Bank Zachodni WBK

Weekly economic update

3 – 9 December 2007

First part of the week was dominated by the uncertainty regarding the decision of the MPC, amid fears of some market participants of an interest rate hike by 50 bp. As the move by 25 bp was in line with analysts' expectations and the official statement and the press conference were not clearly "hawkish", it seems that the Council will pause with further monetary policy tightening till the next year. We expect yet more two interest rate hikes by 25 bp at the start of 2008. It is hard to say, how the financial market is pricing further moves of the MPC, as the money market is under influence of fears over the liquidity of the sector at the end of year. If the forecast of the Ministry of Finance for the next months is pessimistic again, than the market rates may rise. However, so far, in the past week at the end of the yield curve there was some recovery (yield of 5Y and 10Y bonds went down by 6-7 bp), though the GDP data had some negative influence on the market. In our view, good GDP data were rather neutral from the point of the view of inflation prospects, amid favourable breakdown of the economic growth (fast growth of investments). They were also, together with information, that the most important rating agencies consider Poland's rating upgrade already next year, a factor, which supported Polish currency. However it was the wave of the improved sentiment in the global markets that was crucial, as it affected the FX market and EURPLN did not break 3.70 despite several tries and it fell almost to 3.60. This week in the international markets is going to bring the decisions of the ECB and data from the housing market from the United States. Any further information of problems of financial institutions exposed to mortgage markets will also be important to the sentiment and risk appetite.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (3 December)					
10:00	**PL**	**Auction PLN2.0bn of Treasury Bills**					
9:00	EMU	Manufacturing PMI	Nov	pts	52.5	-	51.5
15:00	US	Manufacturing ISM	Nov	pts	50.4	-	50.9
		TUESDAY (4 December)					
10:00	EMU	PPI	Oct	%YoY	3.0	-	2.7
		WEDNESDAY (5 December)					
10:00	**PL**	**Auction of PLN2.0-3.0bn of 2Y OK0709 bonds**					
9:00	EMU	PMI services sector	Nov	pts	53.7	-	55.3
13:15	US	ADP report	Dec	pts	70	-	106
13:30	US	Unit labour costs	Q3	%	-0.7	-	-0.2
13:30	US	Labour productivity	Q3	%	5.5	-	4.9
15:00	US	Factory orders	Oct	%	0.3	-	0.2
15:00	US	ISM services sector	Nov	pts	55.0	-	55.8
		THURSDAY (6 November)					
12:00	GB	BoE meeting – decision		%		-	5.75
12:45	EMU	ECB meeting – decision		%	4.0	-	4.0
13:30	US	New jobless claims		'000		-	352.0
		FRIDAY (7 November)					
13:30	US	Non-farm payrolls	Nov	'000	84.0	-	166
15:00	US	Preliminary Michigan index	Dec	pts	75.8	-	76.1

Source: BZ WBK, Parkiet, Reuters

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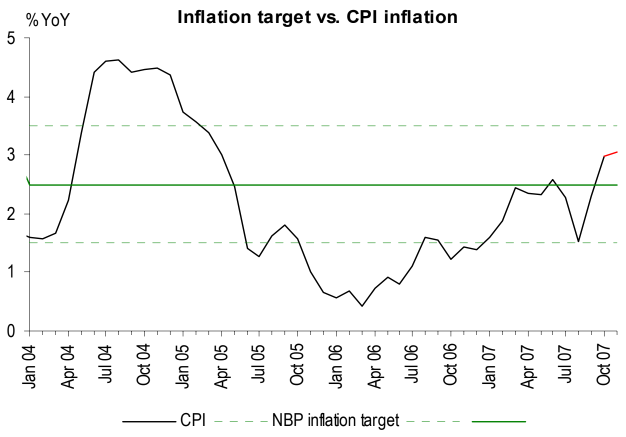
What's hot this week – MinFin's inflation forecast, central banks' decisions

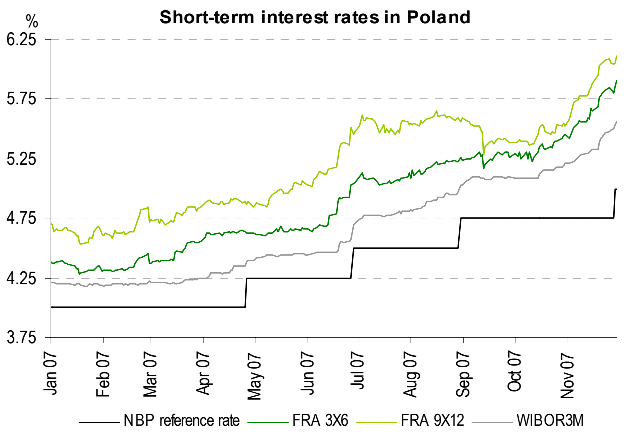


▪ Amid lack of important data releases the publication of the inflation forecast of the Ministry of Finance for December is going to be the most important event of this week. Our estimate shows acceleration of inflation to 3.1%YoY amid 0.3%MoM growth. Recently the forecasts of the finance ministry significantly affected the market.

▪ The ISM and PMI indices will point the tendencies in economic activity in the US and the euro zone. The non-farm payrolls figure is going to be the main release of the week in the US, especially after poor data on jobless claims.

▪ The ECB and the Bank of England will make decisions on interest rates. The ECB is going to leave rate unchanged and the communiqué after the meeting will be important, as it may suggest further actions in monetary policy in the EMU. Comments of Fed representatives may also be important ahead of incoming meeting.

Economy last week – Strong sales, rates rise by 25 bp, sound GDP data

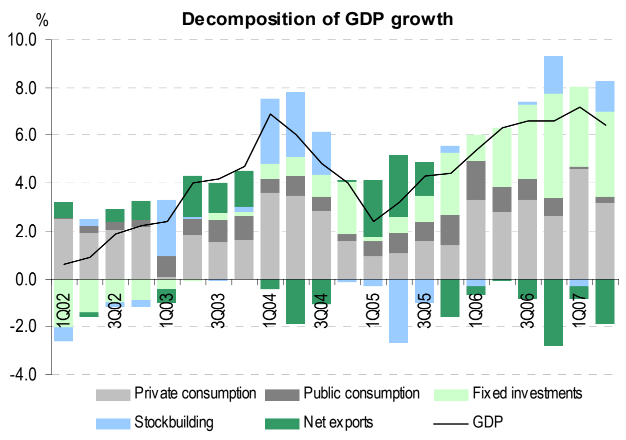


▪ Retail sales rose in October by 19.4%YoY and by 16.3%YoY in real terms significantly exceeding market forecasts, which showed, that private consumption stays an essential factor of economic growth and its rate in Q4 is going to exceed 5%.

▪ Data on firm's investments after Q3 were quite optimistic and they rose by 30.8%YoY.

▪ Net core inflation amounted in October to 1.4%YoY, which confirmed, that the core of the inflation processes in the domestic economy stays under control.

▪ The rate of registered unemployment fell in October to 11.3% from 11.6% in September by 3.6 pct pts lower than in the previous year. The LFS results showed a fall of unemployment rate to 9.0%, though they also suggested similar as the Q3 data on the employment in the whole economy showed a deceleration of labour demand growth.



▪ In line with market consensus the Monetary Policy Council raised interest rates by 25 bp (reference rate to 5.0%), though some market players started to price-in a hike by 50 bp. The statement was not overly hawkish, similarly to some comments of MPC members, which calmed down the market in terms of risk of another rate increase already in December.

▪ GDP data for Q2 were better than expected with growth at 6.4% against expectations at 5.8%. Growth breakdown was also optimistic as private consumption growth (5.2%) was below consensus and fixed investments rose more than expected (ca. 20%). This may induce some of the MPC members to think about inflation prospects in somewhat brighter colours. However, for other central bankers it is important that domestic demand growth remained above potential GDP growth rate.

Quote of the week – Only one MPC member for a rate hike in December?

Jan Czekaj, MPC member, Reuters, 29 Nov

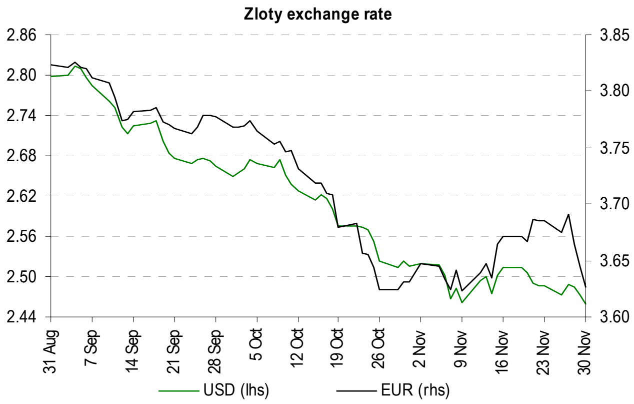
From the point of view of assessment of inflationary pressure core inflation measures are more adequate. (...) However, CPI inflation affects expectations. (...) Rise in food prices may be a reason of second round effects. If (...)inflation forecasts are optimistic but current inflation is quite high, it may be an argument for monetary tightening.

Marian Noga, MPC member, PAP, 29 Nov

Main interest rate by the end of 2008 should increase to (...) 5.75%. We have time though. Until publication of February's inflation projection there will be probably one more rate hike needed, by 25 bp. Interest rate hikes should not be cumulated. (...) There is no need to use 50 bp steps. We cannot act towards hampering economic growth.

Although Dariusz Filar confirmed the day after the decision, that in his opinion a concentrated interest rate hikes are necessary already now, this view is not shared by other, also "hawkish" MPC members Andrzej Wojtyna and Mariana Noga. On the other hand, the comments of Jan Czekaj, who was crucial for this year's rate hike decisions were quite hawkish and one may conclude, that this central banker is going to vote in favour of further rate hikes in the nearest time, which supports our scenario on rates presuming further hikes in January and March. After the GDP data Mirosław Pietrewicz stated on the other hand, that they decreased fears over economic growth and they meant a decrease of inflation pressure.

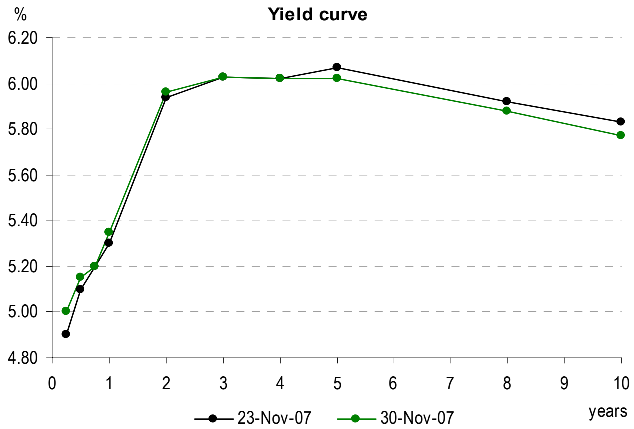
Market monitor



Significant appreciation of the zloty

▪ After a few attempts of the EURPLN rate to break the level of 3.70, the significant appreciation of the zloty took place. The domestic currency gained in reaction to increase in risk appetite. The tendency was additionally supported by comments from major rating agencies that Poland may be upgraded the next year. Thus, the zloty strengthening began earlier than we predicted.

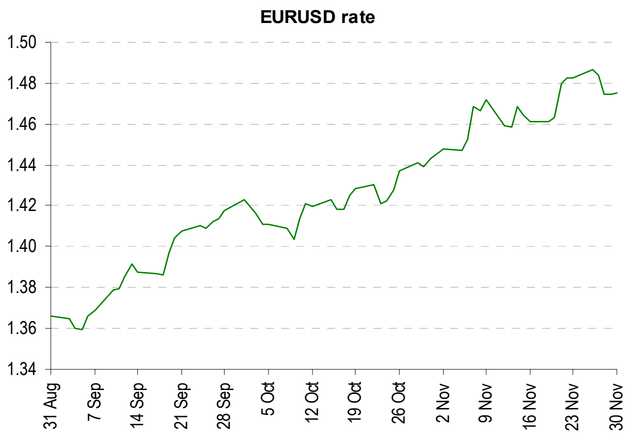
▪ This week the zloty exchange rate against major currencies should stabilize at stronger levels and a possible correction is not likely to be significant. We lower range of expected moves of the EURPLN to 3.60-3.70 and for the USDPLN to 2.40-2.50.



Recovery of longer dated bonds

▪ In the first part of last week the debt market was waiting for the MPC meeting and yields were slightly increasing. However, on Tuesday there was increase in risk appetite on the global markets and this supported Polish bonds. After the MPC decision announcement and not very hawkish official statement of the Council, a significant strengthening took place. This was coupled with further increase in risk appetite and positive comments on Poland from major rating agencies. Positive effect of these factors was then partly offset by later comments from rate-setters and stronger-than-expected data on GDP growth in Q3.

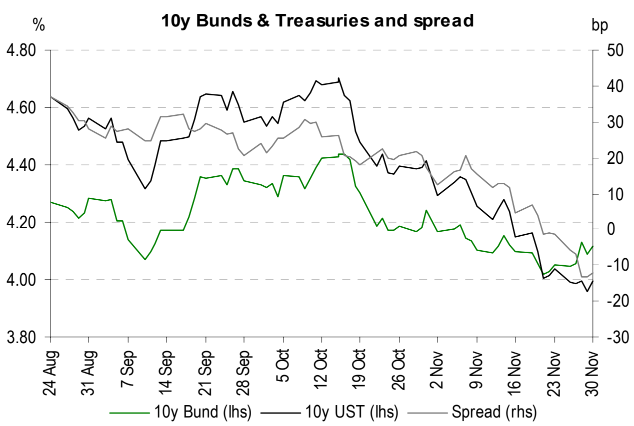
▪ This week the domestic debt market will be under influence of the FinMin's inflation estimate. With no local data releases, the Polish market will be also focused on developments in the international markets.



The dollar gained with high volatility

▪ The last week brought some recovery of the dollar against the euro. This was driven among others by news about cash injection for the Citigroup from investors from the Middle East. Besides, an important role was played by comments from Fed officials, strengthening expectations for further rate cuts in the US, which could support the economy. The helped not only the dollar, but also the stock markets. At the end of the week the dollar was at 1.477 against the euro.

▪ This week the key event for the EURUSD rate will be the US non-farm payrolls report due on Friday and ADP report scheduled earlier in the week. The data will be key factor for expectations regarding Fed actions. The markets will be also keeping a close eye on the ISM and PMI indices, which indicate tendencies in the world's main economies.



Low yields in the US

▪ The first part of the week was marked by significant fall in yields in the core debt markets, which was connected with strong risk aversion. However, later in the week the situation changed and risk appetite increased along with stronger expectations for rate cuts by the Fed. Besides, when yields of 10-year Treasuries reached a mere 3.80% (the lowest level since 2004), investors came to a conclusion that they are too expensive. As compared to the previous week yields of 10-year Treasuries fell by 4 bps to 4.00% and yields of 10-year Bunds rose by 6 bps to 4.10%.

▪ This week investors will wait for the upcoming Fed meeting, keeping a close eye on the US data from the labour market and economic activity indices.

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