Bank Zachodni WBK

Weekly economic update

18 – 24 August 2008

In the past week the zloty depreciation trend was continued and the EURPLN rate as we expected exceeded 3.30, while the bond market experienced yields decline. The weakening of the domestic currency resulted mostly from the strengthening of the dollar in the international markets. It was gaining as result of concerns the weakening of other economies than US and of further drop in commodities' prices. Oil prices dropped to 110$ per barrel.

Data about June's balance of payments disappointed, as trade deficit increased to €1.7bn and cumulated 12-month current account deficit rose to 4.5% of GDP. Inflation data were in line with median market forecast and similarly to current account figures had negligible impact on the financial market. Higher impact had dovish comments of the Ministry of Finance about estimates of inflation in August not exceeding 5%.

We predict further weakening of the domestic currency amid deceleration in dollar appreciation. We also do not expect further fall in yields on the debt market because of publication of new local data for July. Industrial output and PPI will be in our opinion higher than market consensus and core inflation will remain at elevated levels. Even though wage growth may be lower than predicted by the market, it will remain very high, strengthening inflationary pressure. We still expect a slight slowdown in employment growth. Minutes of the MPC meeting in June should have no significant impact on the local financial market. High number of important publications will be released abroad and they may impact the relation between the dollar and euro and core debt markets.

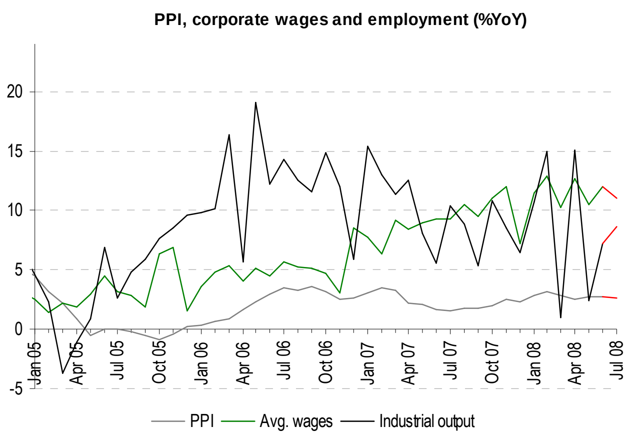
Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 August)					
9:00	**PL**	**T-bill auction: 26-week worth of PLN500m and 52-week worth of PLN500m**					
12:00	**PL**	**Wages in corporate sector**	**Jul**	**%YoY**	**11.5**	**11.0**	**12.0**
12:00	**PL**	**Employment**	**Jul**	**%YoY**	**4.6**	**4.5**	**4.8**
		TUESDAY (19 August)					
9:00	DE	ZEW index	Aug	pts	-60.0	-	-63.9
12:30	US	New house starts	Jul	m	0.96	-	1.066
12:30	US	Build permits	Jul	m	0.98	-	1.138
14:00	US	PPI	**Jul**	%MoM	0.5	-	1.8
		WEDNESDAY (20 August)					
9:00	**PL**	**Switch auction**					
12:00	**PL**	**Industrial production**	**Jul**	**%YoY**	**7.3**	**8.6**	**7.2**
12:00	**PL**	**PPI**	**Jul**	**%YoY**	**2.5**	**2.6**	**2.7**
		THURSDAY (21 August)					
12:00	**PL**	**Core inflation**	**Jul**	**%YoY**	**3.5**	**3.5**	**3.4**
12:00	**PL**	**MPC minutes**	**Jul**				
14:00	US	Philadelphia Fed index	Aug	pts	-11.5	-	-16.3
		FRIDAY (22 August)					
12:00	**PL**	**Business climate**	**Aug**				

Source: BZ WBK, Parkiet, Reuters

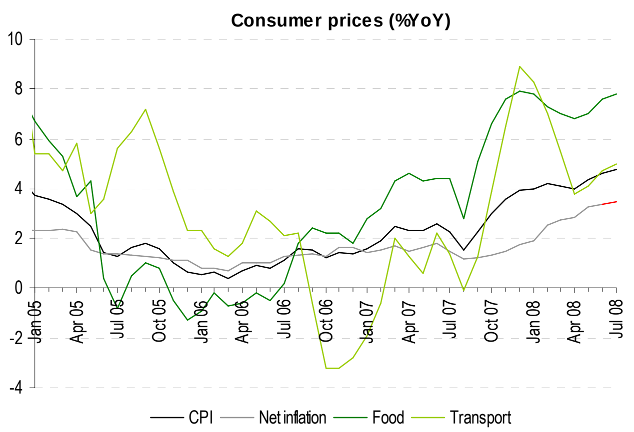
Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – Series of domestic data

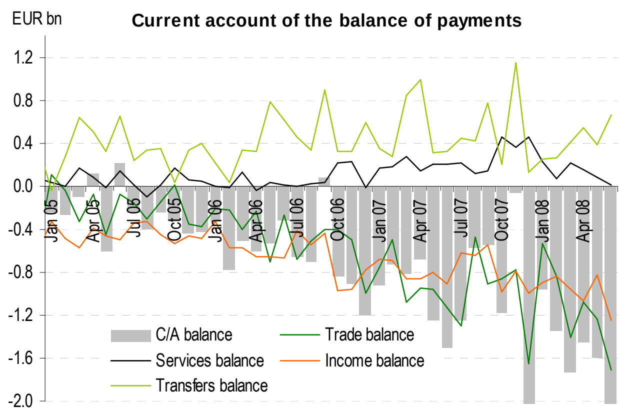


- After higher than expected data on wages in the corporate sector in June (12%YoY), we expect that wages growth dropped to 11%YoY in July. In our opinion growth rate in employment will remain in decreasing trend and was at 4.5% in July.
- Our forecast of industrial output at 8.6%YoY is pretty much above median of market forecasts. We believe that growth in producers' prices slowed down to 2.6%YoY. It is worth to examine the domestic PPI, which remains at high level.
- According to our estimations, net inflation rose by 3.5%YoY in July. However, in our view new indicator of NBP's core inflation dropped to 2.1%YoY, but we expect it will rise above target level next month.
- MPC's *minutes* from July's meeting, will not bring critical info.

Economy last week – Inflation as expected, trade and C/A deficits much above consensus



- CPI for July was higher than our forecast at 4.7%YoY and in line with market expectations. It accelerated to 4.8%YoY from 4.6% in June.
- Data did not change inflation prospects. Current inflation is still driven by food, fuel and energy prices, as well as increase in some taxes (tobacco products) and service prices.
- We still think that increase in inflation above 5% in August will persuade MPC to hike the key rate to 6.25-6.5% to counteract growth in inflation expectations and second-round effect.
- Situation in the commodities market positively influences prospects for inflation at least in short-term. Last week, further drop in oil prices to 110$ per barrel was observed. From peak at the beginning of July, decrease in oil prices reached ca. 24%.



- Despite the increase in export growth to 16.1%YoY in June, sharp increase in trade deficit was observed (€1.7bln) as a result of stronger import (20.2%YoY). Current account deficit rose to €2.3bln, and 12-month cumulative balance result increased to 4.5% GDP and most likely will rise in next months. Significant worsening occurred on the services account, while on income account strong outflow in dividends was noted. It affected negative result in foreign direct investments, which has been below zero first time since September 2006.
- Money supply rose in July by 16.5%YoY (market consensus: 15.9%). The deposit growth rate increased by 19.3%. On the other hand the credit growth clearly decelerated to 25.2% from 27.7%, and for households to 30.3% from 34.4%.

Quote of the week – One more rate hike may be enough

Jan Czekaj, MPC, Reuters, 12 August

I think yes [central bank may refrain from rate decisions in summer] ...we will need to wait and see what happens in the economy. There are some signs of growth weakening. We will have to analyse them.

Marian Noga, MPC, Reuters, 12 August

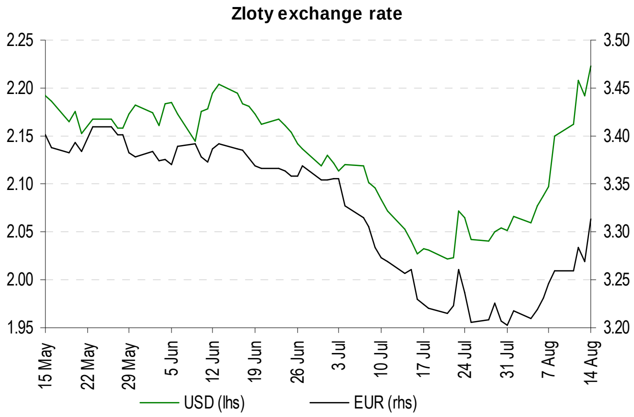
One more rate hike this year will probably be enough to bring inflation back to the central bank's 2.5 percent target over the next two years.

Stanisław Owsiak, MPC, PAP, 12 August

The mentioned factors force cautious stance on running monetary policy, as there are many factors, which point that we already have had or will soon have the peak of inflation passed.

Some of MPC members made calm comments on prospects of further monetary policy tightening. According to the "hawkish" Dariusz Filar, one or two rate hikes should bring core inflation down next year. Halina Wasilewska-Trenker claimed that rate hikes are necessary; however the exact moment may be postponed as a result of uncertainty in economic situation. In Marian Noga's opinion, cycle of tightening may be ended by one more hike. It is worth to notice that Stanisław Owsiak stressed a necessity of being sensible while conducting monetary policy. Jan Czekaj, who is the key-member of MPC, said that next MPC's move should be made after holidays. We expected such a move in September.

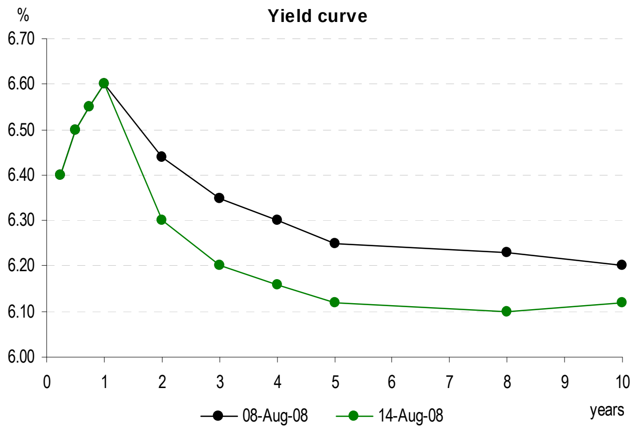
Market monitor



The zloty above 3.30 against euro

▪ After significant weakening in the last week, the zloty remained quite stable in recent days, inter alia due to appreciation trend of the dollar against the euro, which affected currencies in our region. Data on balance of payments negatively influenced the zloty; however it was counteracted by rebound in EURUSD rate. Renewed strengthening of the dollar resulted in further zloty weakening, which was supported by Jan Czekaj's and FinMin's comments on inflation in August.

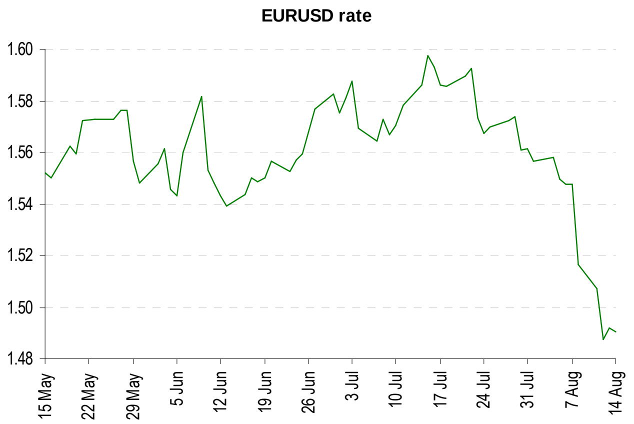
▪ We expect further weakening of the zloty, though its scale may decrease in connection with possible weakening of the dollar and bigger exporter's activity in the market. We change expected range for EURPLN to 3.26-3.36 and for USDPLN to 2.17-2.27.



Interest rate market still strengthening

▪ Despite investors' low activity at the beginning of the week before the publication of CPI data, gradual decrease in yields was observed. Although, inflation was in line with a median of market's forecasts and paused the strengthening for a while, MPC member's comments and FinMin's estimates of inflation in August resulted in further drop in rates in the interest rate market.

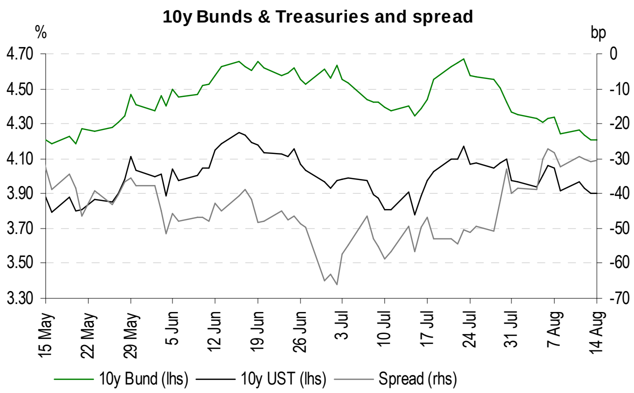
▪ We expect slowdown of increasing prices in the debt market. Though our forecast of wages is slightly below consensus, the growth is still high. Growth in yields will be supported by output data, which in our opinion will be much above the market consensus. Further increase in prices will not be supported by data on PPI and net inflation either.



Further dollar's drop

▪ Recently rising investors' conviction that slowdown of economy is not only US problem, resulted in closing of short positions in the dollar and drop in oil prices. This week it was similarly and EURUSD rate decreased to almost 1.48. At the end of the week slight correction to 1.49 took place.

▪ We expect temporary revision of EURUSD rate upwards; however decrease in commodity prices will be risk for such a scenario. At the next sessions data from the US housing market will be crucial for EURUSD rate, since they will show whether the crisis is close to the end. Activity index Philly Fed will be important as well. German index ZEW, which will reveal signals for EMU economy, will be crucial for the euro.



Decrease in Bunds' yields

▪ After slight increase in yields in the US at the beginning of the week, further strengthening took place in next days, inter alia as a result of drop in prices of oil and shares, and negative information from financial institutions. At the end of the week, 10Y Treasuries' yield was close to levels from previous Friday (3.91%). Strengthening of Bunds after ECB's meeting was continued and supported by factors, which were strengthening US market. Yields of 10Y German Bunds dropped to 4.21% from 4.24%.

▪ We think that further decrease in yields is possible if there is confirmation of the scenario of global economic slowdown and drop in oil prices. This week, investors will focus their attention on important data from the US and the euro zone.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl