not accelerating any more, which may signal that tensions on the labour market will not escalate in near future.



- Industrial output growth in September was at 5.2%YoY, below market consensus. Construction output surprised even more, as after a number of months with double digit growth this time it decelerated to nearly zero. At this stage it is hard to judge whether this is a beginning of a new trend, especially as regards construction (other signals do not confirm this), however September's results are negative for GDP growth estimates for Q3 – it will be difficult to reach 6%.
- Balance of payments data for August showed continuation of rapid export growth (16.7%YoY) and clear slowdown in import growth (12.8% against 23.5% in July). In effect, trade deficit reached only €289m (over €1bn lower than in June), and current account deficit was at €637m (3.8% of GDP).

Quote of the week – Will MPC vote on rate hike in October?

Andrzej Wojtyna, MPC member, PAP, 17 Oct

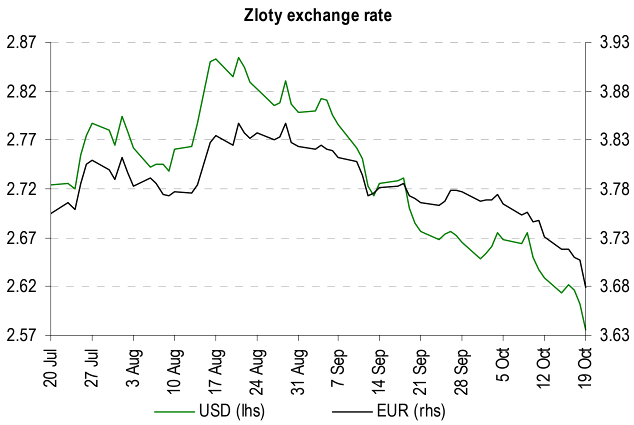
In my opinion there was a change in the balance of risk – one more rate hike is needed this year. Using a language of policy bias, we have still tightening bias. This year's hike – in my opinion – will not be the last one. I would take into account a rate hike next year.

Stanisław Owsiak, MPC member, PAP, 19 Oct

Rate hikes made so far gave – in my opinion – some comfort for the MPC that allows to watch coming data without excessive tension. But I cannot rule out a rate hike in 2008.

Recent comments of some MPC members (Filar, Wojtyna) suggested that motion on rate hike could be submitted at the MPC meeting in October. The key question is whether the most hawkish central bankers will be able to convince the moderate camp to back the motion. While Jan Czekaj did not give any clear hint in this regard, Stanisław Owsiak does not seem likely to vote for snap rate hike. It still seems more likely to us that this month interest rates will remain unchanged, and the Council will deliver next tightening in November.

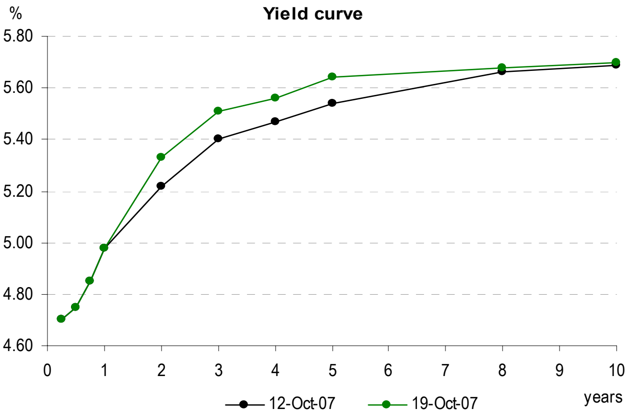
Market monitor



Record strong zloty

▪ Last week Polish currency appreciated to record high levels against both euro and the dollar, despite appreciation of low yielding currencies. At the end of the day the EURPLN broke 3.70 and the USDPLN rate 2.60, among others due to higher than expected inflation, significant weakening of the dollar in the international markets, while additional factor might have been expectations for PO victory in Sunday's elections.

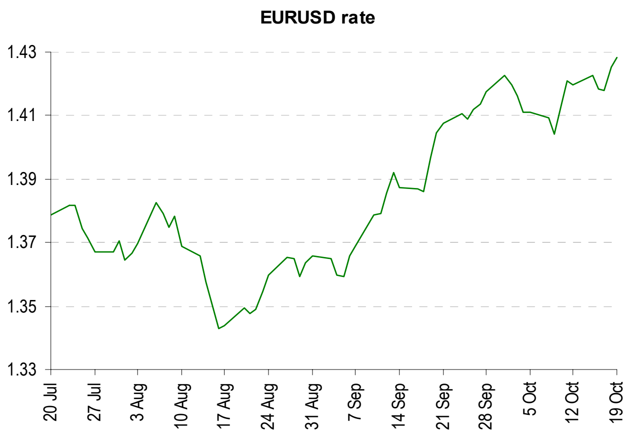
▪ Realisation of the scenario indicated by polls would be zloty positive, though only in the short term. After recent appreciation, there may be a correction soon, and this may follow some dollar recovery. We do not change our year-end forecast for zloty close to current levels, though we see the FX ranges asymmetrically to the upside for this week for EURPLN at 3.66-3.76 and at 2.55-2.65 for USDPLN.



Inflation weakened debt

▪ After several days of stabilisation in the debt market there was a significant weakening experienced in the last week most of all due to strong inflation data. Weaker figures from the labour market did not balance the high CPI effect and the tone of output data was mixed. Bonds might have been also negatively affected by the comments of MPC members, which tone was more restrictive. The end of week came strengthening at the longer end of the curve.

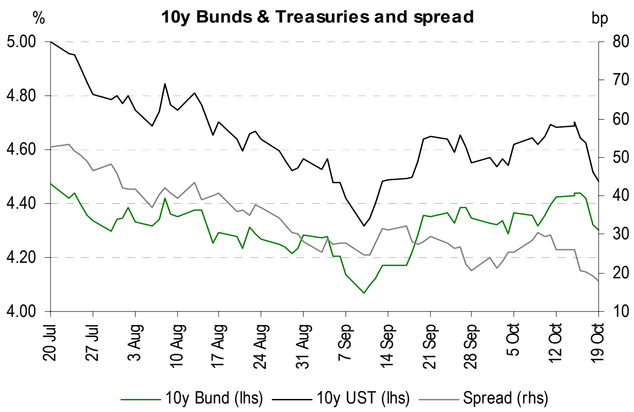
▪ In the next few days there may be a slight strengthening in the debt market, against a yields drop in the core bond markets. Moreover the next inflation data and retail sales will have a positive overtone. Minutes from September MPC meeting should not substantially affect the market, as the view of central bankers might have changed after CPI.



The dollar record weak again

▪ The US dollar depreciated against the euro in the past week to the weakest level in the history. The EURUSD rate broke 1.43 level. Such move was connected with quite dovish comments of Ben Bernanke, poor housing and labour market data from the US and fears revival over the condition of the US economy with regards to the results of next financial institutions.

▪ In the coming days the statements of G7 summit participants on too strong euro may be important for the EURUSD rate, which might have resulted in the EURUSD rate correction. We will also know the preliminary PMI indices in the euro zone Ifo index for German economy, which may show, if moods of German enterprises clamed down after the financial markets turmoil. Housing market data will be crucial among the US data releases.



The market expectations for rate cuts in the US revive

▪ Events, which resulted in the dollar depreciation contributed to the strengthening of the US debt market, which was followed by the German market. Apart from that higher than expected inflation in the US amid in line with consensus core CPI was less important than the poor figures from the housing market. Flight to quality on news Turkey was planning an intervention in the northern Iraq was an additional factor. Yields of 10Y government bonds in the US and Germany fell during the week by 21 and 15 bp respectively to 4.48% and 4.27%.

▪ The housing market data from the United States are going to have the largest influence on the core debt markets this week.

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