

# Weekly economic update

23 – 29 June 2008

Economic data released last week delivered some surprises. Current account deficit in April was higher than predicted (rise to 4.6% of GDP) although it still has safe financing and is no significant threat for external economic stability. Higher than expected was also PPI growth in May (mainly due to high energy prices). Growth in wages and industrial output were below forecasts, but we do not think that a scale of a slowdown would be significant from the point of view of next movements in monetary policy. It was confirmed in comments of the MPC members, who signalled that a room for manoeuvre in monetary policy in Poland has been increasing, among others due to expected decisions of the main central banks. Consequently, we predict, similarly as the market, that the MPC will hike interest rates by 25 bp at the meeting this week. Moreover, in our view the tone of the MPC's communiqué may be more hawkish than in the previous months, as it will justify a rate hike, and also because the Council members may want to prepare the market for further tightening. Also, conclusions from the new inflation projection (based on the new model and new core inflation measure) may be also hawkish. Those factors may support the zloty and keep interest rate market under pressure. A potential support for bonds may come from core debt markets (where the Fed meeting will be important and the statement of the US central bank), amid possible decrease in expectations for interest rate hikes in the euro zone.

## Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (23 June)</b>							
12:00	PL	<b>Business climate</b>	Jun				
8:00	DE	Ifo index	Jun	pts	102.5	-	103.5
8:00	EZ	Preliminary manufacturing PMI	Jun	pts	50.3	-	50.6
8:00	EZ	Preliminary services PMI	Jun	pts	50.5	-	50.6
<b>TUESDAY (24 June)</b>							
8:00	PL	<b>Retail sales</b>	May	%YoY	15.0	15.0	17.6
8:00	PL	<b>Unemployment rate</b>	May	%	10.0*	9.9	10.5
13:00	US	Consumer confidence	Jun	%YoY	57.0	-	57.2
14:00	US	Case/Shiller index	Apr	pts	-15.7	-	-14.4
<b>WEDNESDAY (25 June)</b>							
	PL	<b>MPC meeting – decision</b>		%	6.00	6.00	5.75
12:30	US	Durable goods orders	May	%	0.0	-	-0.6
14:00	US	New home sales	May	m	0.51	-	0.526
18:15	US	Fed meeting - decision		%	2.0	-	2.0
<b>THURSDAY (26 June)</b>							
8:00	EZ	M3 money supply	May	%YoY	10.4	-	10.6
12:30	US	New jobless claims		'000	380		381
12:30	US	Final GDP	Q1	%	1.0	-	0.9
14:00	US	Home sales	May	m	4.88	-	4.89
<b>FRIDAY (27 June)</b>							
12:30	US	Core PCE	May	%MoM	0.2	-	0.1
13:55	US	Final Michigan index	Jun	pts	57.5	-	59.8

Source: BZ WBK, Parkiet, Reuters \* forecast of the Ministry of Labour and Social Policy

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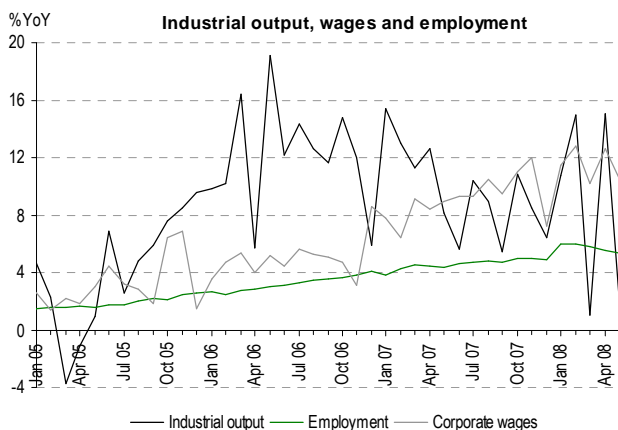
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## What's hot this week – MPC decision and retail sales

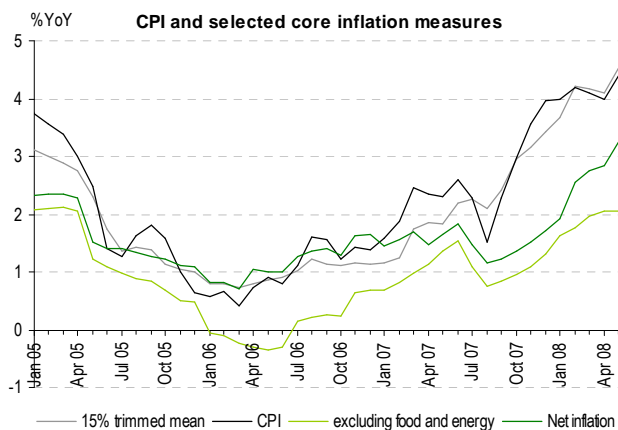


- We predict that the Monetary Policy Council will hike main interest rates by 25 at the meeting on Wednesday. For the market, the MPC communiqué will be crucial that may be more hawkish than previously due to change in MPC members' attitude in the face of increasing expectations for interest rate hike in the euro zone that would reduce impact of interest rate disparity on the zloty. The statement will also refer to the results of the inflation projection that will be released on Friday.
- Before the MPC decision, the CSO will release the monthly Statistical Bulletin including next data from the economy. In our view, retail sales growth decelerated in May to 15%YoY, in line with market consensus, from 17.6% in April. We also predict a decline in unemployment rate to 9.9% from 10.5% in April, versus Labour Ministry's estimate of 10%.

## Economy last week – Wages and industrial output below forecasts, higher PPI growth and C/A deficit



- Wages and employment in enterprises sector were lower than expected in May, increasing 10.5%YoY and 5.4%YoY, correspondingly. Wage bill in the sector increased 16.4%YoY in nominal terms and 11.5% in real terms, which was the slowest gain since December 2007.
- The data did not show further increase in labour market tensions, which decreases concerns about inflation perspectives and may be an argument against next interest rate hikes.
- Industrial output growth in May reached 2.3%YoY, much below market expectations. Similarly to March, this resulted to a large extent from the number of hours worked, so one should not treat it as an indication of rapid economic slowdown. Construction output growth reached 16.6%YoY in May and despite the lower number of working days showed that investment activity remains strong.



- The balance of payments data for April showed wider than expected current account deficit (over €1.5bn) and its cumulated value for the last 12 months rose to 4.6% GDP from 4.2% after March. The exports and imports growth rates exceeded 30% level and trade deficit was at €1.25bn.
- PPI inflation accelerated to 2.8%YoY in May, mainly due to hikes in energy and natural gas prices. So far producers do not indicate willingness of large price increases (producer prices in manufacturing grew a mere 1.6%YoY).
- Net inflation for May was at 3.2%YoY and was below forecasts, however, all measures of core inflation used so far accelerated. New measure excluding foods and energy prices was unchanged from April level at 2.1%. It will be included in a new model of June inflation projection and is going to replace the current net inflation measure starting from next year.

## Quote of the week – More rate hikes after June can not be ruled out

**Halina Wasilewska-Trenkner, MPC, Reuters, 17 June**

*It seems unlikely that we will end monetary tightening with the main rate at 6 percent. After the probable hike in June, I do not see a reason why we should wait with further tightening. (...) Intuition suggests that this [rates at 7%] could unfortunately happen. It can be that the projection will show weakening growth and still high inflation in year-and-half's time.*

**Andrzej Sławiński, MPC, Tok FM, 17 June**

*The central bank would not be concerned with wages growth rate of ca. 7% (productivity growth plus inflation target).*

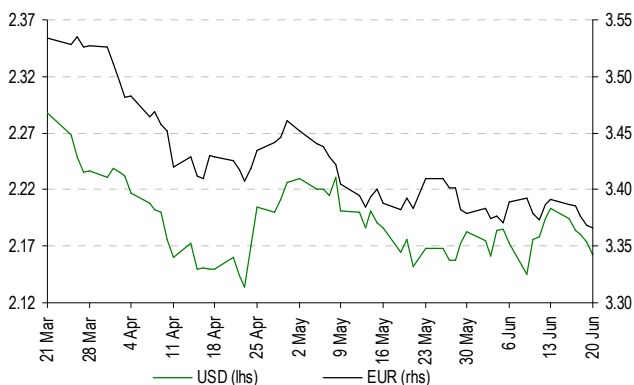
**Jan Czekaj, MPC, Thomson Financial News, 16 June**

*Taking decisions on interest rates, to a certain extent we have to reflect what other banks are doing, in particular the ECB. We cannot rule out further rises in interest rates (after June).*

Since hawkish comments of the ECB president and due to building expectations for interest rate hikes in the euro zone and in the US, increasing number of the MPC members is suggesting a possibility of continuation of monetary policy tightening after June. Apart from inflation persisting at elevated level (causing a risk of second round effects), high growth of wages (according to Sławiński, safe level of wage growth is much lower than current growth and predicted for near future), the MPC members also pointed to uncertainty concerning development of commodity prices and exchange rates. Possible zloty weakening is a risk for inflation in a context of predicted rate hikes abroad, which increases a manoeuvre field for monetary policy in Poland.

**Market monitor**

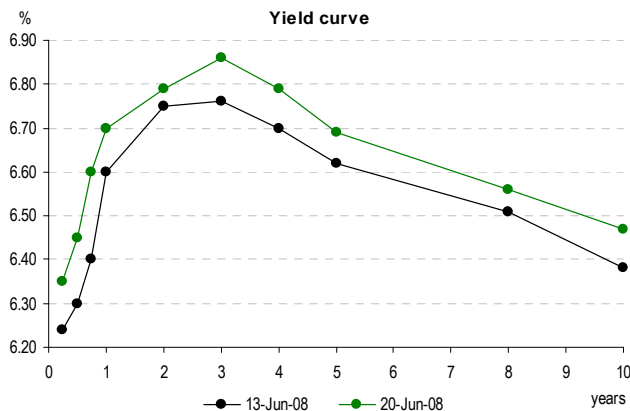
**Zloty exchange rate**



**Zloty stronger again**

- Last week the zloty has been gradually appreciating against major currencies, which was accompanied by some improvements in moods in the emerging markets. The EURPLN rate remained in the narrow fluctuation band of 3.36-3.40, though it fell to 3.367 at the end of the week. Despite the fact that most of domestic data were below market expectations, they did not influence expectations as regards further tightening in monetary policy, especially as they were counterbalanced by hawkish comments of MPC members.
- The zloty will probably stay at stronger levels awaiting the decision on interest rates. Hawkish communiqué and another wave of central bankers' comments may support the zloty. Also, appetite for risk on global markets and the situation on the dollar market will also have influence on the zloty. This week we see the zloty trading range of 3.34-3.44 for EURPLN and 2.13-2.23 for USDPLN.

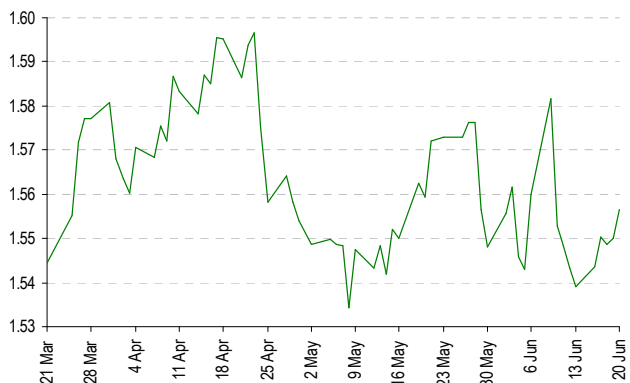
**Yield curve**



**Temporary recovery on the debt market**

- The beginning of the week showed increase in bond prices, as investors perceived high yield as attractive to buy. This was additionally supported by lower-than-expected labour market data. However, during the week a number of MPC members' comments appeared. Initially, they were ignored but in the course of the week yields started to rise again. The overall influence of weak output data and high PPI was negative and additionally some weakening was observed in core markets.
- We maintain the view that there are limited factors, which may lead to significant strengthening of the Polish debt market in the nearest future. The expected rate hike and hawkish statement of the Council will not support the market. Some positive signals may appear abroad in the case of limiting expectations for monetary tightening by the ECB.

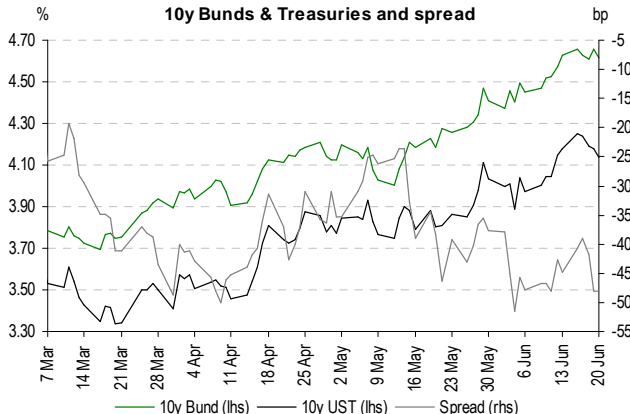
**EURUSD rate**



**Dollar weakens**

- After quite significant dollar strengthening in the previous week, last couple of days brought another rise of EURUSD rate to 1.561. Single European currency was positively influenced by higher than expected data on the EMU's inflation rate and weaker than forecast data on economic activity in the US. Lower ZEW figure had only temporary impact on the euro, while US PPI was in line with expectations.
- Still, the risk for the dollar is connected with a possible overshooting of market expectations as regards the scale of monetary tightening by Fed. From this point of view, the Fed statement will be the key, as well as another set of economic indicators, including consumer confidence and housing market data. As regards the euro zone, German Ifo and preliminary PMI will be released.

**10y Bunds & Treasuries and spread**



**Moderate yields changes abroad**

- The beginning of last week saw strengthening in core bond markets, which was driven by weaker than expected data from the US, as well as low ZEW reading. High HICP inflation in the euro zone led to some rise yields. At the end of the week more substantial weakening took place in both US and Europe amid high growth in UK retail sales though Friday brought some recovery. As compared to previous Friday, yields of Treasuries and Bunds declined moderately.
- Fed statement will be the key factor for the bond markets this week, as investors will look for a possible change in bias for more restrictive in the context of recent comments by Fed members. As regards data releases, Ifo index, manufacturing and services PMI will be important to assess a possible scale of economic deterioration in the euro zone.

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