Bank Zachodni WBK

Weekly economic update

11 – 17 February 2008

The past week was quite interesting due to significant changes in the financial markets, where a significant zloty appreciation was followed by weakening on a risk aversion wave, which also affected the stock markets. The bond market also experienced a correction. The deterioration of sentiment in the international markets took place after the release of weak data from the EMU, which increased fears over economic slowdown and interest rate cuts in the euro zone, as well as poor data from the US. The tone of the ECB President's comments strengthened expectations of monetary policy easing in the EMU.

The nearest week will be full of important data releases from the domestic economy for January. Inflation should stay at the December level, similar as the employment growth, while wages growth accelerated in our view. Our forecasts of wages and CPI are below the market consensus. On the other hand our estimate of current account deficit is slightly above median of market forecasts. We expect an increase of the deficit above EUR1bn, though its level in relation to GDP is still low. Zloty is going to stay under influence of global moods, though it is worth to notice its relative stability despite the turmoil in the foreign markets.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 February)					
10:00	**PL**	**Auction of PLN0.5bn 52-week Treasury Bills**					
	JP	Market holiday					
		TUESDAY (12 February)					
13:00	**PL**	**Current account balance**	**Nov**	**€ m**	**-1140**	**-1301**	**-351**
13:00	**PL**	**Trade balance**	**Nov**	**€ m**	**-**	**-1251**	**-793**
10:00	DE	ZEW index	Feb	pts	-44	-	-41.6
		WEDNESDAY (13 February)					
10:00	**PL**	**Auction of PLN2-3bn pf 10Y DS0117 bonds**					
10:00	EZ	Industrial production	Dec	%YoY	2.3	-	2.7
13:30	US	Retail sales	Jan	%MoM	0.2	-	-0.4
		THURSDAY (14 February)					
13:00	**PL**	**M3 money supply**	**Jan**	**%YoY**	**13.0**	**13.3**	**13.1**
10:00	EZ	Preliminary GDP	Q4	%YoY	2.2	-	2.7
13:30	US	New jobless claims	Dec	'000	345	-	356
13:30	US	Trade balance	Dec	$ bn	-61	-	-63.72
		FRIDAY (15 February)					
13:00	**PL**	**Wages**	**Jan**	**%YoY**	**10.0**	**9.6**	**7.2**
13:00	**PL**	**Employment**	**Jan**	**%YoY**	**4.9**	**4.9**	**4.9**
13:00	**PL**	**CPI**	**Jan**	**%YoY**	**4.1**	**4.0**	**4.0**
13:30	US	Import prices	Jan	%MoM	0.4	-	0.0
13:30	US	New York Fed index	Feb	Pts	7.5	-	9.03
14:00	US	Capital flows report	Dec		-	-	-
14:15	US	Capacity utilisation	Jan	%	81.4	-	81.4
14:15	US	Industrial production	Jan	%MoM	0.1	-	0.0
15:00	US	Preliminary Michigan	Feb	pts	76.5	-	78.4

Source: BZ WBK, Parkiet, Reuters

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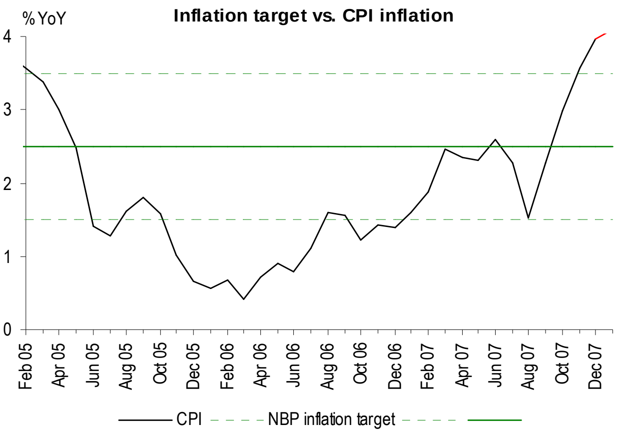
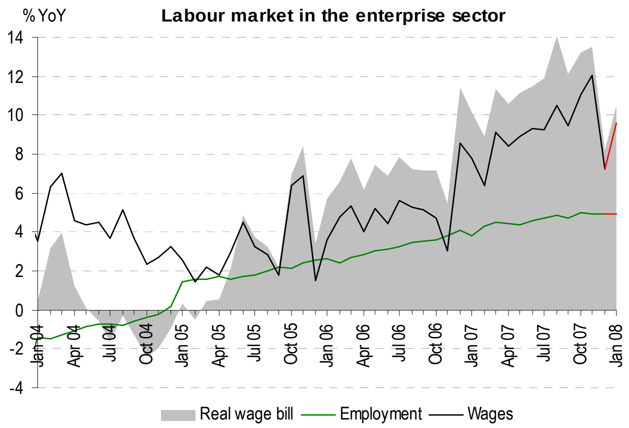
What's hot this week – Important figures from the domestic economy



▪ This week several most important data from the Polish economy are going to be released. The preliminary CPI index for September rose in our view by 0.5%MoM and 4.0%YoY. According to the estimates of the Ministry of Finance inflation amounted in January also to 4.0%YoY though with slower monthly growth of 0.4%. The market consensus that was set before the release of the FinMin points to CPI growth of 4.1%YoY. Our forecast is lower due to postponing some regulated prices hikes.

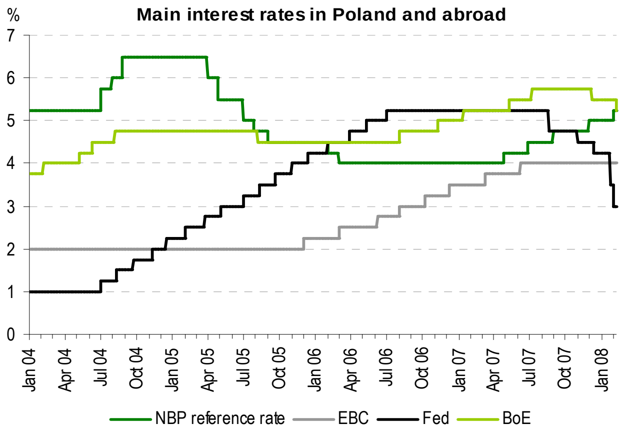
▪ We also expect a current account deficit increase to above EUR1.0bn due to deterioration of trade balance to EUR-1.25bn (amid exports growth at 14.2%YoY and imports growth of 15.6%YoY), a slight weakening of the services and current transfers account, which should however stay at ca. EUR1.0bn.



▪ The monetary statistics should show a slight bounce back of money supply growth to 13.3%YoY, though in next months we expect a falling trend. In our view credit growth rate will decline to ca. 29%.

▪ We expect a moderate acceleration of wages growth in the corporate sector to 9.6%YoY after a significant fall to 7.2%YoY. After the wages figures for December, which showed a clear slowdown, we decided to slightly downwardly revise the wages growth path for the whole year. The wages growth slowdown was recorded in different sectors and was not a result of earlier bonuses payments, which was confirmed by the detailed data in the last Statistical Bulletin of the CSO. We also expect the employment in January growth stayed at a very high level of 4.9%YoY. In the next months we expect a slowdown of employment growth.

Economy last week – Rates in the euro zone unchanged, weak data from the EMU and the US



▪ This time the negative news in the global markets came from the services sector both in the euro zone and in the US. Strong fall to 52.0 pts was recorded by the PMI index, while the ISM index collapsed to 41.9 pts, which was the lowest value since October 2001.

▪ As expected the ECB left interest rates unchanged (the main rate was left at 4.0%), and the Bank of England decided to lower rates by 25 bp with the main rate down to 5.25%). Jean Claude Trichet has still emphasised, that the price stability is the most important task for the ECB. On the other hand the ECB's President did not say that the monetary policy in the euro zone in accommodative. Moreover he noticed increased risk for the economic growth in the euro zone. The tone of his comments could have brought the perspective of rate cuts in the EMU closer. In our view steps by 25 bp will follow in Q2 and Q3.

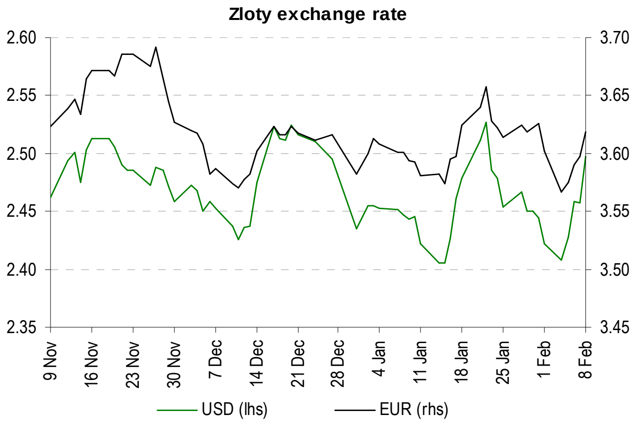
Quote of the week – Next data and major central banks decisions essential

Jan Czekaj, MPC member, Gazeta Prawna, 6 February
The decisive will be the fact whether weaker data from the economy will repeat again and what will be the behaviour of the world central banks. If we move in the opposite direction than other banks, we may achieve excessive zloty appreciation. (...) we also have to affect the demand so as not to allow for excessive core inflation growth.

Dariusz Filar, MPC member, Radio PiN, 5 February
If they [FinMin] want to meet the fiscal Maastricht criteria the fulfilment of inflation and interest rates criteria is also needed (...) the last quite effective decisions affecting inflation at relatively low cost should be made in the months of Q1.

Apart from the core inflation growth two other factors will play more and more important role in decision-making process on interest rates, which comprise ECB's decisions on rates and the moment of ERM2 entry date. The rising probability of faster interest rate cuts in the euro zone would limit the scale of further monetary policy tightening with regards to the risk of excessive zloty appreciation. Some MPC members including Jan Czekaj present this argument. The other argument will work in favour of larger tightening if the government clearly declares that it is planning to enter the ERM2 as soon as possible. Dariusz Filar emphasises the need of fulfilling the inflation criteria and stands by his view of fast moves.

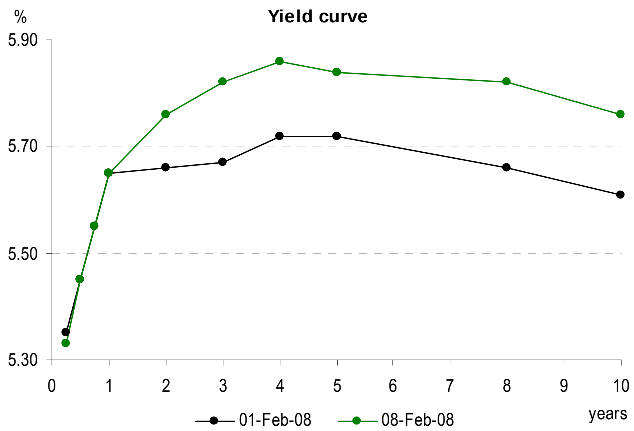
Market monitor



Zloty correction after a strong appreciation

▪ At the start of the past week we experienced a significant strengthening of the zloty against the major currencies. The EURPLN rate tested the 3.56 support level. Later on there was a wave of risk aversion after very poor data from the EMU and the US, which resulted in a sell-off in the stock markets and depreciation of merging market currencies amid dollar recovery. At the end of the week the EURPLN rate amounted to 3.61, while the USDPLN rate to 2.496.

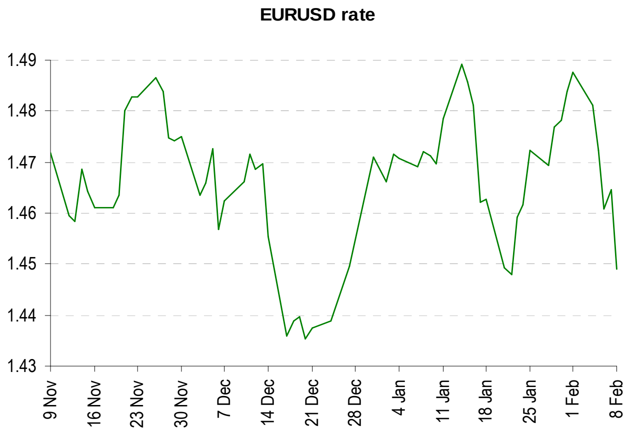
▪ The zloty is going to be still under influence of the global sentiment. It is worth to notice a sound resistance of the domestic currency to the financial markets turmoil. Even at moments of strong risk aversion the weakening, which occurs than is relatively small. We slightly increase the trading ranges for this week to 3.55-3.65 vs. the euro and to 2.44-2.54 vs. the dollar.



Change of trend in the local bond market

▪ In the domestic fixed income market there was a weakening after a several session of price gains. Despite slightly „dovish" comments of some MPC members investors decided to take profits. Strong sell-off in Hungary might have also contributed to the weakening, and the accompanying return from the emerging markets. At the end of the week there was a slight recovery.

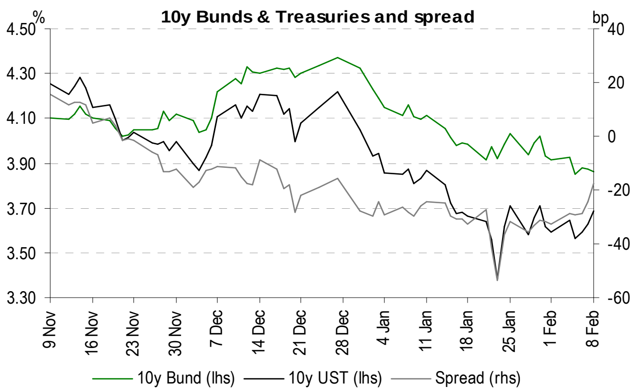
▪ This week the market will focus on the crucial data from the domestic economy. Bonds may slightly gain on the CPI, though probably after the FinMin forecast release the analysts' estimates most probably moved lower. The labour market data may also give a positive signal. International market moods will work the opposite way. The bond auction and further MPC members' comments will be also important.



Strong dollar recovery

▪ The weaker data from the euro zone (PMI index for the services sector, retail sales) contributed to an increase of expectations of interest rate cuts in the EMU. The dollar was not harmed by the dramatic fall of the services ISM, while investors awaited the ECB meeting. President Trichet was slightly less hawkish than previously which resulted in a further fall of the euro. At the end of the week the EURUSD rate fell below 1.45 against 1.48 in the previous Friday.

▪ In our view, after a strong downward move of the EURUSD rate, there may be a rebound, though in a few months we expect a gradual dollar recovery. This week the German ZEW and the US retail sales data will be key factors for EURUSD.



Core bond prices fluctuate in narrow ranges

▪ In the last few days core bond prices were strongly fluctuating. Significant yield drop was experienced by the long-term German Bunds, especially after weak services PMI, amid expectations that the ECB will lower interest rates this year. This resulted in a rise of spread between 10Y Treasuries and Bunds to -17 bp from -33 bp a week ago. Negative news came also form the US (ISM, sales and financial results forecasts of enterprises).

▪ The ZEW index may be crucial for the euro zone market, while Thursday Bernanke appearance and ample data scheduled on Friday in the US will be essential for the US apart from the retail sales figure. We expect the Bund yields will gradually decline this year following further interest rate cuts in the EMU.

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