Bank Zachodni WBK

Weekly economic update

17 – 23 December 2007

This week the Polish financial market will be awaiting for the result of the MPC meeting, to be announced on Wednesday. Higher than expected CPI in November has strengthened market belief that this year the Christmas gift from the MPC may be a rate hike in December (although only one of polled analysts predicts such decision). We do not share such view and expect a rate hike in January. We predict that labour market data due for release on Monday will support our scenario, showing slowdown in annual wage growth by ca. 1 pct. point. Other data concerning economic activity to be released this week (industrial output, retail sales) also should not augment concerns about inflation prospects, showing slightly slower growth rates than in October, however they will be released probably after the announcement of the MPC decision. Core inflation measures are likely to rise, but more slowly than the CPI, confirming that the underlying inflationary pressure is still modest.

Among data releases abroad, the most important figures will include German Ifo index (especially in the context of deteriorating GDP growth forecasts in Germany), and data in the US: revised GDP figures, Fed's favoured inflation measure PCE, and business climate indices from Fed regional branches.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 December)					
13:00	**POL**	**Wages in enterprises sector**	**Nov**	**%YoY**	**11.2**	**10.1**	**11.0**
13:00	**POL**	**Employment in enterprises sector**	**Nov**	**%YoY**	**5.0**	**5.1**	**5.0**
9:00	EMU	NTC PMI manufacturing	Dec	pts	52.5	-	52.8
9:00	EMU	NTC PMI services	Dec	pts	53.8	-	54.1
13:30	USA	New York Fed index	Dec	pts	21.0	-	27.4
14:00	USA	Overall capital flows	Oct	$ bn	-	-	-14.7
		TUESDAY (18 December)					
13:30	USA	New house starts	Nov	m	1.19	-	1.23
		WEDNESDAY (19 December)					
	POL	**MPC meeting – decision**	**Dec**	**%**	**5.00**	**5.00**	**5.00**
13:00	**POL**	**Industrial production**	**Nov**	**%YoY**	**9.1**	**9.5**	**10.6**
13:00	**POL**	**PPI**	**Nov**	**%YoY**	**2.8**	**2.9**	**2.2**
9:00	GER	Ifo index	Dec	pts	103.8	-	104.2
		THURSDAY (20 December)					
13:30	USA	Final GDP	Q3	%	4.9	-	4.9
13:30	USA	Core PCE	Q3	%	1.8	-	1.8
13:30	USA	GDP deflator	Q3	%	0.9	-	0.9
17:00	USA	Philadelphia Fed index	Dec	pts	7.0	-	8.2
		FRIDAY (21 December)					
9:00	**POL**	**Retail sales**	**Nov**	**%YoY**	**19.1**	**19.0**	**19.4**
9:00	**POL**	**Registered unemployment rate**	**Nov**	**%**		**11.3**	**11.3**
9:00	**POL**	**Business climate indicators**	**Dec**	**pts**	**-**	**-**	**-**
13:00	**POL**	**Net core inflation**	**Nov**	**%YoY**	**1.5**	**1.6**	**1.4**
13:30	USA	Core PCE	Nov	%MoM	0.2	-	0.2
15:00	USA	Final Michigan index	Dec	pts	-	-	76.1

Source: BZ WBK, Parkiet, Reuters

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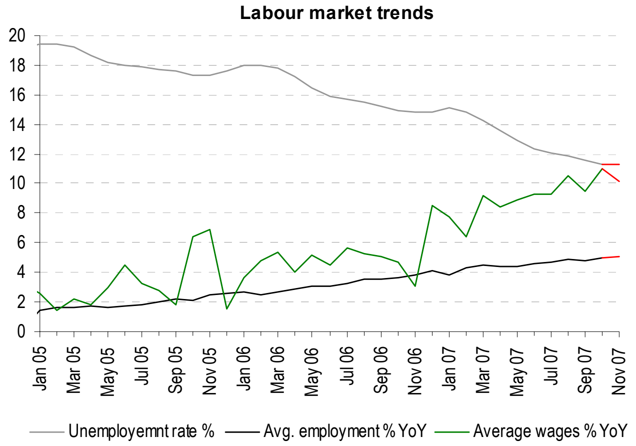
What's hot this week – Busy week just before Christmas

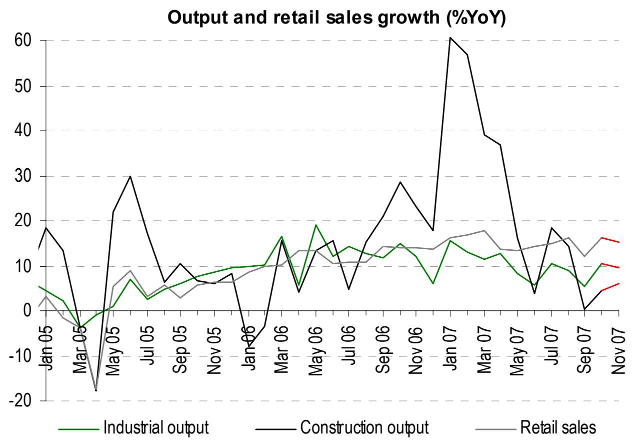


▪ The last week before Christmas will be busy in the financial markets, due to building concerns about effects of financial crisis and a large number of events and publications in the agenda.

▪ A key event for the local market will be the MPC decision on interest rates on Wednesday. We expect the Council to keep rates on hold this time.

▪ The labour market data released before the meeting will show in our view a slowdown in wage growth by ca. 1 pp. and only slight acceleration in job creation, which should be moderately positive signal for the MPC.

▪ On Wednesday afternoon, the CSO will release data about industrial output and PPI. We predict slight slowdown in production growth in November to 9.5%YoY and acceleration in PPI growth to 2.9%.



▪ Next set of domestic data will be released on Friday and will be less important for the market.

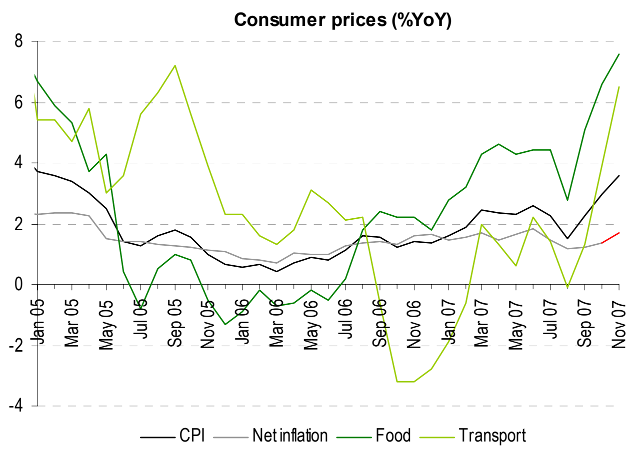
▪ Core inflation is likely to rise, but more slowly than the CPI, remaining at moderately low level.

▪ Retail sales growth should remain high, being supported by high households' revenue, although according to our forecast slightly below October's level.

▪ Registered unemployment rate should stay at 11.3%, the same as in October.

▪ The list of data releases abroad is shorter, however several important figures are due in the agenda. The focus of attention will be on German Ifo index and set of data from the US: housing market statistics, revised GDP numbers, PCE inflation gauge, and several business climate indicators from regional Fed branches.

Economy last week – Inflation and current account gap higher than expected



▪ Inflation in November increased to 3.6%, exceeding forecasts, mostly due to strong rise in prices of food and fuels. Net inflation went up as well, but to lower extent – according to our estimate to 1.5-1.6%. In January CPI may exceed 4%, but in our view in next quarters it should be gradually decreasing.

▪ Current account deficit was higher than predicted and reached €1.3bn, even though trade deficit (€587m) was very close to our forecast, similarly to export and import growth. Deterioration in C/A gap was caused by worse balances in income and current transfers – first due to high reinvested profits, latter due to low EU transfers. Both factors are unlikely to worsen the external imbalance persistently.

▪ FOMC cut main interest rate by 25 bp, which disappointed some investors triggering higher risk aversion.

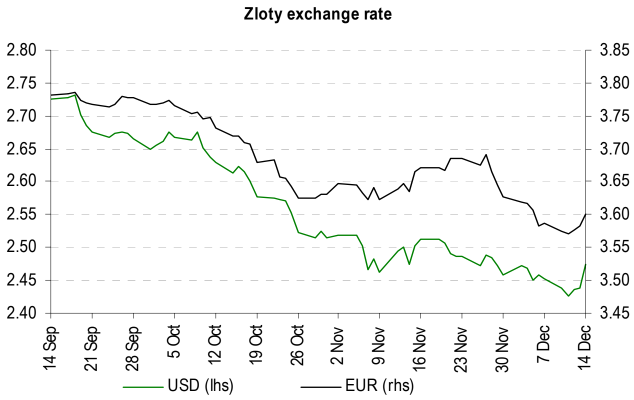
Quote of the week – How to slay the hydra of inflation?

Andrzej Sławiński, MPC member, Reuters, 11 December

Well, the hydra of inflation is raising her heads again, at least three of them. Food prices are rising. Fast wage growth continues. Inflation in China is mounting. (...) If wages in Poland keep growing fast, then strong demand-pull pressure may arise. By now, a factor than makes our life easier is favourable structure of GDP growth. (...) So far, there is little evidence that demand pressure has significant effect on core inflation. But we will see what will be the behaviour of processed food prices. So far, low core inflation gives the MPC the ability to act in decisive yet judicious manner, taking into account, among others, that monetary policy restrictiveness is determined jointly by interest rates and the exchange rate.

Comments of the MPC members and the minutes of November's MPC meeting do suggest that the central bankers see the risk concerning possible inflation rise, however at the same time they understand their limited ability to counteract the major drivers of accelerating price growth. As long as core inflation stays low, it seems it will be difficult to convince majority of the MPC members to increase scale of frequency of rate hikes. Especially that from the latest minutes one may conclude, that along our presumptions there was no motion applied of a 50 bp interest rate hike in November, which suggests that even the most "hawkish" council members were not prone to radical moves.

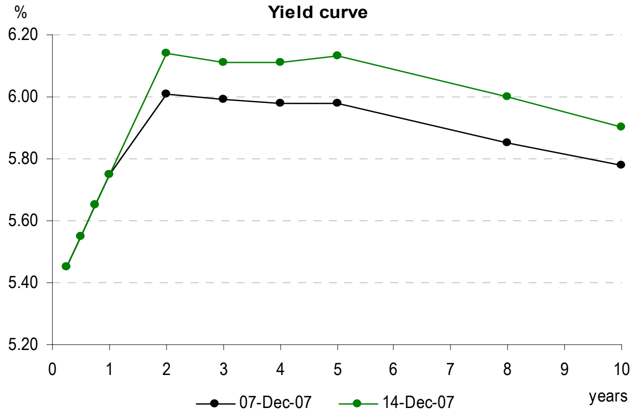
Market monitor



Zloty keeps gaining before Christmas

▪ While in the first part of the week, the zloty kept appreciating, after the Fed decision the trend reversed, as fears of recession in the US and effects of credit market crunch started prevailing again on world financial markets, and global risk aversion resurged. At the end of the week the correction gained momentum, the EURPLN rose temporarily above 3.62 and USDPLN exceeded 2.50. At the end of day, zloty erased some losses.

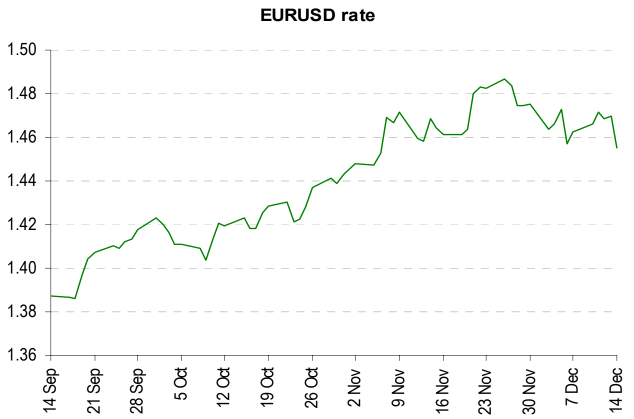
▪ This week the depreciation of the zloty, which we have been expecting for some time, may continue. It will be supported among others by lack of interest rate hike by the MPC, slightly weaker macroeconomic data, and most of all building risk aversion abroad. We move up the fluctuation bands for this week to 3.58-3.68 for EURPLN and band for USDPLN remains at 2.40-2.50.



Yields keep rising before the MPC meeting

▪ Yields on the Polish debt market were climbing during the week, being pushed initially by comments of MPC members, and most of all by the release of CPI numbers, that exceeded already high expectations. Although only one of polled analysts predicts a rate hike this week, the market is pricing in such possibility much stronger.

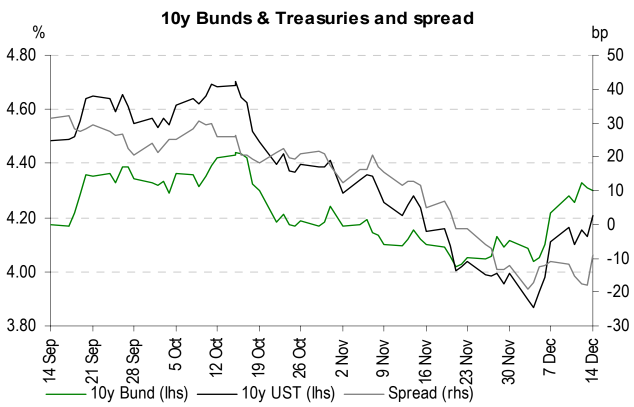
▪ Events and data releases planned for this week should favour strengthening of the debt market, if they prove to be in line with our forecasts,. Both slowdown in pay growth in November and lack of rate hike will have positive impact on yields. Short end of the curve will probably remain under negative impact of low liquidity at the end of the year.



New data releases supporting the dollar

▪ Dollar strengthened significantly against euro at the end of the week, which was triggered among others by new data publications in the USA (retail sales, industrial output, inflation) that trimmed market expectations for next FOMC rate cuts. Additional factor was a rise in global risk aversion and flight to quality.

▪ The last week before Christmas will be probably quite nervous for world financial markets. In the nearest days there will be several more data releases that may have important effect on the investors' sentiment, including data from US housing market, revised GDP figures, PCE inflation indicator.



Yields up, driven by rising inflation

▪ Publication of macroeconomic data in the US, trimming expectations for further interest rate cuts, triggered weakening in core bond markets. Yields of 10Y Treasuries increased during the week by 10 bp, while yields of Bunds rose by 8 bp. A factor that was limiting a scale of yields increase was building risk aversion, feeding the demand for safe assets.

▪ Likewise in case of dollar, data to be released this week may be important for the international fixed income markets. Investors will also focus on comments of ECB's Trichet and Liebscher due to speak on Wednesday. Lower liquidity at the turn of the year will also have negative impact on bond yields.

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