Bank Zachodni WBK

Weekly economic update

11 – 17 August 2008

Interest rate cut in the Czech Republic and dollar appreciation after the ECB meeting suggesting no soon interest rate hikes in the euro zone contributed to weakening of currencies in our region last week, including the zloty. At the same time, bond market strengthened, which was favoured by situation on core debt markets and expectations that CNB's rate cut may herald near end of tightening cycle in other countries in the region.

After short break in data releases, this week markets will focus on monthly macroeconomic indicators again. The most important will be inflation data on Wednesday, which we predict to have risen to 4.7% in July, slightly below market consensus and FinMin's forecast. One should pay attention to a scale of food prices deflation, as it may hint on what will be the impact of this year's dry weather on domestic inflation rate. Also, the MPC members' comments that may follow the CPI release may be important for the market. Tuesday's data about balance of payments should favour continuation of zloty correction, showing a rise in current account deficit despite faster export growth than in May.

Abroad, inflation data will be also in focus this week and may affect expectations concerning monetary policy perspectives in the US and euro zone. Besides, there will be numerous important figures on economic activity (among others, industrial output and GDP in the euro zone, output and retail sales in the US).

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 August)					
9:00	**PL**	**T-bill auction: 26-week worth of PLN0.7bn and 25-week worth of PLN0.7bn**					
		TUESDAY (12 August)					
9:00	**PL**	**Current account balance**	**Jun**	**€ bn**	**-1.62**	**-1.80**	**-1.602**
12:30	US	Trade balance	Jun	$ bn	-61.0	-	-59.79
		WEDNESDAY (13 August)					
9:00	**PL**	**Auction of 10Y bonds worth PLN and 12Y CPI-linked bonds**					
12:00	**PL**	**CPI**	**Jul**	**%YoY**	**4.8**	**4.7**	**4.6**
9:00	EZ	Industrial output	Jun	%YoY	0.1	-	-0.6
12:30	US	Import prices	Jul	%MoM	1.0	-	2.6
12:30	US	Retail sales	Jul	%MoM	0.2	-	0.1
		THURSDAY (14 August)					
12:00	**PL**	**Money supply (M3)**	**Jul**	**%YoY**	**15.9**	**16.1**	**16.2**
9:00	EZ	GDP flash	Q2	%YoY	1.5	-	2.1
9:00	EZ	HICP final	Jul	%YoY	4.1	-	4.0
12:30	US	CPI	Jul	%MoM	0.4	-	1.1
12:30	US	Jobless claims	w/e	k	430.0	-	455.0
		FRIDAY (15 August)					
12:30	US	NY Fed index	Aug	pts.	-3.0	-	-4.92
13:00	US	Capital flows	Jun	$ bn	70.0	-	67.0
13:15	US	Capacity use	Jul	%	79.8	-	79.9
13:15	US	Industrial output	Jul	%MoM	0.1	-	0.5
13:45	US	Michigan index preliminary	Aug	pts.	62.0	-	61.2

Source: BZ WBK, Reuters

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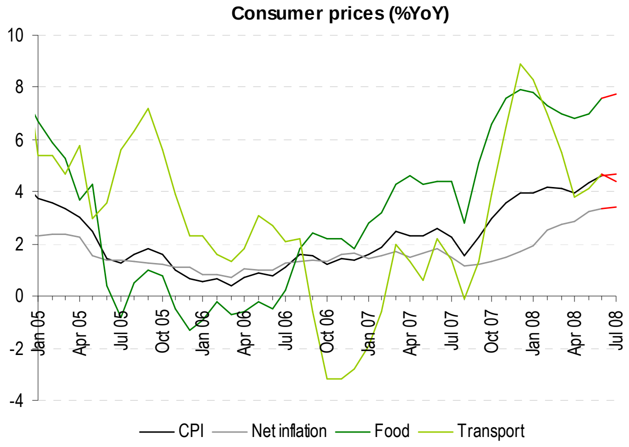
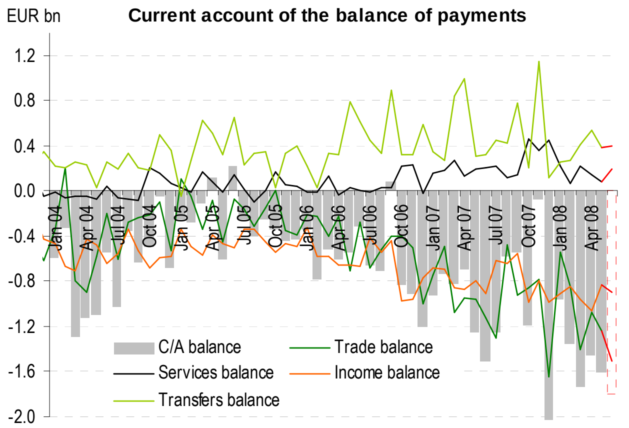
What's hot this week – New important data releases ahead

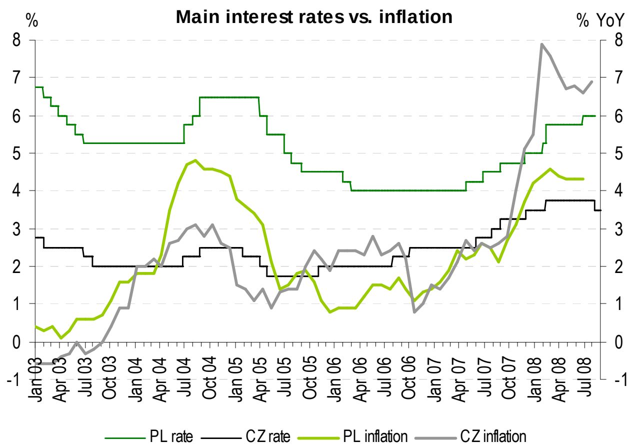


- This week, market's attention will be focused on important local and foreign data publications. The key focus of attention will be inflation data (on Wednesday Polish CPI, on Thursday HICP for the euro zone and CPI for the US), however other key indicators will be published as well.
- We expect Polish CPI to grow to 4.7%YoY, a bit less than expected by Ministry of Finance and the market consensus.
- FinMin assumes drop in food prices of 1%MoM and increase in fuel prices of 1%MoM, however in our opinion food prices fell slightly more (-1.2%MoM) and rise in fuel prices was minimal. Behaviour of food prices will be important hint how high inflation peak could be in August.
- Fulfilment of our CPI forecast would mean stabilisation of net core inflation (without food and fuel prices) at 3.4% in July (market consensus 3.5%).



- On Tuesday, NBP will publish balance of payments data for June. According to our forecast, deficit on current account rose to €1.8bn, against median of market forecasts and result of €1.6bn in May. Cumulative 12-months deficit was at 4.3% of GDP, similarly as in May. Export growth probably rebounded in June (to ca. 17%YoY), following acceleration in industrial output. However, in further months we expect gradual slowdown, as a result of strong zloty and weakening business climate abroad.
- Money supply data will be less important for the market. We expect M3 increased by 16.1%YoY in July (market 15.9%), amid sharp rise in credits (27.2%) and deposits (18.4%).

Economy last week – Rate cut in Czech Republic, ECB on hold



- In line with the expectations, ECB and BoE kept rates on hold (4.0% and 5.0% respectively). ECB president's comments suggested no rate hikes for the euro zone in the nearest future. In our opinion, ECB will decide to cut rates in the next year, when inflation will drop towards 2%, and economic growth will remain weak, but for some time, official statements should stay 'hawkish'.
- Czech central bank cut key rate by 25bp (to 3.5%), which was surprising for the market, although rate-setters suggested such a possibility in their comments. Appreciation of the Czech crown was one of the main reason of that decision. According to central bank, it could bring inflation down below the target at 3% in 12-18 months. What is important, decision was made unanimously and further cuts were not excluded in this year.

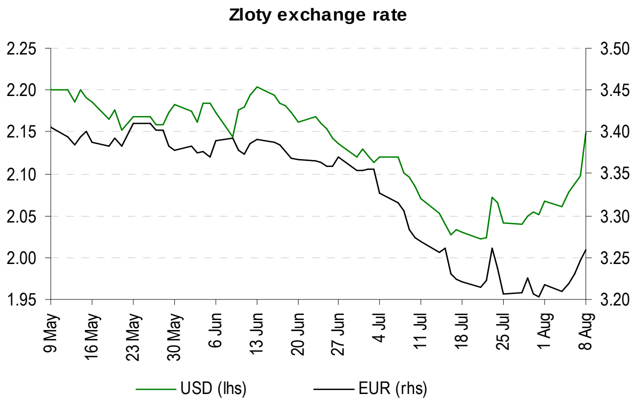
Quote of the week – Decision-makers concerned about strong zloty

Waldemar Pawlak, economy minister, Reuters, 6 August
There are possibilities that may be potentially used but it is a case for the finance ministry. It is now a good time to talk about it (stopping appreciation). Some companies have to limit or even shut down their production. And it is not a matter of productivity....it is a matter of the zloty exchange rate.

Sławomir Skrzypek, prezes NBP, TVP Info, 7 sierpnia
I am worried about pace of zloty appreciation. Too strong appreciation of our currency may cause problems for economic stability. According to our estimates, current account deficit in relation to GDP could approach 6% in 2008. The problem is serious.

Although zloty started to depreciate significantly soon after Deputy Prime Minister Pawlak's comment, in our opinion it was not due to the verbal intervention, but other factors (like dollar strengthening, changes in sentiment in the region, expected economy slowdown) were behind this move. Government's ability to influence exchange rate is limited. In the case of NBP, such an intervention towards zloty depreciation is hardly imaginable, since inflation is still significantly above the target. However, as Czech central bank's example shows, currency strengthening may influence interest rate decision. In the instance of MPC, at least one more rate hike after holiday is still reasonable, though further decisions will be dependent on exchange rate movements and the scale of economy slowdown in the second half of the year.

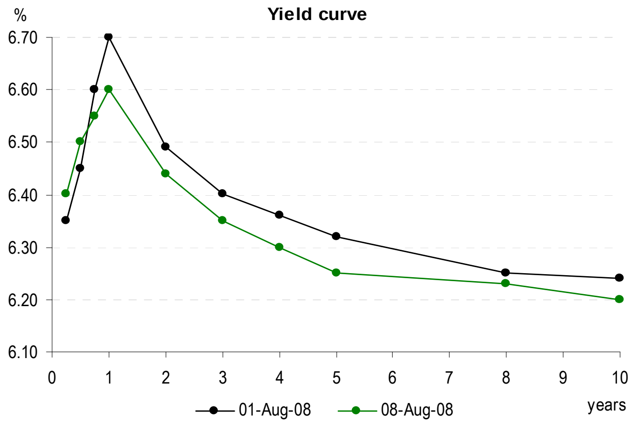
Market monitor



Zloty weaker

▪ After unsuccessful attempt to break the level of 3.20 against the euro, the zloty continued correction last week, rising to 3.28 on Friday. This was driven by the rate cut in the Czech Republic and significant appreciation of the dollar against the euro which resulted in USDPLN rise much stronger than in case of EURPLN.

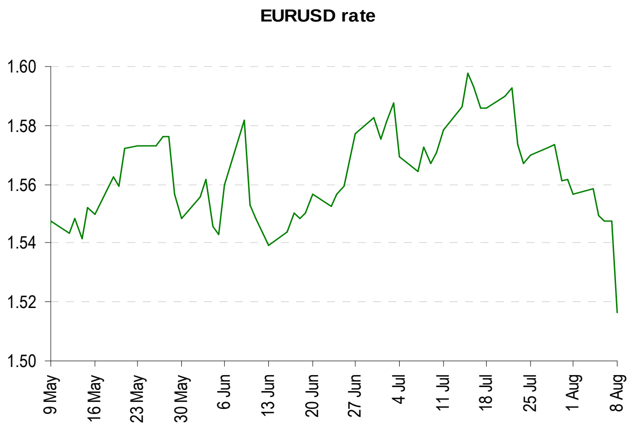
▪ This week the local FX market will be affected by new domestic data and their influence on assessment of next MPC steps. Our forecast of high C/A deficit (above consensus) and CPI inflation (below consensus) are arguments for continuation for the zloty weakening. On the other hand, likely correction of the EURUSD may be positive for the zloty. We change expected range for EURPLN to 3.23-3.33 and for USDPLN to 2.10-2.20.



Yields of local bonds keep falling

▪ Over the last week, the debt market strengthened significantly. Domestic yield curve fell by more than 10bps until Thursday. This was driven by strengthening in the European debt market after the ECB meeting, decision of the Czech central bank and good results of local 2Y bonds auction. On Friday, a correction took place in profit taking before the weekend.

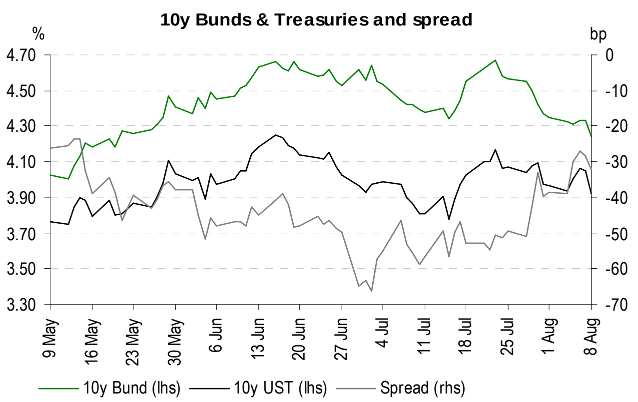
▪ This week key focus of attention for the local debt market will be CPI data on Wednesday and performance of the core debt markets amid publication of inflation indicators in the euro zone and the US one day later. While in our view the domestic inflation figures should be positive for local bonds, the foreign data (in particular US inflation numbers) may be a negative surprise.



Dollar strongest in 6 months

▪ After the ECB communiqué and comments of the Jean Claude Trichet suggesting lack of further interest rate hikes in the euro zone and expected slowdown in the euro zone economy, as well as after release of better than expected data from the US, the dollar strongly appreciated against the euro, approaching 1.50 on Friday (against 1.56 a week before). It also resulted from significant drop of oil prices in the world markets.

▪ In the short term some profit taking is possible regarding the EURUSD rate. Data, which are going to be released this week will have strong influence on investors moods. They include figures on prices and economic activity in the major world economies.



Euro zone bonds gain, US bonds loose

▪ Comments after the ECB decision, as well as fears over significant economic slowdown in the euro zone, resulted in a decline in yields of the European bonds last week. At the same time the US debt slightly weakened due to higher risk appetite and lower interest in safe-haven assets.

▪ Inflation data will be at foreground this week and most probably will show further rise of price indices. On the other hand, weak data from the real economy should keep away concerns about interest rate hikes in the major world economies. Also, on Thursday the ECB will release its monthly bulletin, which may have importance for the market given recent influence of the comments by ECB's representatives.

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