

# Bi-weekly economic update

7 – 13 January 2008

The Polish financial market was calm in the holiday period with very limited activity of investors. At the start of the new year the market activity revived, but market moods has not changed significantly as compared to pre-holiday period. The domestic interest rate market remain under pressure of accelerating CPI inflation, although comments from the Ministry of Finance to its estimate of the inflation rate in December could give the market some hope for weakening of the upward trend in the food prices. FinMin estimates that the CPI inflation in December accelerated to 4%YoY from 3.6%YoY in November, with food price growth of 0.5%MoM. Our assumption regarding food price growth is consistent with that of the ministry, but we predict that the overall CPI inflation rate grew slightly weaker, to 3.9%YoY. Over the last two week the EURPLN rate was traded in relatively narrow range, between 3.58 and 3.62. In turn, the USDPLN dropped significantly below 2.50 noted before Christmas. This was related to significant weakening of the dollar in the international markets after release of weaker than expected data from the US, which intensified concerns about condition of the US economy.

There are no major domestic events scheduled for this week. However, the Wednesday's auction of 20-year bonds will have some importance for the debt market. On Tuesday the Senate's Committee of the National Economy will start working on the 2008 budget bill, but given that the ruling PO party has majority of seats in the Upper House of parliament, there should be no surprises. With no crucial domestic events, participants of the Polish financial market will focus on developments in the foreign markets. The key factors to watch will be meetings of the ECB and the Bank of England. As regards the former one there is dominant view that rates will be kept on hold while in the latter case some market participants predict another rate cut, although the market consensus points to no change in rates.

## Economic calendar

| Time GMT                     | COUNTRY   | INDICATOR                                        | PERIOD | FORECAST |       | LAST VALUE |        |
|------------------------------|-----------|--------------------------------------------------|--------|----------|-------|------------|--------|
|                              |           |                                                  |        | MARKET   | BZWBK |            |        |
| <b>MONDAY (7 January)</b>    |           |                                                  |        |          |       |            |        |
| 10:00                        | EZ        | Economic sentiment indicator                     | Dec    | pts      | 104.3 | -          | 104.8  |
| 10:00                        | EZ        | PPI                                              | Nov    | %YoY     | 4.0   | -          | 3.3    |
| <b>TUESDAY (8 January)</b>   |           |                                                  |        |          |       |            |        |
| 10:00                        | <b>EZ</b> | <b>Retail sales</b>                              | Nov    | %YoY     | 0.5   | -          | 0.2    |
| 15:00                        | <b>US</b> | <b>Pending home sales</b>                        | Nov    | %        | -0.5  | -          | 0.6    |
| <b>WEDNESDAY (9 January)</b> |           |                                                  |        |          |       |            |        |
|                              | <b>PL</b> | <b>Auction of 20-year bonds worth PLN1-2.5bn</b> |        |          |       |            |        |
| 10:00                        | EZ        | GDP revised                                      | Q3     | %YoY     | 2.7   | -          | 2.5    |
| <b>THURSDAY (10 January)</b> |           |                                                  |        |          |       |            |        |
| 12:00                        | GB        | Bank of England – decision                       | -      | %        | 5.0   | -          | 5.0    |
| 12:45                        | EZ        | ECB – decision                                   | -      | %        | 4.0   | -          | 4.0    |
| 13:30                        | US        | Wholesale inventories                            | w/e    | '000     | 340.0 | -          | 336.0  |
| 15:00                        | US        | Initial jobless claims                           | Nov    | %        | 0.4   | -          | 0.0    |
| <b>FRIDAY (11 January)</b>   |           |                                                  |        |          |       |            |        |
| 13:30                        | US        | Import prices                                    | Dec    | %        | 0.2   | -          | 2.7    |
| 13:30                        | US        | Trade balance                                    | Nov    | \$bn     | -59.0 | -          | -57.82 |
| 19:00                        | US        | Federal budget                                   | Dec    | \$bn     | 50.0  | -          | 41.96  |

Source: BZ WBK, Parkiet, Reuters

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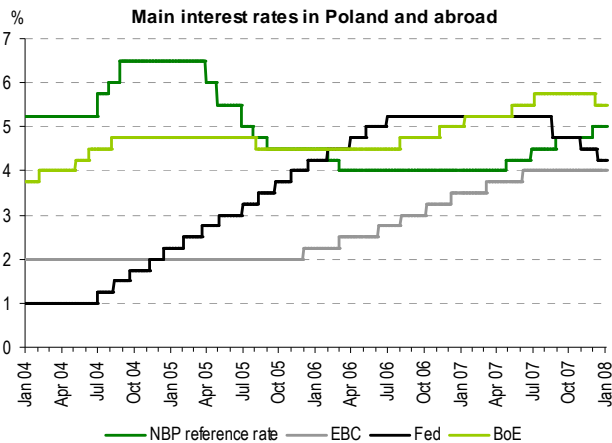
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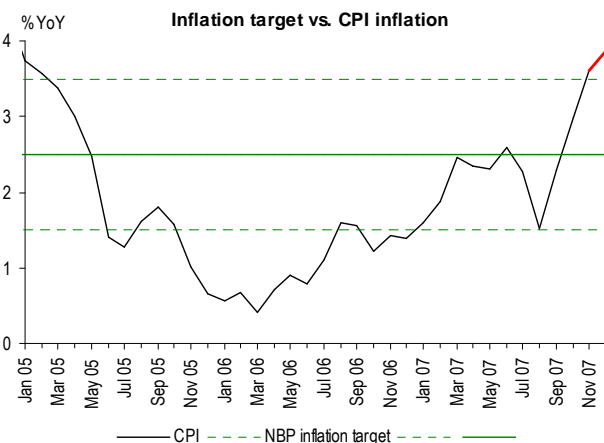
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## What's hot this week – Meetings of the ECB and the Bank of England

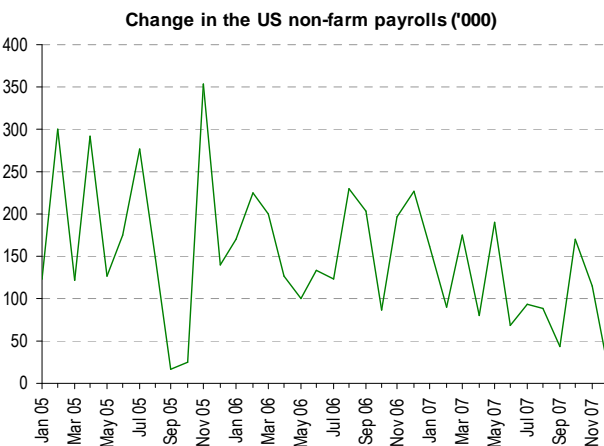


- This week there are no local data releases in the agenda. For the debt market, auction of 20Y bonds may be important. On Monday, the MinFin will announce the planned supply at the auction.
- On Tuesday the Senate's Economic Committee will start working on the 2008 budget bill. The Senate will debate on the budget during its meeting at 15-17 January. Considering PO's majority in the Upper House, one should not expect any problems and surprises during further work on the budget bill.
- As regards foreign events, the most important will be meetings of the European Central Bank and the Bank of England. While the market is predominated by view that interest rates in the euro zone will remain unchanged, some analysts predict another interest rate cut in the UK, although market consensus also in this case is no change in rates.

## Economy last week – FinMin suggests that food prices pressure subsidies



- On Wednesday the FinMin announced its estimate of the CPI inflation rate in December, at 4%YoY against 3.6% in November. On a monthly basis, prices rose 0.3%. According to the ministry, similarly as in previous months, the acceleration in the CPI inflation was dragged mainly by food prices, which increased 0.5%MoM in December.
- Such growth of food prices is consistent with our earlier assumptions, although our forecast of CPI inflation in December is slightly lower, at 3.9%YoY and 0.2%MoM.
- Deputy finance minister Katarzyna Zajdel-Kurowska stressed in a comment to the release of the Finmin's estimate that growth in food prices decelerated from 2.4%MoM in September, 1.7% in October and 1.5%MoM in November, which in her opinion may signal a gradual termination of the recently seen upward tendency.



- According to Polish media, Stanisław Gomułka will be the new deputy finance minister, responsible for coordination of work on public finance reform. In the interview with *Parkiet* daily, Gomułka said that his priority will be a reduction of share of budget's fixed expenditure from current 70% to 50% in the next four years. Another target will be an increase in employment of people in the age of 50+ by 1 million. At the moment, there is no information how the new minister plans to achieve the targets.
- The most important event of the week in the international markets was, as usually at the start of a new month, release of the US non-farm payrolls report. It showed an increase of new jobs by 18,000 against forecasts at 70,000. Despite previous month was revised up from 94,000 to 115,000, the data strengthened concerns about state of the US economy.

## Quote of the week – The MPC anticipated inflation close to 4%

**Jan Czekaj, MPC member, TVN CNBC, PAP, 3 January**

*More likely are interest rate hikes than no change in rates. There are pressures building up in the economy, the most important are those connected with the labour market. (...) So far, no demand-pull pressure in the economy can be seen, net inflation is quite low. (...) We have expected inflation around 4% (in December), this results from negative environment in agriculture and high energy prices.*

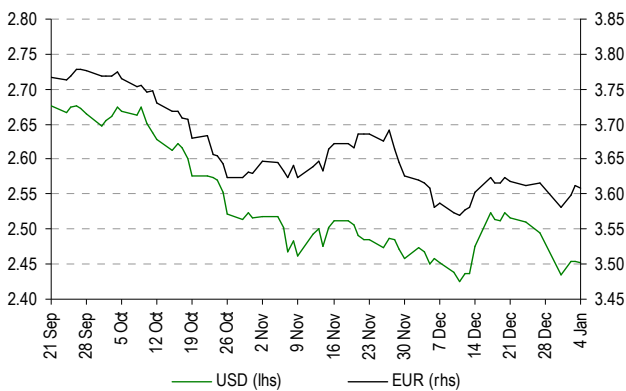
**Marian Noga, MPC member, PAP, 31 December**

*In my opinion, a level (of rates) that would assure inflation approaching 2.5% and its anchoring in the target, would be 5.75%. Experience of other central banks and ours shows that we cannot strike too strong. (...) It seems that 25 bp (hike) is the best what we can apply.*

Last week numerous comments of the central bankers appeared. On of hawkish members, Marian Noga, said directly that in his opinion a level of reference rate that would guarantee a return of inflation to target and its stabilisation would be 5.75%, which implies an increase of interest rates by 75 bp from today's level. According to Noga, rate hikes should be applied in 25 bp steps. In our opinion, majority of Council members is more cautious in delivering monetary tightening. Therefore we still predict that a total scale of further rate hikes will be 50 bp, in two steps of 25 bp: in January and in March. A balanced comments from Jan Czekaj, whose vote tipped the balance several times at the MPC meetings last year, seem to confirm our view.

**Market monitor**

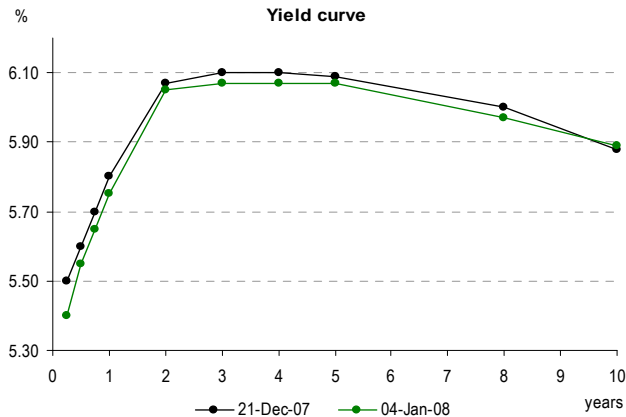
**Zloty exchange rate**



**Zloty stable against euro, stronger versus dollar**

- The EURPLN rate remained in a narrow range in the last two weeks, between 3.58 and 3.62. The EURPLN rate recorded a clear decline from over 2.50 in the pre-Christmas period, to below 2.44 at the end of last week. It was connected with significant dollar weakening in the international markets. All in all, the zloty remained strong, despite not very good sentiment in global financial markets.
- Amid lack of important domestic events, this week the zloty will remain under influence of changing sentiment abroad. We predict that ranges of zloty fluctuations for this week will be symmetric versus levels from the end of the last week. The EURPLN rate should range between 3.56 and 3.66 and the USDPLN rate between 2.40 and 2.50.

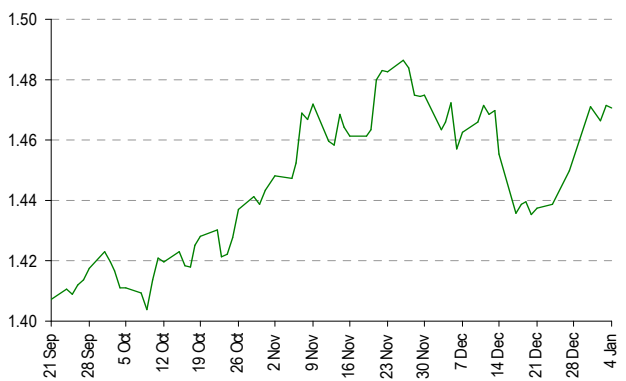
**Yield curve**



**Increase in bond yields**

- In the last two weeks, local interest rate market was under pressure of rapid inflation growth. As compared to the end of week before Christmas, yields went up by 5-6bps. The release of FinMin's inflation estimate had no significant impact on the market as rates had increased earlier in anticipation that the forecast will show further significant rise in the CPI inflation rate.
- There are no domestic events scheduled for this week, which could indicate clear direction for the interest rate market. Possible next comments from rate-setters, with no new information on the economic situation, also should not dramatically change the situation. Thus, the domestic market may be driven by events abroad.

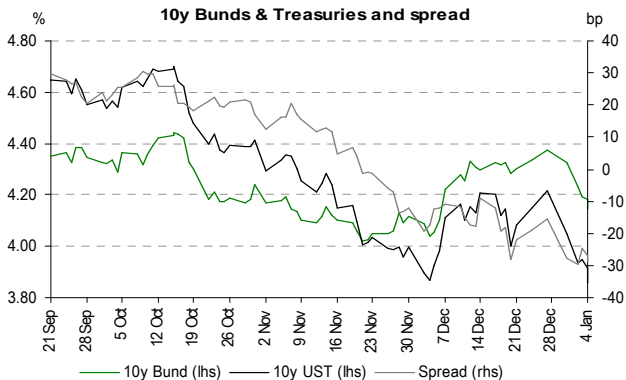
**EURUSD rate**



**EURUSD sharply up**

- The turn of the year was not successful for the US currency. The US data published in the last two weeks increased concerns about condition of the world's largest economy. As a result, the dollar clearly weakened. While before Christmas the dollar was below 1.44 against the single currency, at the end of last week, after publication of the closely watched by the market US non-farm payrolls report, the EURUSD rate climbed above 1.48.
- This week important factors for the EURUSD rate will be data due for release in the US and the euro zone as well as the outcome of the ECB meeting. While the decision of the bank seem to be determined, tone of comments after the ECB meeting will be crucial for the EURUSD rate.

**10y Bunds & Treasuries and spread**



**Lower yields in the core debt markets**

- Weaker than expected data from the US led to a rise in risk aversion in the global markets and increased interest in safe assets. Falling stock prices were coupled with clear drop in yields of bonds. As a result, while at the end of pre-Christmas week yields of 10-year Treasuries and Bunds were at 4.08% and 4.30%, respectively, last Friday they were at 3.85% and 4.13%.
- After the weaker than predicted US non-farm payrolls report for December, bonds yields in the core markets should remain relatively low. Later in the day, the market performance will depend on next data and outcome of the ECB meeting scheduled on Thursday.

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