Bank Zachodni WBK

Weekly economic update

19 – 25 November 2007

Increase in risk aversion in the global markets contributed to the weakening of the domestic currency. While earlier the zloty had been quite resistant to waves of risk aversion in the global markets, last week the domestic currency became more vulnerable to deteriorated sentiment in the global markets. It seems that this is related to waning hopes, aroused by after-election euphoria, that the new government will carry out radical reforms and Poland will adopt the euro very soon. As a result, there was increase in yields of long-term bonds to levels seen before the election. Meanwhile, the short end of the yield curve was hurt by publication of higher-than-forecast CPI data and labour market statistics.

The new coalition government of the PO and PSL parties has been sworn in by the President and expose of the new Prime Minister Donald Tusk and confidence vote in his government is due on Friday. There should be no problems with the vote. Given comments from PO officials there should be also not much details on economic program in the Prime Minister's expose.

Apart from the political events, this week will also bring another portion of fresh economic data. Tuesday's release of output figures are expected to confirm that at the beginning of 4Q08 the economy is still expanding at solid pace, but slower than in the first half of the year. PPI numbers should show acceleration in producer price growth, but mostly in relation to base effect and increase in commodities prices, while price growth in other, competitive branches should remain moderate. Core inflation measures, due on Friday, should at least somewhat comfort central bankers as regards strength of underlying inflationary pressures.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (19 November)					
	POL	**Auction of Treasury bills**					
		TUESDAY (20 November)					
13:00	**POL**	**Financial results of enterprises**	**1-3Q**	**-**	**-**	**-**	**-**
13:00	**POL**	**Industrial output**	**Oct**	**%YoY**	**9.4**	**8.8**	**5.2**
13:00	**POL**	**PPI**	**Oct**	**%YoY**	**2.5**	**2.5**	**2.0**
	US	House starts	Oct	m	1.17	-	1.191
		WEDNESDAY (21 November)					
10:00	**POL**	**Auction of 5-year bonds**					
	US	Initial jobless claims	Nov	'000	330.0	-	339.0
	US	Final Michigan index	Nov	pts	75.0	-	80.9
	US	Minutes of the FOMC meeting		-	-	-	-
		THURSDAY (22 November)					
13:00	**POL**	**Minutes of the MPC meeting**	**Nov**	**-**	**-**	**-**	**-**
	US	Market holiday		-	-	-	-
		FRIDAY (23 November)					
13:00	**POL**	**Net inflation**	**Oct**	**%YoY**	**1.4**	**1.4**	**1.2**
13:00	**POL**	**Business climate indicators**	**Nov**	**-**	**-**	**-**	**-**
	JP	Market holiday		-	-	-	-
	EMU	Preliminary PMI manufacturing	Nov	pts	51.0	-	51.5
	EMU	Preliminary PMI services	Nov	pts	55.2	-	55.8

Source: BZ WBK, Parkiet, Reuters

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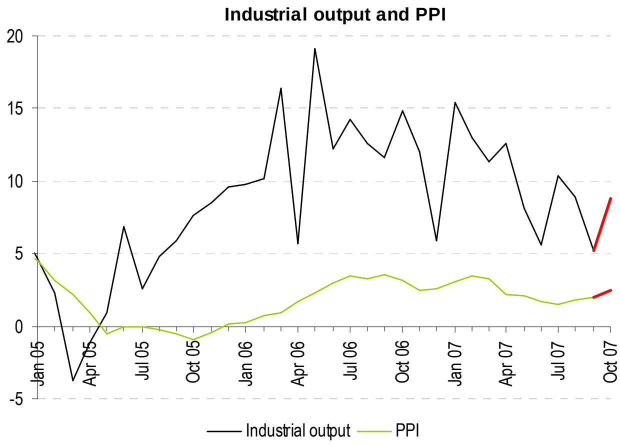
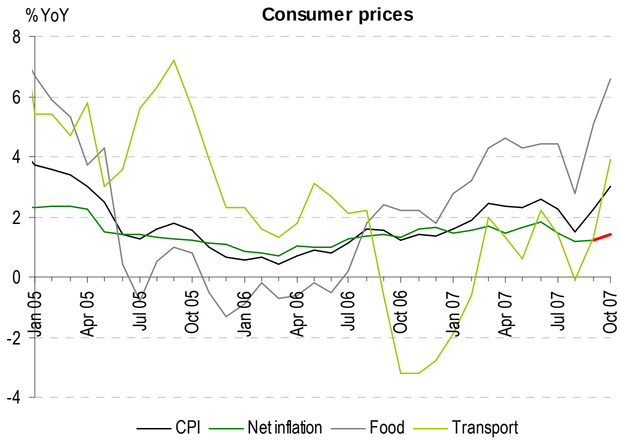
What's hot this week – New domestic data, lower market activity abroad

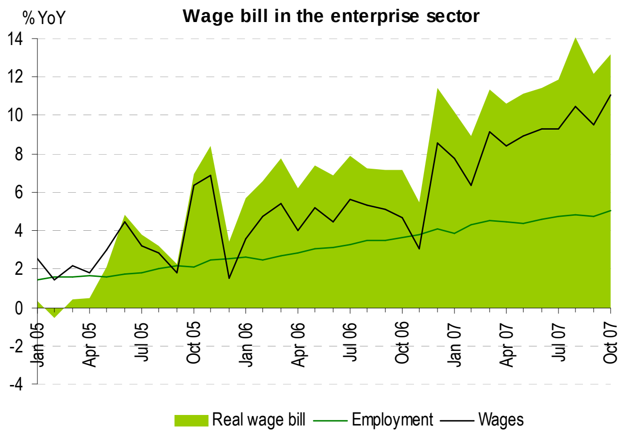


- It is a quiet week on the data and news fronts on foreign markets, with trading set to be curtailed anyway by the Thanksgiving holiday in the US and holiday in Japan.
- Nevertheless, numerous events are in the local agenda. The focus will be on the industrial output figures for October, which should present faster production increase than in September and slightly faster than in Q3. On the same day, PPI data will be released, being a hint on how building cost pressure translates to producers' prices. Data on firms' financial results in Q3 will show to what extent a rise in costs affected enterprises' condition.
- Publication of MPC minutes is not likely to introduce many new elements to the assessment of monetary policy.
- Friday's core inflation measures should confirm that underlying inflationary pressure remains contained.

Economy last week – Food prices boost inflation



- Consumer prices in October rose 0.6%MoM, in line with our forecast (below market and FinMin's prediction), but annual inflation rate rose to 3% (above our forecast and market consensus, in line with FinMin's prediction). A rise in inflation was caused mainly by fast increase in food prices.
- Changes in prices of other goods and services were consistent with our expectations. In effect, core inflation rose to 1.4%YoY according to our estimation, i.e. in the same extent that assuming CPI forecast at 2.8%YoY.
- Inflation data did not change the medium-term inflation prospects and did not change our predicted scenario in monetary policy. Money supply figures for October confirmed some slowdown in monetary expansion, reflecting slight deceleration in economic growth in H2.



- Data on average wage and average employment in the corporate sector for October proved much higher than expected. In the short run, it may imply higher cost pressure for firms and stronger consumption demand, and thus a threat for inflation. However, in the long run wage rise exceeding productivity gains may hurt economic activity. In sum, the data increased probability of interest rate hike at MPC meeting in November, but do not change our expectations regarding further moves of the Council.
- Balance of payments data for September showed lower than predicted current account balance, but it did not result from better trade balance, yet lower income deficit. In line with our predictions, trade gap rose significantly due to slowdown in export growth, while import growth was below expectations, despite large one-off transaction.

Quote of the week – The MPC does not have to react rapidly

Stanisław Owsiak, MPC member, PAP, 14 Nov

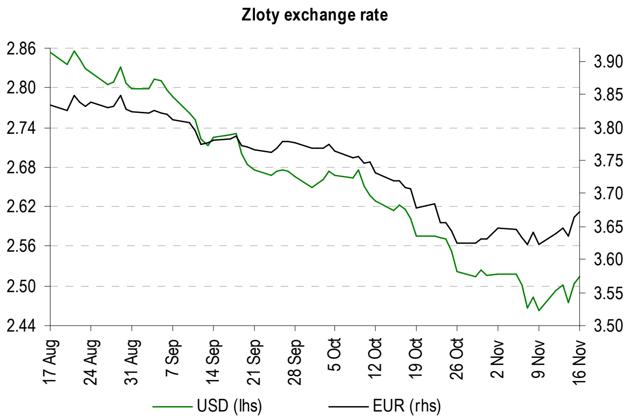
Unfortunately, one could have expected increase in inflation. Such level requires considering of the situation, but in my opinion more full assessment of the situation will be possible only after publication of next data.

Mirosław Pietrewicz, MPC member, Reuters, 14 Nov

We don't have to react rapidly. There are reasons to stay calm because we have strong appreciation of the zloty. Only after release of annual data for 2007 we will be able to be sure about persistence of the trend, that is around the middle of the first quarter, that is around February, we will have better picture of the situation.

Comments from two doves from the MPC indicate that not all members of the Council believe that inflation increase under influence of food prices requires rapid reaction of the central bank. In our opinion this will not prevent the MPC from hiking interest rates in November, because there should be majority of more conservative rate-setters for the tightening. However, comments from Owsiak and Pietrewicz show that one should not count on aggressive moves of the MPC supported by vast majority of its members. The key for interest rates decisions is still views of moderate Jan Czekaj who said in an interview on November 5 that probability of rate hike this month is equal to 55% and did not exclude further monetary tightening in 2008.

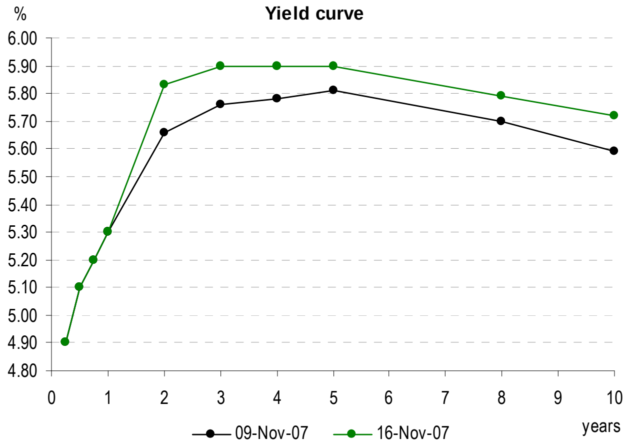
Market monitor



Zloty weakens on risk aversion

▪ Earlier the zloty had been strong even despite rising risk aversion in the global markets, but last week weaker moods in the world markets, with gradual return of investors to reality and weakening hopes for radical reforms after the election in Poland, contributed to depreciation of the domestic currency. During the whole week the zloty depreciated by 1.3% vs. the euro and 2.0% vs. the dollar.

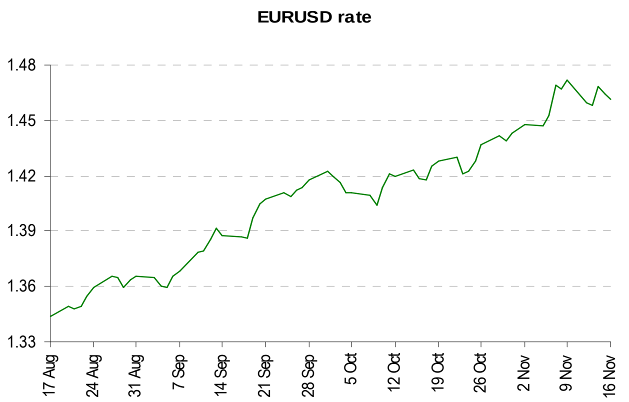
▪ In our view this week the zloty rate may stabilise. The risk aversion is going to be a negative factor, though the expectations of interest rate hikes by the MPC (among others due to recently released inflation and labour market data) will be a positive one. We expect that this week the zloty will be traded in range of 3.62-3.72 against the euro and in 2.45-2.55 versus the dollar.



Domestic yield curve up

▪ Last week was not favourable for the domestic debt market. Yields of Polish government bonds clearly went up. This regarded all segments of the yield curve. The short end was hurt by the release of higher-than-expected data on inflation and wages, while the longer end of the curve weakened as after temporary period of post-election euphoria investors started more realistically asses chances of introduction of radical reforms by the new government and fast adoption of the euro zone.

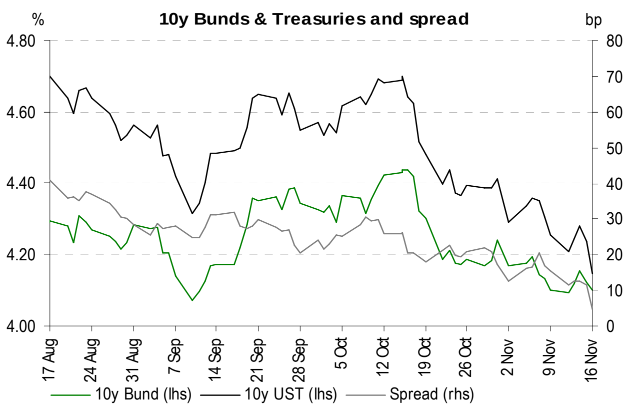
▪ Another portion of domestic data, which is going to be released this week, should rather not contribute to strengthening of the expectations of further interest rate hikes by the MPC. The 5Y bond auction may be a litmus paper of the market sentiment. Apart from that, performance of the core debt markets will be important.



Dollar supported by risk aversion

▪ On Monday, the dollar partly recovered after losses in the previous week and the EURUSD rate declined significantly below the record weak level of 1.475, approaching 1.45. This was supported by rising risk aversion in the global markets. On Tuesday and Wednesday the moods in the world markets improved and the EURUSD rate started rising again, reaching ca. 1.47. However, the end of the week brought another wave of risk aversion, which was in dollar's favour, and the EURUSD ended the week at slightly above 1.46 level.

▪ This week the EURUSD rate may stabilise due to market holiday in the United States on Thursday and in Japan on Friday. Earlier the release of next data from the housing and labour market will be crucial.



Stronger core debt markets

▪ Similar to the EURUSD market, the last week's situation in the core debt markets depended on changes in risk aversion. On Monday yields declined, and later started rising to fall again. At the end of the week 10Y Treasuries and German Bunds were traded at 4.15% and 4.09%, respectively, against 4.26% and 4.10% a week ago. Treasuries experienced more substantial strengthening, which reflects fears over condition of the US economy and expectations of further interest rate cuts by the Fed, while the ECB is expected to keep rates on hold.

▪ This week the next data from the US and minutes of thr last FOMC meeting will be the most important events for the core bond markets. However, holiday in the US may lower activity in the core debt markets.

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