

Weekly economic update

16 – 22 June 2008

Last week brought many important events. In the international markets there was a significant rise in bond yields and the largest weekly strengthening of the dollar in 3 years. As compared to the market moves abroad, volatility in the Polish market was moderate as investors waited for CPI inflation figures. The data showed that CPI inflation in May rose to 4.4%YoY from 4% in April, in line with our forecast and slightly above the FinMin's estimate and market consensus of 4.3%. At the same time, a structure of price growth was slightly different from what we expected, which lowered our estimate of net inflation in May to 3.3% from 3.6%. Money supply growth was slightly higher than forecast and remained at high level of 15%YoY. All in all, we have not changed our expectations regarding monetary policy prospects. We predict a rate hike and see significant risk of further tightening later in the year.

This week will be busy in terms of major data releases both locally and internationally. While according to our forecasts domestic output and PPI figures should be lower than the market consensus, which may temporarily strengthen the interest rate market, the other data releases and accompanying them possible comments from the MPC are likely to confirm high probability of the rate hike in June and risk of further tightening later on. The international FX markets will be under influence of result of the referendum in Ireland and next data from abroad.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (16 June)							
9:00	PL	T-bills auction, PLN1.4bn of 13-week and PLN1.4bn of 52-week					
9:00	EZ	Final HICP	May	%YoY	3.6	-	3.3
12:00	PL	Wages in enterprises sector	May	%YoY	11.7	11.8	12.6
12:00	PL	Employment in enterprises sector	May	%YoY	5.5	5.5	5.6
12:30	US	NY Fed index	Jun	pts.	-3.0	-	-3.23
13:00	US	Capital flows	Apr	\$ bn	-	-	-48.2
18:45	Euro2008	Poland – Croatia	-	-	-	2:0	1:0*
TUESDAY (17 June)							
9:00	DE	ZEW index	Jun	pts.	-42.0	-	-41.4
12:00	PL	Current account balance	Apr	€ bn	-1.463	-1.227	-1.605
12:30	US	House starts	May	m	0.98	-	0.982
12:30	US	PPI	May	%MoM	0.9	-	0.2
13:15	US	Capacity use	May	%	79.7	-	79.7
13:15	US	Industrial production	May	%MoM	0.1	-	-0.7
WEDNESDAY (18 June)							
12:00	PL	Industrial production	May	%YoY	6.9	5.6	14.9
12:00	PL	PPI	May	%YoY	2.7	2.4	2.5
THURSDAY (19 June)							
12:00	PL	MPC minutes	May	-	-	-	-
12:30	US	New jobless claims	w/e	'000	380.0	-	384.0
14:00	US	Philadelphia Fed index	Jun	pts.	-12.0	-	-15.6
FRIDAY (20 June)							
12:00	PL	Net inflation	May	%YoY	3.3	3.6	2.8

Source: BZ WBK, Parkiet, Reuters * friendly game, 3 June 2006

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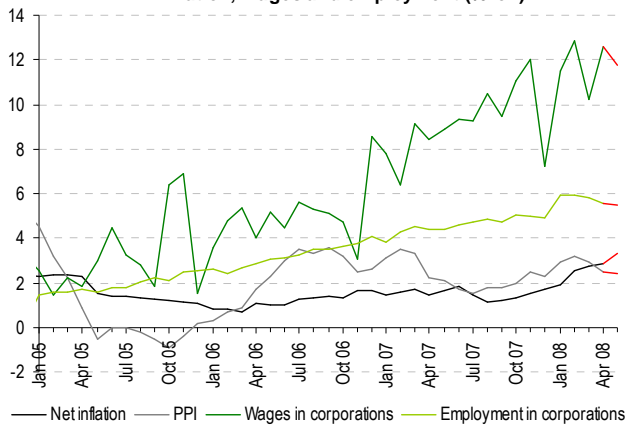
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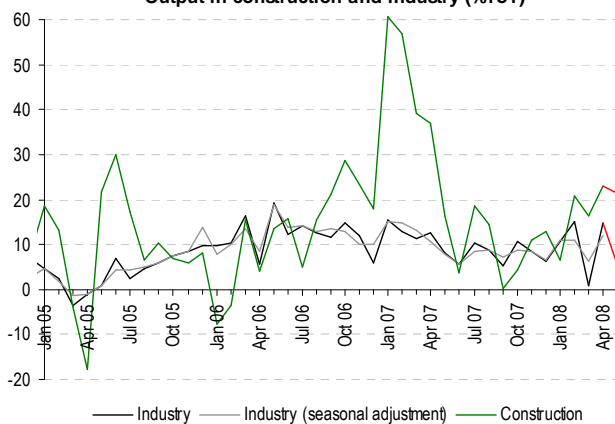
What's hot this week – Another exciting week ahead

Inflation, wages and employment (%YoY)



- This week will see many important economic data releases and next important games in EURO 2008. Emotions will be high already on Monday when the CSO announces the labour market statistics, while Polish team will play against Croatia.
- We expect a slight weakening of the wage growth in May to 11.7%YoY and employment growth to 5.5%YoY (close to market consensus). However, the data will rather not decrease strongly concerns over the impact of tight situation in the labour markets on inflation prospects.
- The probability of an interest rate hike in June, which is discounted by the market may slightly fall on Wednesday after the release of the industrial output and PPI figures, which according to our forecasts may be lower than the market consensus. However, already on Friday, the core inflation measures will show most probably a clear rise in May (net inflation to 3.3%).

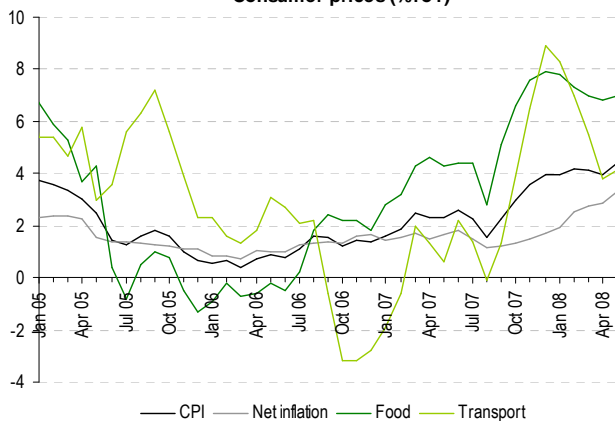
Output in construction and industry (%YoY)



- We expect the industrial production growth decelerated again to ca. 5.6%YoY, among others due to lower number of working days and two long weekends in May. The seasonally adjusted output should stay close to 10%YoY.
- We also estimate the producer prices growth at low level, as the recent data showed the companies are reluctant to pass the rise of costs to goods prices. However, the risk to our forecast is to the upside due to large price hikes of fuel in May.
- In our view the current account data for April will show strong exports and imports growth (over 30%YoY) and decline of current account deficit (though in relation to GDP an increase to 4.5%). This may slightly strengthen the zloty.
- *Minutes* from the MPC meeting in May as usually will have rather small influence on the market. The report may reveal what the Council members were focusing while taking decision to pause with monetary policy tightening.

Economy last week – Inflation up in line with our forecast

Consumer prices (%YoY)



- CPI inflation increased in May to 4.4%YoY, in line with our forecast and slightly above FinMin's predictions and market consensus. Prices of gas, fuels and food went up strongly, although acceleration in services prices was also seen. We still predict inflation peak at 4.9% in August and after that a gradual deceleration in price growth.
- The government approved the tentative budget assumptions for 2009, presuming the deficit PLN18.2bn (1.3% of GDP) amid revenues PLN310.5bn and spending of PLN328.7bn. This is positive information for the market, as it gives chances for realisation of the fiscal consolidation path assumed in the convergence programme. However the realisation of the revenues and the deficit is at risk in our view. Despite similar fears, the European Commission, recommended lifting the excessive budget deficit procedure against Poland. The ultimate decision will be made by the Ecofin Council in July.

Quote of the week – Will one more rate hike be enough?

Marian Noga, MPC member, PAP/Reuters, 13 June

There is a need for one more rate hike, we will not bring inflation back to the target without the reference rate at 6%. (...) Then, one will have to watch the situation carefully. Data for September will be important, but they will only be published in October, so there should not be any moves until October. (...) Therefore, I would not exclude that if there is a further move, it will be in November at earliest.

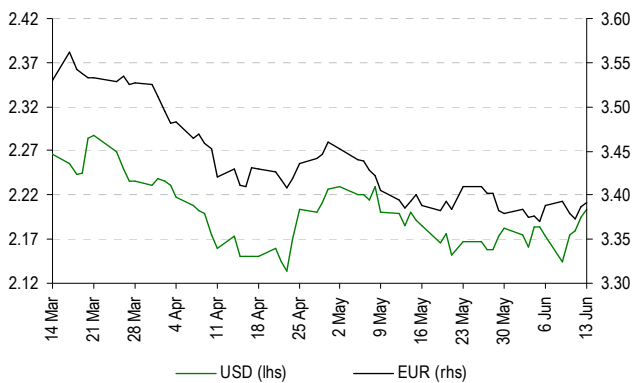
Dariusz Filar, MPC member, TVN CNBC, 13 June

[Rise in services, food and fuel prices] increase probability of swift reaction of the MPC. The expected CPI inflation peak in August may be slightly higher than I thought [4.8%]. It is important what will happen later. I am still more convinced to the view that the peak will be in August and then inflation will gradually decline.

In recent weeks, concerns abroad about inflation have substantially increased, which fuelled expectations for rate hikes by the ECB and the Fed. The ECB is likely to raise rates already in July by 25bps while not so long ago rate cuts were expected. The Fed also signals a necessity to counteract inflationary pressures. In such situation there is growing risk that the rate hike by the MPC in June, which seems a deal-done, will not be the last one in the cycle, especially that apart from exogenous shocks there is also tight labour market situation in Poland. As for now, we assume the risk scenario will not materialise. However, if it happens, the Council may take further steps sooner than suggested by Noga, as already in summer it will be known what is happening with food and fuel prices, and with ECB rates.

Market monitor

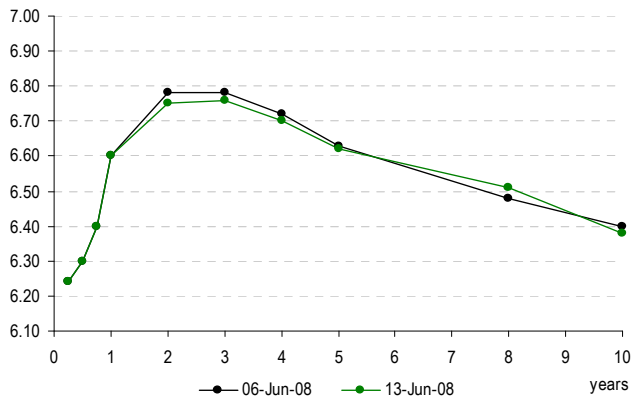
Zloty exchange rate



Zloty slightly depreciating ahead of data releases

- During the last few days there was no clear trend in the FX market. There was an atmosphere of waiting for the release of the new data, while the zloty exchange rate fluctuated in range of 3.37-3.40 against the euro through most part of the week. At the end of the week the factors, which weakened moods, affected the markets (like early results of the referendum in Ireland).
- This week there will be a large number of new data releases, which may positively influence the zloty, as in spite of quite weak output data on Wednesday, other data should support expectations for interest rate hikes. The changes in risk aversion in the core debt markets may also important. We maintain a range of EURPLN fluctuations at 3.34-4.44 and increase for USDPLN to 2.15-2.25.

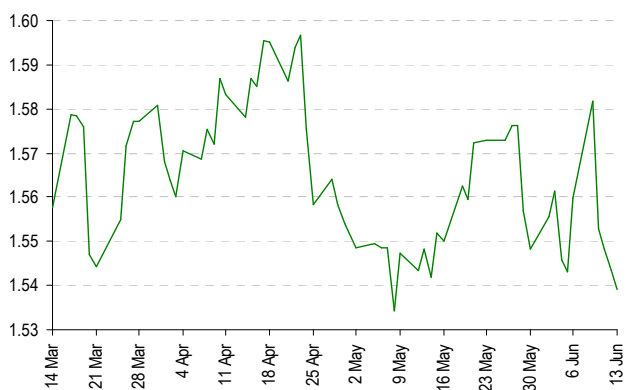
Yield curve



Local debt market still in negative moods

- Sentiment in the local debt market remained negative last week and yields increased by a few basis points following significant rise a week earlier, reaching the highest levels in a few years. On Friday in the afternoon investors' demand appeared and yields returned to the level seen a week earlier.
- CPI inflation increase in May, although slightly above market consensus, triggered a positive reaction of the market due to relatively dovish comments of MPC's Noga. This week the positive factor for the market should be output and PPI figures. However, we think one should not count on a noticeable strengthening amid risk of further rate hikes by the MPC and continued bearish moods in the core debt markets.

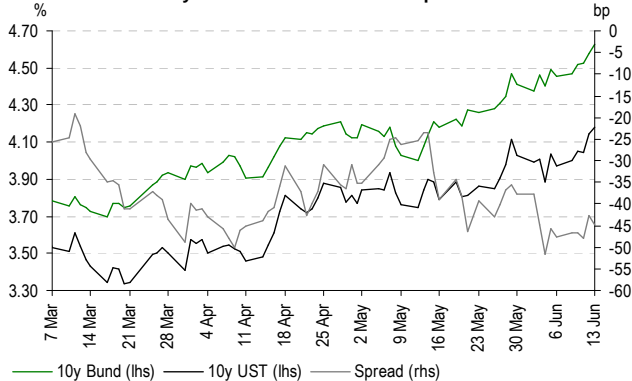
EURUSD rate



Strong dollar appreciation

- The dollar recorded the biggest weekly strengthening in the last three years. This was supported among others by better than expected data from the US economy, comments of Fed representatives suggesting the necessity of curbing inflation and statements (among others of Ben Bernanke, Henry Paulson) heralding a policy of strong dollar. At the end of the week also the early results of referendum in Ireland pointing to rejection of constitutional treaty and fears over verbal interventions during the G8 summit affected the market.
- This week the dollar may be supported by the still restrictive rhetoric of US central bank, though US housing market data and business climate indices will also be important. However, the scale of the euro weakening will be limited due to expectations of monetary policy tightening by the ECB.

10y Bunds & Treasuries and spread



Rising concerns about inflation and rate hike abroad

- Almost the whole last week was marked by rising concerns about future inflation and expectations of rate hikes by the ECB and the Fed, which was fuelled by comments from the major central bank's officials and rise in crude oil prices. Yields of 10Y Treasuries and Bunds increased by some 20bp over the week.
- This week there will be next data releases which may affect inflation expectations, especially PPI data in the US. There are also public appearances of ECB and Fed representatives scheduled for this week and they may bring another hawkish comments. Data from the US housing market and economic activity indicators from the US (industrial output) and Germany (ZEW) will also be important.

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