

Weekly economic update

21 – 27 January 2008

The past week brought a series of data releases from the domestic economy and most of them to large extent differed from the market consensus. The inflation data appeared in line with expectations, though their breakdown was less favourable from the point of the view of net inflation path than one might have expected. On the other hand this negative effect was partly offset by lower then forecasted wage growth in December, which resulted among others from a volatility of bonuses payment dates in some sectors. Industrial production similar as the producer prices figure was below expectations. The net effect of the data release form the Polish economy resulted in a strengthening in the domestic debt market. This move was supported by the opinions of the MPC members, who are key for the Council decisions. Very low current account deficit also surprised, and it was influenced by significant inflow of current transfers. Meanwhile in the FX market the zloty was depreciating against euro and the dollar through most part of the week similar as other currencies in the region, which went in line with deterioration of moods in the global markets. Strong declines were recorded in the Warsaw Stock Exchange as well.

This week the publication of core inflation data for December looks very interesting. After the breakdown of CPI headline figure was worse than expected, we decided to revise our net inflation estimation upwards, however, we do not know whether market expectations has changed as well. On the other hand, retail sales figure for December should show some moderation in annual growth rate and we also expect the unemployment rate to rise seasonally. Moods in global financial markets are likely to be unstable, which can influence also the Polish markets, though the beginning of the week might be calmer amid the holiday in the United States. As regards international markets, the economic calendar is not so heavy with some housing market figure for the US and economic activity indicators for the euro zone. In our opinion the zloty should remain at slightly weaker levels in the upcoming days.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (21 January)							
	US	Market holiday					
TUESDAY (22 January)							
13:00	PL	Net inflation	Dec	%YoY	1.7	1.5	
WEDNESDAY (23 January)							
13:00	PL	Business climate	Jan				
9:00	EZ	Flash PMI – manufacturing sector	Jan	pts	52.1	-	52.6
9:00	EZ	Flash PMI – services sector	Jan	pts	52.8	-	53.1
12:00	US	Mortgage index	Jan	pts		-	906.4
THURSDAY (24 January)							
9:00	PL	Retail sales	Dec	%YoY	20.3	18.5	19.2
9:00	PL	Rate of unemployment	Dec	%	11.5	11.4	11.2
13:00	PL	MPC minutes	Dec				
9:00	DE	Ifo index	Dec	pts	102.2	-	103.0
13:30	US	New jobless claims	w/e	'000		-	301
15:00	US	Home sales	Jan	m	4.95	-	5.0

Source: BZ WBK, Parkiet, Reuters

Maciej Reluga Chief economist (+48 22) 586 8363

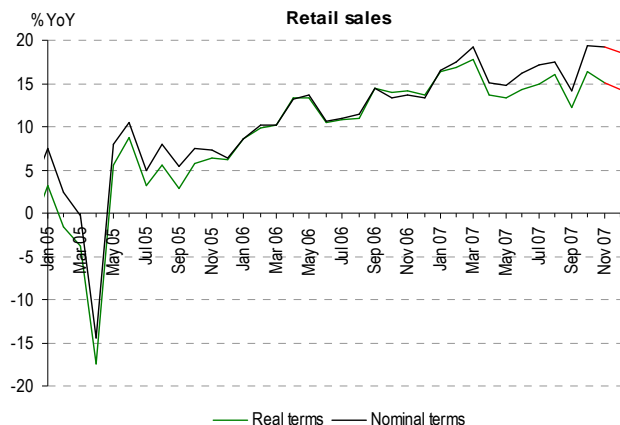
Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341

Cezary Chrapek (+48 22) 586 8342

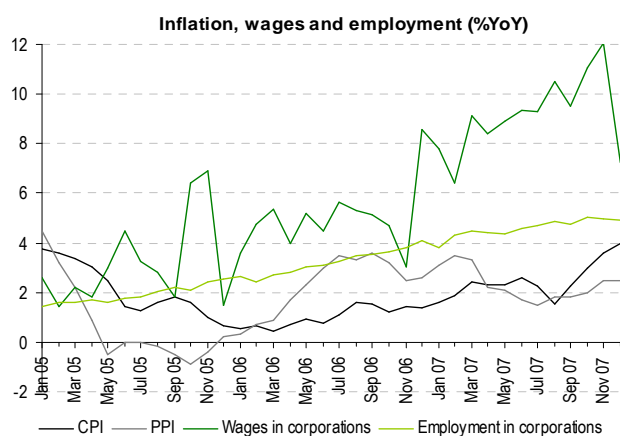
e-mail: ekonomia@bzwbk.pl

What's hot this week – New portion of domestic data

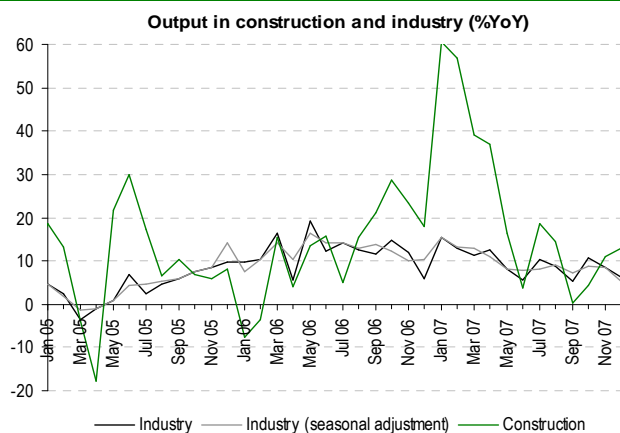


- The core inflation data will be one of the most important data releases scheduled for this week, as the breakdown of the December CSO's data on inflation points to more significant acceleration of net inflation (to 1.7%YoY in December) as compared to our previous estimates. The MF's forecast is a bit more pessimistic and shows an increase of net inflation to 1.8%.
- The retail sales data for December should show a slight slowdown to 18.5%YoY from 19.2%YoY in November. Despite an expected weakening this would be still a high growth level signalling still strong consumption in Q4.
- We expect a slight rise of rate of unemployment to 11.4% mainly due to seasonal factors, i.e. weakening of labour demand in the winter months.
- The MPC *minutes* should not introduce any breaking news to the assessment of the monetary policy prospects.

Economy last week – Many surprising figures



- The December inflation matched the market forecast and reached 4%YoY (our forecast was at 3.9%YoY), though breakdown of CPI growth was worse than expected. Monthly food prices growth was lower than predicted by us and the MinFin. The tone of the data was rather "hawkish" increasing risk for third rate hike by 25 bp in Q2 (after two in January and March, which seem to be a deal-done).
- The annual rate of wages and employment growth in the corporate sector in December amounted to 7.2% and 4.9% and was below forecasts (11% and 5% respectively). The weakening of wage growth partly resulted from the effect connected with the moment of bonuses payments in some sectors of the economy. The data may be important for the monetary policy prospects if the detailed breakdown by sectors shows that this was not only a one-off phenomenon.



- Industrial output growth in December amounted to only 6.2%YoY (5.3% s.a.), which was below market consensus (8.6%). In the manufacturing sector a slowdown was recorded to 5.7%YoY (the weakest result in over two years). On the other hand the construction assembly production rose by 13%, in line with our expectations.
- PPI rose only by 2.5%YoY (with consensus at 2.8%), amid a decline by 0.5%MoM (which could be a result of strong zloty lowering the import prices).
- The current account deficit amounted to EUR350m against market expectations of ca. EUR1bn, mainly due to strong inflow of transfers (among others from EU funds). The account of current transfers recorded a surplus of EUR1.3bn. The growth rate of exports and imports was below expectations.

Quote of the week – Gradual rate hikes, excessive zloty appreciation undesired

Jan Czekaj, MPC member, TVN CNBC, 15 January

At the turn of 08/09 we should see inflation at the target (...) Two rate hikes are a deal-done, though I am not able to say whether more will be needed.

Jan Czekaj, MPC member, PAP, 16 January

So far one may not say about a change of approach to the situation, lower wage growth would have to hold for 2-3 months. The core inflation (...) is probably going to rise.

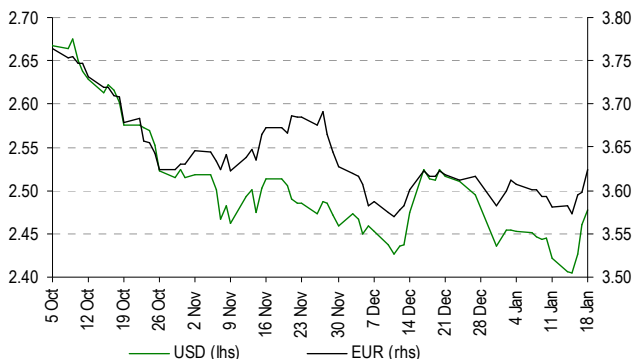
Andrzej Sławiński, MPC member, Parkiet, 17 January

(...) the wage growth rate may be still high, and this means a need to tighten the monetary policy further. It would not be good, if the zloty was in the group of currencies, which are being a subject of carry trade, and a risk of such situation is rising along the increasing interest rate disparity.

The members of the MPC, which are crucial for the Council decisions on interest rates, Jan Czekaj and Andrzej Sławiński do not suggest in their comments a need of aggressive monetary policy tightening. However, they will certainly support the interest rate hikes in January and March. In Jan Czekaj's view inflation is going to return to the target at the turn of the year. He holds his opinion that the MPC policy does not influence on factors resulting in higher inflation. Despite this, he noted the net inflation would probably rise. Jan Czekaj positively interpreted wages data and in his view the lower wages growth may be maintained, however only after the data for the next months are released one may say about a change of approach to the situation. On the other hand Andrzej Sławiński would like to avoid excessive zloty appreciation, which according to the last release of the MPC became an important argument for the Council.

Market monitor

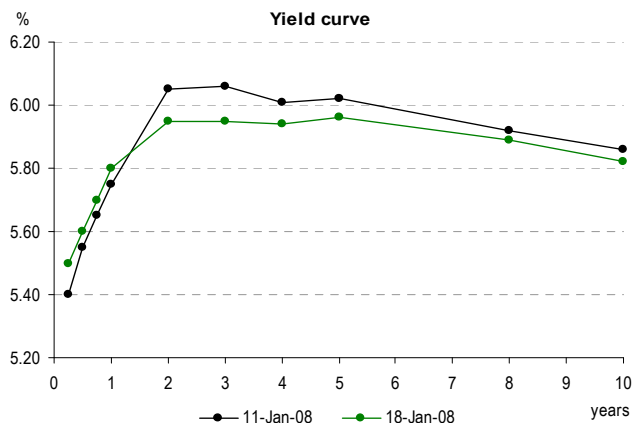
Zloty exchange rate



Zloty weaker with worsening in global moods

- After a moderate zloty appreciation at the beginning of the week, the weakening driven to some extent by global moods took place, which we indicated in the previous report. At the end of the week the EURPLN rate rose to above 3.62 while the depreciation against the greenback was more significant amid the EURUSD fall on international markets.
- The beginning of the week should be relatively calm amid holiday in the US. However uncertainty and instability on global markets maybe maintained, which would not be supportive factor for the Polish currency. We increase moderately the expected ranges of fluctuation for the EURPLN rate to 3.57-3.67 and for the USDPLN rate to 2.44-2.54.

Yield curve



Continued strengthening of the local debt market

- Last week the local debt market was strengthening, recovering from correction on Friday the previous week. The most notable rise in prices was seen at the short end of the yield curve, leading to its steepening. Despite of the fact that CPI inflation figures for December were worse than expected (worsening estimates of the net inflation), the market focused on comments from MPC's Jan Czekaj that were interpreted as rather dovish. Lower than expected wage growth and comments from MPC's Andrzej Stawiński additionally improved the market sentiment.
- We predict that retail sales data may be positive for the debt market. Core inflation measures may have the opposite effect. The long end of the yield curve will be under positive influence of fall in yields on the core markets. The market may be also affected by possible next comments from MPC members.

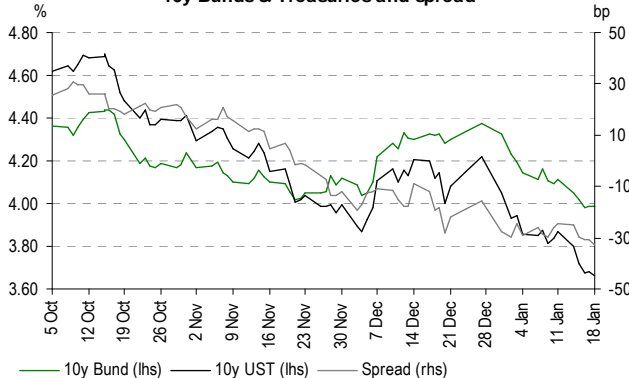
EURUSD rate



Dollar stable, but still under pressure

- After stabilisation of the EURUSD close to 1.48, the dollar started to appreciate versus the single currency, despite new worrying news from the US (poor results of some large banks, weaker than expected retail sales and Philly Fed index) and comments from Ben Bernanke, confirming the Fed is ready to counteract threat to the economic growth through decisive actions. In turn, comments from ECB's Yves Mersch on possible weakening of the economic growth in the euro zone led to substantial drop of the EURUSD rate below 1.47.
- In our opinion the dollar will return to the downward trend, in relation to continued weak data from the US that will increase concerns about recession and expectations of deeper rate cuts by the Fed.

10y Bunds & Treasuries and spread



Drop in yields after new worrying news from the US

- Last week saw significant strengthening in the core debt markets following weaker than expected data from the US, which increased risk of a recession in the US economy and increased risk aversion in the global markets and dramatic falls in the stock markets. Yields over the last week, yields of 10-year Treasuries plummeted by 21bps to 3.65%. Drop in yields of 10-year Bunds was weaker and reached 15bps to 3.98%.
- This week the number of data releases abroad will not be large and holiday in the US may additionally limit market activity at the beginning of the week. However, it is worth to watch the next data from the US housing market towards the end of the week. In the euro zone, the focus will be on preliminary PMIs and Ifo index.

This publication has been prepared by Bank Zachodni WBK S.A. (a member of AIB Group) for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity or an AIB Group entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, <http://www.bzwbk.pl>



Bank Zachodni WBK is a member of Allied Irish Banks Group