Bank Zachodni WBK

# Weekly economic update

## 5 – 11 November 2007

**Despite the long weekend the past week was not calm at all. The MPC did not change interest rates, though fears emerged in the market that there may be a rate hike this month. The Council communiqué did not surprise and the released inflation projection did not bring much new changes as well and – as Jan Czekaj said – it did not change the fundamental picture of the monetary policy. Our scenario stays unchanged and we expect an interest rate hike at the next meeting in November. The investors' attention was also focused on the meeting of the US central bank, which cut interest rates by 25 bp. Investors were surprised by the tone of the statement, which suggested, that Fed wanted to limit expectations for continuation of monetary policy easing in the United States. During the week there was a slight zloty correction against the major currencies, which was connected with higher risk aversion at the end of the week on disappointing financial results of US banks. The fixed income market weakened with regards to maintained expectations of interest rate hikes. Moreover the yield curve flattening was continued.**

**The inflation forecast of the Ministry of Finance is going to be crucial, especially in the context of the growth of food prices. In our opinion the acceleration of the CPI growth is going to be continued, which may keep the yield of shorter-term bonds at elevated levels. The first sitting of Sejm after elections was scheduled on Monday, during which the PM Jarosław Kaczyński is going to dismiss its Cabinet. The line-up of the new government and the comments of future ministers on economic affairs will be important, taking into consideration many, often different declarations of politicians of the new coalition. The European Central Bank will most probably leave interest rates unchanged and its communiqué should not surprise either. Ample data are going to be released abroad, and they may influence the moods in the international financial markets, which may affect the behaviour of the domestic market.**

### Economic calendar

| Time GMT | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (30 October)** | | | | | |
| **10:00** | **PL** | **Auction of PLN1.0bn of 52-week Treasury Bills** | | | | | |
| 15:00 | US | Non-manufacturing ISM | Oct | pts | 54.0 | - | 54.8 |
| | | **TUESDAY (30 October)** | | | | | |
| 9:00 | EMU | Services PMI | Oct | pts | 55.6 | - | 54.2 |
| 10:00 | EMU | Retail sales | Sep | %YoY | 1.9 | - | 1.0 |
| | | **WEDNESDAY (31 October)** | | | | | |
| **10:00** | **PL** | **Auction of PLN1.5-2.0bn of 2Y OK0709 bonds** | | | | | |
| 13:30 | US | Unit labour costs | Q3 | % | 1.3 | - | 1.4 |
| 13:30 | US | Labour productivity | Q3 | % | 2.4 | - | 2.0 |
| 15:00 | US | Wholesale inventories | Sep | % | 0.2 | - | 0.1 |
| | | **THURSDAY (1 November)** | | | | | |
| 12:00 | **GB** | **Bank of England meeting – decision** | | % | 5.75 | - | **5.75** |
| 12:45 | EMU | ECB meeting – decision | | % | 4.00 | - | 4.00 |
| 13:30 | US | New jobless claims | | '000 | | - | 327 |
| | | **FRIDAY (2 November)** | | | | | |
| 13:30 | US | Import prices | Oct | % | 0.9 | - | 1.0 |
| 13:30 | US | Trade balance | Sep | $ bn | -58.00 | - | 57.59 |
| 15:00 | US | Preliminary Michigan index | Nov | pts | | - | 80.9 |

Source: BZ WBK, Parkiet, Reuters

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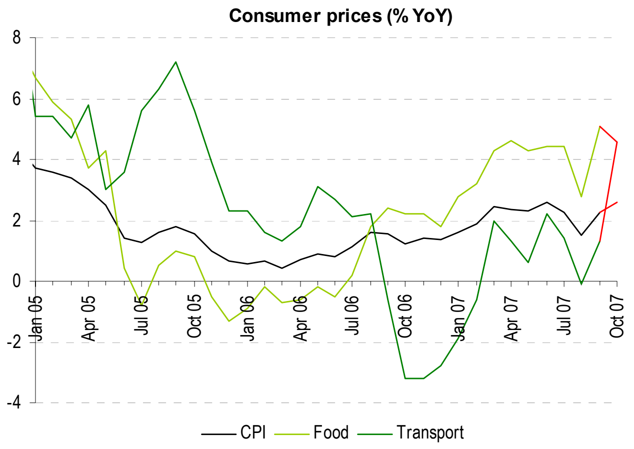
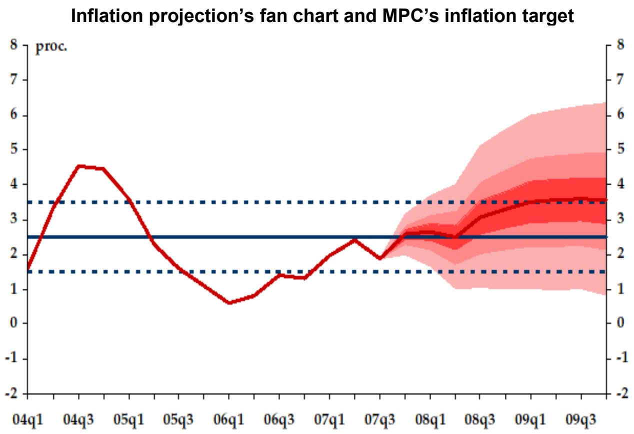
## **What's hot this week** – MinFin's CPI forecast, data from abroad, ECB's decision on interest rates

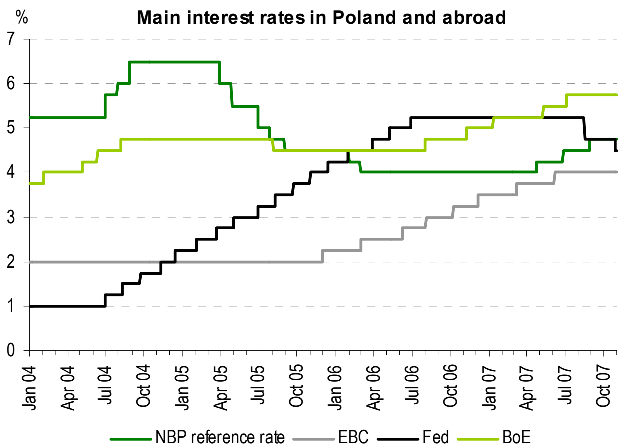



- The release of the inflation forecast of the Ministry of Finance was postponed to this week. These estimates may be especially important taking into account the surprisingly high growth of CPI in September and risks from food prices mentioned by the MPC. In our view inflation accelerated in October to 2.6%YoY.
- The results of the 2Y bonds auction may be quite interesting for the debt market. The finance ministry should have problems with placing the issue in the market.
- This week is also going to be dominated by the events and data releases scheduled abroad, most of all in the United States and some in the euro zone.
- The ECB is going to leave rates unchanged, against maintained uncertainty in the financial markets and strong euro.

## **Economy last week** – MPC left interest rates unchanged, possible end to rate cuts in the US




- The Monetary Policy Council left interest rates unchanged and the reference rate stayed at 4.75%.
- In its communiqué the Council maintained its opinion the probability of inflation running above the inflation target is still higher than the probability of inflation running below the target, which corresponds to restrictive policy bias. The situation on food market was included on the list of risk factors for inflation. We hold our view that next interest rate hike by 25 bp will take place in November and two more hikes may take place in H1 2008
- The main difference in the inflation projection as compared to the July one was lower inflation path till mid 2008 and higher after this date. However, it is worth to notice, that according to the *Inflation report* taking into account the off-model uncertainty factors the risk for the inflation projection is asymmetrical to the downside in the long term.




- Fed decided to cut main interest rates by 25 bp and the main rate declined to 4.50%
- In the statement the central bank signalled that actions made so far "should help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and promote moderate growth over time". The Fed also said that the upside risks to inflation roughly balanced the downside risks to growth, which may suggest the bank will not be very keen to continuing monetary easing in the near time.
- Nevertheless, we still believe that Wednesday's rate cut was not the last one in the cycle and we expect another 25 bp rate cut in the first quarter of 2008.
- The non-farm payrolls in the US in October rose by 166k, much above the expectations (80k), though the past month data were downwardly revised.

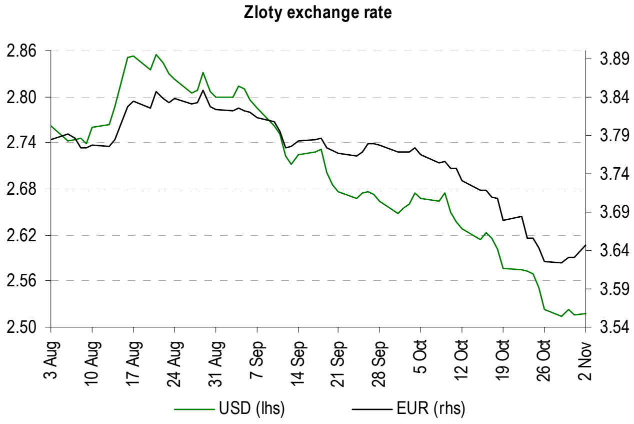
## **Quote of the week** – Interest rate hike most probably in November

**Jan Czekaj, MPC member, PAP, 2 Nov**

*It is too early to claim that we are facing an economic slowdown, as it is possible that it is only temporary decline of growth rate. If a rate hike is needed this year, it will be most probably pursued in November. W We may take such decision based on the data available in November. Currently I assess the probability that there will be a rate hike in November for 55% (...). The balance of risks did not significantly change – on one hand we have a new threat in the form of food prices, on the other hand the zloty is strongly appreciating. I would not rule out rate hikes in 2008, though this going to depend mainly on how deep will be the slowdown of the economy. (...) An interest rate hike could add to its [zloty's] appreciation, and it is not our goal.*

The MPC member, who became one of the most important central bakers deciding on interest rates, suggested, that next month there may be an interest rate hike, which for a long time has been in line with our base scenario and for some time has been in line with expectations of the market and analysts. The MPC member noticed, that further rate hikes would not be needed, if the GDP growth slowed down to ca. 5%. On the other hand if the food prices stabilises at higher level, this may have some second round effects in the form of a mounting wage pressure, which will require monetary policy tightening. Jan Czekaj is also not a proponent of decisions, which might contribute to too strong zloty appreciation.

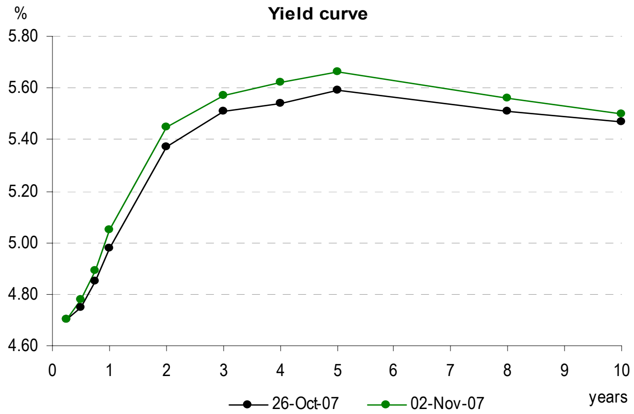
## Market monitor




### Zloty weakens on risk aversion

▪ According to the scenario, which we outlined in the previous weekly report the zloty strengthened close to 3.60 against the euro on the wave of positive moods after the parliamentary elections. The was a correction of the EURPLN rate before it reached this level, and temporarily rose on bonds sell-off on fears that the MPC could rise interest rates. Later zloty weakening was connected with higher risk aversion.

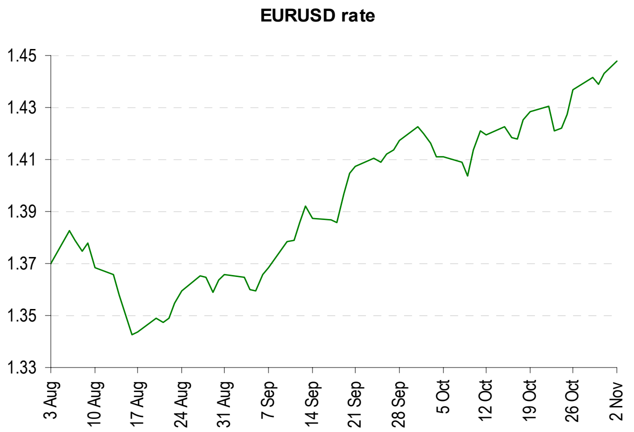
▪ In the next few days there will be small number of data releases in the domestic market. Official presentation of the next government may be also an important event. The moods in the international financial markets may have larger influence on the domestic FX market that recently. This week the EURPLN rate is going to stay in range of 3.60-3.70, while the USDPLN rate in range of 2.48-2.58.




### Slight weakening and further yield curve flattening

▪ At the start of the week the moves in the fixed income markets from the previous week were continued, i.e. there was further yield curve flattening, amid larger weakening of 5Y bonds. However later on fears over interest rate hike contributed to a slight correction. Friday session amid lower liquidity due to long weekend brought further curve flattening with yields rise of 2Y and 5Y bonds (among other on Jan Czekaj comments).

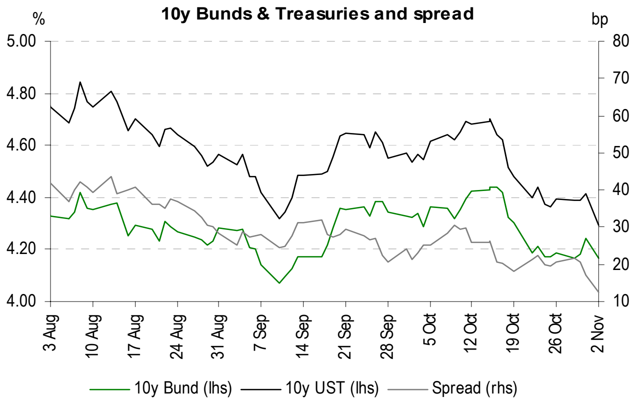
▪ This week the inflation forecast of the Ministry of Finance is going to be the main release in the fixed income market. The comments about priorities in the economic programme of the new government may be also important. The core debt market and investors' sentiment may also have some influence on the domestic market.




### Dollar at record weak levels again

▪ In the last days investors awaited most of all the main event of the week, i.e. Fed's decision. During that time the dollar was gradually depreciating against the major currencies. The US central bank cut interest rates and its statement seemed to suggest a possible end to further cuts. In spite of this the EURUSD rate rose to a record high level (1.45). Later on it slightly recovered after poor results of the US banks, which resulted in higher risk aversion. Despite sound non-farm payrolls the dollar weakened again ion Friday.

▪ In our view the greenback may depreciate further in a next few months, among others due to one more rate cut by Fed and pausing with rate hikes by the ECB. This week besides the ECB meeting the markets will focus on the ISM, PMI activity indices and Michigan index.




### Small changes despite high fluctuations

▪ The start of the past week was quite calm ahead of the results of the FOMC meeting. After a quite surprising Fed's communiqué core bond markets weakened. However, poor performance of financial institutions in the US resulted in a flight to safety, which was accompanied by a correction in the stock markets. Yields of 10Y Treasuries and Bunds fell to 4.36% and 4.20% recorded at the start of the week.

▪ The ECB's communiqué after the Thursday meeting should be important for Bunds, though we do not assume it will include significant changes as compared to the previous one. Activity indices in the services sector in the US and EMU and inflation import prices data as well as Michigan index showing moods of US consumer will also be important.

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