Bank Zachodni WBK

Weekly economic update

28 July – 3 August 2008

At the beginning of last week there was significant correction of the zloty driven by fall in EURUSD, quite dovish comments from MPC members and suggestion by governor of the Czech central bank about a possibility of a rate hike already at the bank's meeting on August 7, which weakened currencies in the region. In the last two days of the week the zloty recovered, erased earlier losses and reached new high against the euro, but EURPLN failed to break 3.20. We think that also this week the zloty will not strengthened below that level for longer and one should rather wait for another wave of correction. In our view the zloty may be negatively affected by rather dovish message after the MPC meeting this week. Significant moves in the FX market and in the core debt markets translated into large volatility in the local debt market. At the end of the week yields were slightly lower than at a week earlier. Overall influence of the domestic macro data released last week was neutral for the zloty and bonds. An effect of slightly higher than expected net inflation was offset by lower than predicted retail sales. The data has not changed our assessment of monetary policy prospects. Recent comments from MPC members confirmed our view that likelihood of a rate hike in July is close to zero and further tightening may only take place in autumn.

Apart from the MPC meeting (with no uncertainty regarding decision on rates, the market will wait for official statement and central bankers' comments) key events for the Polish market this week include release of the FinMin's inflation estimate for July and many major data releases abroad. Moods in the stock markets and performance of crude oil prices will also be important for the FX and debt markets.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (28 July)					
9:00	**PL**	**T-bill auction: 13-week worth PLN0.5bn and 26-week worth PLN1bn**					
		TUESDAY (29 July)					
13:00	US	Case/Shiller index	May	%MoM	-1.0	-	-1.4
14:00	US	Consumer confidence	Jul	pts.	50.1	-	50.4
		WEDNESDAY (30 July)					
-	**PL**	**MPC meeting – decision**	**-**	**%**	**6.00**	**6.00**	**6.00**
09:00	EZ	Economic sentiment	Jul	pts.	93.0	-	94.9
12:15	US	ADP report	Jul	'000	-58.0	-	-79.0
		THURSDAY (31 July)					
09:00	EZ	Flash HICP	Jul	%YoY	4.1	-	4.0
12:30	US	Preliminary GDP	Q2	%	1.9	-	1.0
12:30	US	GDP deflator	Q2	%	2.1	-	2.3
12:30	US	Core PCE	Q2	%	2.4	-	2.7
12:30	US	Initial jobless claims	w/e	'000	390.0	-	406.0
13:45	US	Chicago PMI	Jul	pts.	49.0	-	49.6
		FRIDAY (1 August)					
08:00	EZ	Manufacturing PMI	Jul	pts.	47.5	-	49.2
12:30	US	Non-farm payrolls	Jul	'000	-73.0	-	-62.0
12:30	US	Unemployment	Jul	%	5.6	-	5.5
14:00	US	Manufacturing ISM	Jul	pts.	49.5	-	50.2

Source: BZ WBK, Parkiet, Reuters

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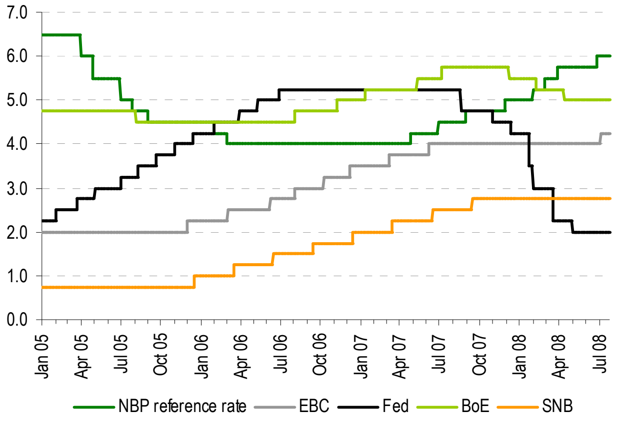
What's hot this week – MPC meeting, FinMin's inflation forecast and crucial data abroad

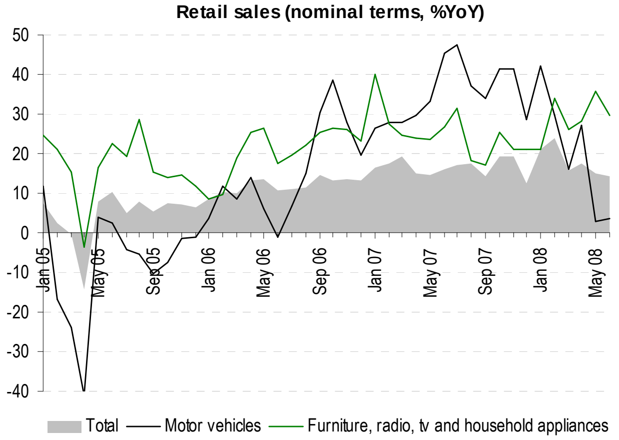
Main interest rates in Poland and abroad



- This week the key domestic events include MPC meeting and publication of the FinMin's inflation forecast for July.
- Taking into account recent data and their assessment presented by rate-setters in media, we think that probability of a rate hike at this week's MPC meeting is close to zero, although we still believe that after the summer break central bankers will against start think seriously about monetary policy tightening.
- As the market has not doubts that rates will remain unchanged, the key focus of attention will be on the official statement and comments from MPC members.
- Among numerous data releases abroad this week , the most important will be the flash estimate of the euro zone's HICP inflation, the US preliminary GDP figures for Q2 and the non-farm payrolls report.

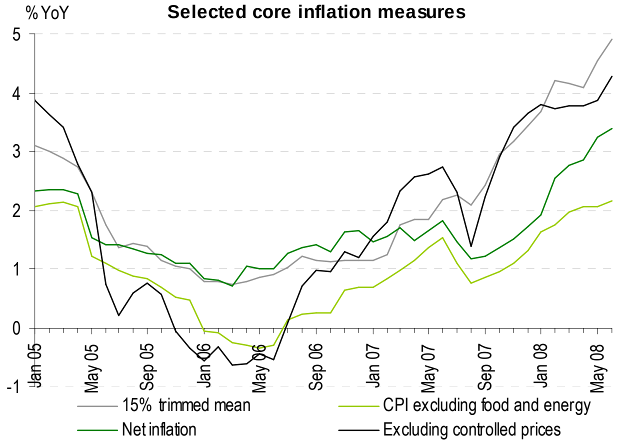
Economy last week – Neutral data

Retail sales (nominal terms, %YoY)



- Retail sales data for June proved weaker than expected (the weakest growth this year at 14.2%YoY), but the breakdown of total sales growth (except weaker rise in sales of motor vehicles and foodstuff still rapid increase) does not suggest permanent change in consumption demand.
- Further fall in the registered unemployment rate (to 9.6%), though slower than in previous months (down 2.7 pp YoY versus 2.9 in May), still positively affects situation of consumers.
- All in all, after full set of monthly economic activity indicators for June we maintain our forecast of GDP growth for 2Q08 at 5.6%YoY, though currently the risk for the forecast seems to be slightly to the downside, while some time ago we saw it on the upside.

Selected core inflation measures



- All core inflation measures increased in June. The two most closely watched measures, i.e. the net inflation and CPI excluding food and energy prices accelerated to the least extent (0.1pp YoY), to 3.4% and 2.2%. Rise in the four other measures ranged from 0.2pp to 0.4pp. All in all, the data confirmed that current inflationary pressure remains strong.
- Business climate indicators for July confirmed earlier seen tendencies. Index for manufacturing reached the lowest level in 18 months (14pts) and scale of its annual fall (9pts) was the largest in 3 years. Index in construction has been at stable level of 27pts for a few months, but in annual terms noticeable fall of 7pts was noted. Relatively the most positive tendency is seen in retail trade for which the index has been stable in annual terms for a few months and also no change in annual terms took place in July.

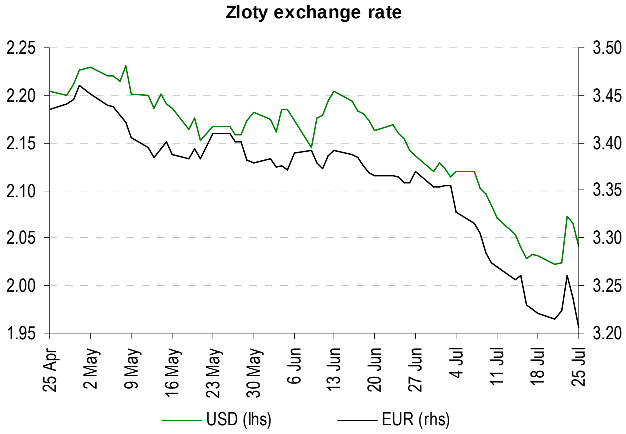
Quote of the week – No hikes in summer, but the MPC vigilant and ready to act

Jan Czekaj, MPC member, PAP, 22 July

I would not expect that something will happen in July and August, which would be a reason for rate hikes at that time. However, the MPC has to remain vigilant and ready to act. (…) Taking into account the current data and the fact that summer holidays are a period of some hibernation of the economy, and additionally there are some effects of first rate hikes, I think that there is no need for immediate reaction of domestic monetary policy. Besides, the MPC conducts the most restrictive policy in the world and the inflation rate is not among the highest ones. (…) As regards inflation, we are not able to do much more. Therefore, currently I do not see a need for higher rates, as inflation is driven by factors out of the monetary policy reach.

The most recent comments from MPC members confirmed our expectations that one should not expect rate hikes in summer. The most clear suggestion with this respect was given by Jan Czekaj, whose vote proved crucial for outcomes of the MPC meetings many times. Currently, prof. Czekaj does not see a need for hikes, but in our opinion the CPI inflation peak above 5% and moderate scale of the economy's weakening will induce him to vote for further tightening in autumn. However, his comments suggest that the reference rate to 6.25-6.5% will be the end of interest rate hikes cycle in Poland.

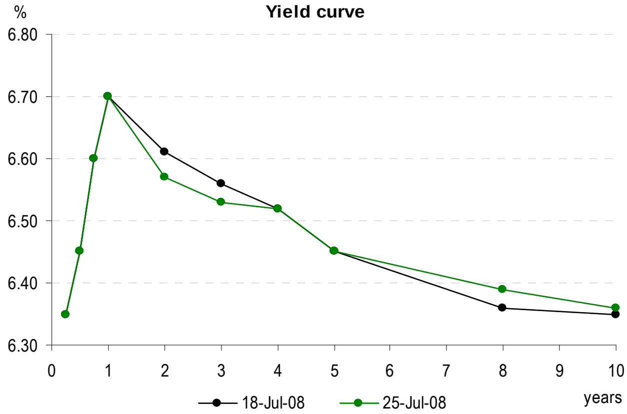
Market monitor



Roller coaster on the Polish FX market

▪ Last week brought a real roller-coaster in moods on the Polish FX market. The beginning of the week saw a significant zloty weakening with EURPLN reaching 3.27. This was driven by fall in EURUSD accompanied by dovish comments by MPC members and comment of the Czech central bank's President governor on possible rate cuts. However, on Thursday the Polish currency recovered and the move was as sharp as previous weakening. On Friday the zloty reached new all-time high at 3.2040. Important psychological barrier at 3.20 was not broken.

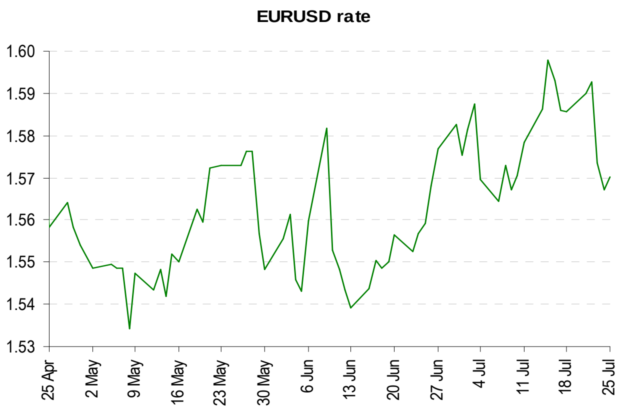
▪ It seems to us that after unsuccessful attempt to fall below 3.20, another wave of the zloty depreciation may appear. This week it may be related to comments from the MPC, which should not be so hawkish. We maintain the expected trading range for EURPLN at 3.20-3.30 and for USDPLN at 2.00-2.10.



... as well as on the local fixed income market

▪ The similar scenario was observed in the Polish fixed income market. At the beginning of the week a weakening took place, but the last two days showed a recovery. This was driven by changes in the zloty rate (and investors' assessment as regards its impact on inflation prospects), as well by the situation in core debt markets. Yields abroad rose as a result of higher appetite for risky assets, but then the situation reversed.

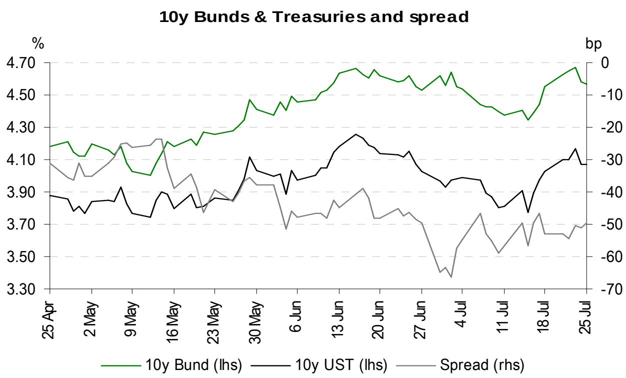
▪ This week the MPC meeting will be the key factor for the market. Comments by MPC members will be more important than decision and we expect them to be not so hawkish, which may support the debt market. Still, core markets will still have large influence given a number of major data releases abroad.



Positive week for the dollar

▪ The US currency strengthened against the euro last week. Fall in EURUSD (to slightly below 1.57 at the end of the week from above 1.59 a week before) was supported by lower investors' concerns about condition of the US financial sector, as well as by lower oil prices (though in this case it is hard to say what was the reason and what was the result). Thursday morning, after the release of weak data from the euro zone, the EURUSD rate temporarily approached 1.56, but then a correction took place as a result of weak data from the US.

▪ Among the number of data releases abroad scheduled for this week, the most important might be flash estimate of HICP inflation for the euro zone (higher figure may support euro), preliminary US GDP data (may be positive for the dollar) and US labour market report.



High volatility on core bond markets

▪ The first part of last week brought sharp rise in yields in the core bond markets. This was a result of higher risk appetite globally as information on financial results of companies were better than expected in majority of cases. At the end of week yields of ten-year bonds of Treasuries and Bunds reached 4.05% and 4.56%, respectively. This was just one basis point above levels recorded one week earlier.

▪ This week there will be many economic data releases important from the point of view of monetary policy prospects and therefore the environment of high volatility in the core debt markets may be maintained.

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