

Weekly economic update

1 – 7 December 2008

The beginning of last week was marked by improvement in moods on the global market and decrease in risk aversion amid announcement of measures supporting the US economy and information about probable nominations for economic positions by Barack Obama. As a result of drop in risk aversion, there was rebound in stock markets, weakening of the dollar and strengthening of the zloty. In the second part of the week, with lower market activity related to long weekend in the US, concerns about global economic slowdown prevailed, which led to rebound of the dollar against the euro. The zloty was gaining against major currencies for the whole week and was not negatively affected by the rate cut delivered by the MPC. The Council decided to shift from neutral to easing bias and trimmed rates by 25bps. The official statement of the Council indicated that next rate cuts are only a matter of time. We expect that the next move will take place in December. The strengthening in the core debt markets and expectations for outcome of the MPC meeting led further significant fall in yields of domestic bonds across the curve. FRA market prices in further rate cuts of at least 150bps while we expect 125bps in 12 months (the reference rate down to 4.5%). However, we predict that further strengthening in the local debt market may take place when situation in the global markets allows for decrease in risk premium. This week the Polish financial market will remain under influence of changes in risk aversion, depending on major data release in the euro zone (PMI) and the US (ISM and the non-farm payrolls report) as well as on decisions of the ECB and the Bank of England. Locally, at the beginning of the week we will get the PMI manufacturing and the FinMin's inflation forecast for November. The FinMin will also held the first auction of bonds since October (at the same time the last one this year), which will be a test for investors' attitude to Polish assets.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
MONDAY (1 December)						
8:00	PL	PMI	Nov	pts	41.7	43.7
10:00	PL	Tender of 0.2-0.5bn 13-week, 0.2-0.5bn 26-week and 0.8-1.8bn 52-week treasury bills				
9:00	EZ	Manufacturing PMI	Nov	pts	36.2	41.1
15:00	US	Manufacturing ISM	Nov	pts	38.4	38.9
TUESDAY (2 December)						
10:00	EZ	PPI	Oct	%YoY	7.0	7.9
WEDNESDAY (3 December)						
10:00	PL	Auction of 2Y bonds				
9:00	EZ	Services PMI	Noc	pts	43.3	45.8
13:15	US	ADP report	Nov	k	-207	-157
15:00	US	Non-manufacturing	Nov	pts	43.0	44.4
THURSDAY (4 December)						
10:00	EZ	Revised GDP	Q3	%YoY	-0.2	-0.2
12:00	GB	BoE meeting - decision	%	%	2.50	3.0
12:45	EZ	ECB meeting – decision	%	%	2.75	3.25
13:30	US	New jobless claims	w/e	k	529	529
15:00	US	Factory orders	Oct	%MoM	-2.8	-2.5
FRIDAY (5 December)						
13:30	US	Non farm payrolls	Nov	k	-300	-240
13:30	US	Rate of unemployment	Nov	%	6.7	6.5

Source: BZ WBK, Reuters

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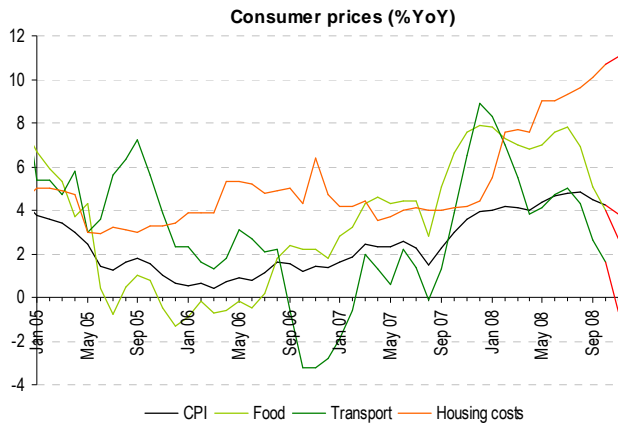
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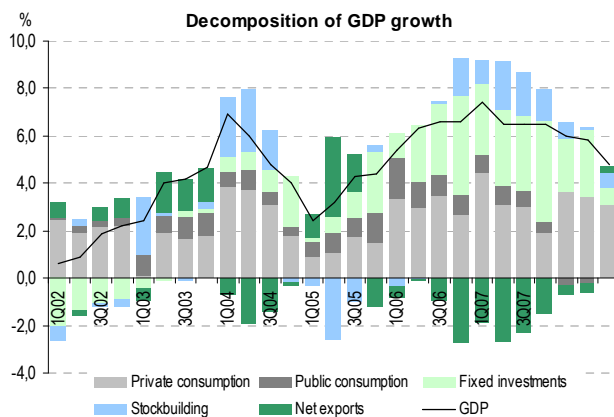
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What's hot this week – PMI, FinMin's inflation forecast and ECB meeting



- At the beginning of this week the FinMin will publish its inflation forecast for November. According to our forecast, consistent with market consensus, CPI inflation fell to 3.8%YoY from 4.2%YoY with monthly price growth of 0.3%. We estimate that on a monthly basis food prices grew 0.4%, housing and energy costs 0.7% while transport prices fell 0.9% with fuel prices drop of 2.4%.
- On Monday we will get Poland's PMI for November. We expect further fall in the index to 41.7 from the lowest level in history at 43.7 in October, following drop in the euro zone's PMI for manufacturing.
- After a few weeks, the FinMin will again organise auction of bonds (2Y papers).
- Abroad the key focus of attention will be decision meetings of the ECB and the Bank of England.

Economy last week – GDP growth not bad, weak retail sales, MPC cut rates



- The MPC lowered interest rates by 25bps and in the very transparent statement introduced an informal easing bias, suggesting next rate cuts soon. The next move is possible even as soon as in December, if new information from the economy confirm deteriorating picture of the economic growth prospects (and improvement in inflation outlook). In our view the reference rate may fall to 4.5% in 12 months.
- Poland's economic growth reached 4.8%YoY in 3Q08, which seem to be a good result at the first sight (in line with consensus). However, there was significant slowdown in fixed investment growth (to 3.5%YoY). This led to positive contribution of net exports to GDP growth, as weaker investment activity substantially constrained imports growth and offset further weakening in exports growth. Consumption growth remained above 5%, but also in this case one should expect a slowdown in future.



- In October retail sales in nominal terms rose by 3.8%MoM and 7.9%YoY (against 15.6%YoY in January-September and 11.2% in Q3), weaker than indicated by the market consensus and our prediction of 9.1%YoY. The real growth in retail sales was 3.4%MoM and 5.0%YoY (against 11.6%YoY in January-September and 7.4% in Q3). The worst situation was still in auto sales.
- There was deepening in fall of consumer confidence indicators. According to the stats office, levels of consumer confidence indicators in the last two months show that a slowdown in private consumption spending is possible.
- A significant rise of consumer concerns about the unemployment rise is connected with announced lay-offs in the domestic market as well as expected return of emigrants. As for now, the registered unemployment rate is still falling and reached 8.8% at the end of September.

Quote of the week – Rate cut in December cannot be excluded

Andrzej Sławiński, MPC, Radio PiN, 27

Situation of the Polish economy is good enough so that we could conduct monetary Policy in a traditional way.

Halina Wasilewska-Trenkner, MPC, Reuters, 27 November

So far, I have had no signals, which would tell that a rate cut should not take place in the first quarter of next year.

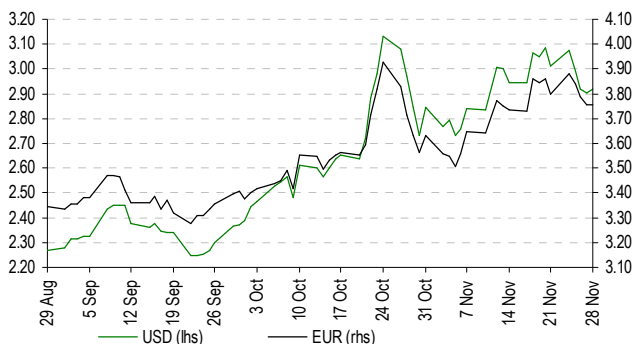
Jan Czekaj, MPC, TVN CNBC, 27 November

Data for October confirm that Poland enters a period of economic slowdown. This could have been some tradition [that rates were not changed in December], but not a rule, which cannot be broken. (...) One cannot treat it as an announcement [that rates will be cut in December], but one cannot exclude it of course.

Comment from A. Sławiński about traditional way of conducting monetary policy suggests that he will be more willing to cut rates in moves of 25bps than of 50bps. Jan Czekaj said that recent data from the economy indicate that the Polish economy entered the slowdown phase and not excluded another rate cut at the next MPC meeting. NBP governor will most likely vote for a rate cut at the next meeting as he sees downward risks to GDP growth. Even hawkish Marian Noga said that rates could be cut also in December, although it seems to him that this will take place only in January and overall scale of rate cuts in Q1 could reach 50bps. Halina Wasilewska-Trenkner also sees a need for monetary easing, although she believes that another move will take place in Q1. We are wondering what are, in her opinion, arguments against a rate cut in December.

Market monitor

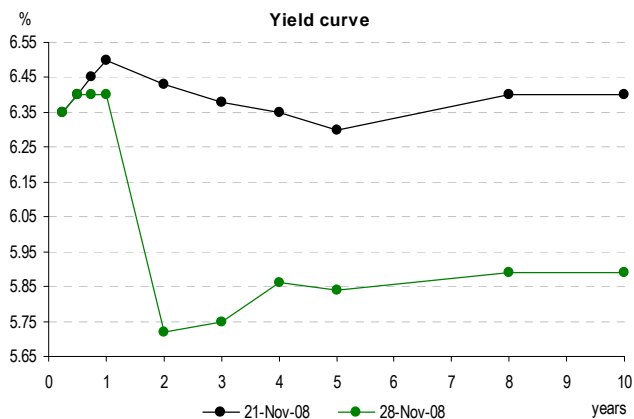
Zloty exchange rate



Zloty rebounding gradually

- There were several factors improving moods in global markets last week - the US government's plan of support for Citigroup, package supporting the consumer credit market, as well as nomination of US President elect Barack Obama for economic position in the new administration. This also led to strengthening of currencies in our region. The zloty has been strengthening during the whole week and did not react to the rate cut by the MPC. During the week the scale of appreciation amounted to 2.8% against the euro and 4.2% against the dollar.
- The Polish FX market will remain under influence of risk aversion on global markets. Weak domestic PMI data, as well as foreign activity indices and US non-farm payrolls may negatively affect the zloty. On the other hand, interest rate cut by the ECB may have positive impact.

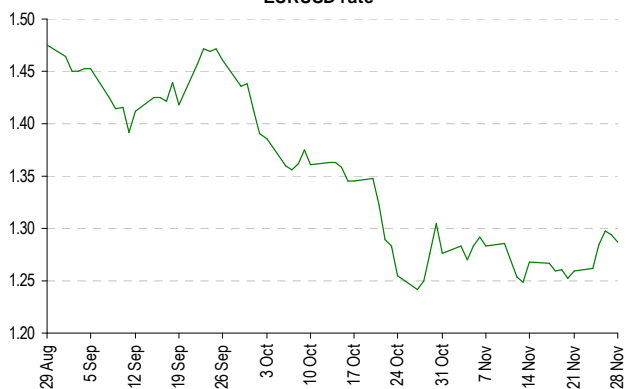
Yield curve



Sharp decrease in market rates

- Last week the domestic interest rates market significantly strengthened. Firstly, market rates were falling amid positive sentiment towards fixed income instruments abroad, awaiting the MPC decision. As official rates were cut by 25 bp further strengthening was observed. Bond yields fell to the pre-crisis level, as expectations for further monetary easing intensified.
- We see a possibility for further rise in bonds' prices, as in our opinion the NBP reference rate is likely to fall to 4.5%. Also, the spread between bonds and IRS should be narrowed (five-year IRS is at ca. 4.80%) if global moods improves. This week the two-year bond auction will be a good indicator as regards the moods towards the Polish market. Also, the ministry of Finance's CPI forecast and the ECB decision will have impact.

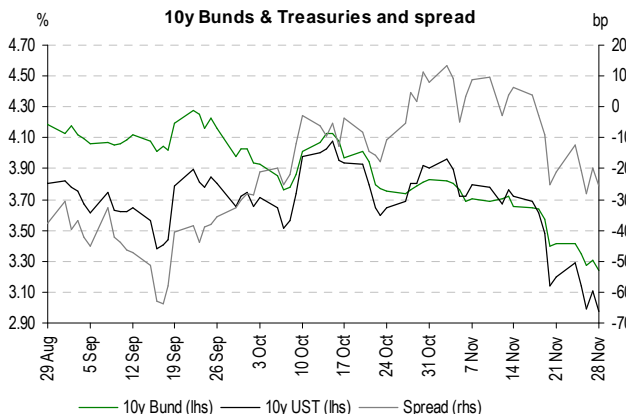
EURUSD rate



Dollar gains at the end of the week

- As global moods improved and risk appetite increased, the American currency lost against the euro in the first part of the week. However, later during the week investors' fears regarding effectiveness of US government's plans and market's focus on deep recession risks and companies' bankruptcies led to lower risk appetite. This in turn helped the US currency, which appreciated to 1.27 against the euro (with limited liquidity amid long weekend in the US).
- A quite heavy economic calendar (PMI activity indices, US labour market statistics), as well as meetings of central banks in Europe will affect changes in EURUSD rate. We think it is well possible that dollar will continue to strengthen towards the year end and at the beginning of 2009.

10y Bunds & Treasuries and spread



New lows of yields in the core debt markets

- Last week saw continuation of the fall in yields in the core debt markets observed on a large scale the previous week. This was related to increase in concerns about condition of the global economy and expectations of further significant rate cuts. Bonds purchases were also connected with the approaching end of the month and some adjustment in portfolios of investors. At the end of the week, yields of 10Y Treasuries and Bunds fell to 2.97% (the lowest level in 50 years) and 3.27% (the lowest since 2005), respectively.
- Weak data from the US labour market may keep the core debt markets strong. For the European debt market the key factor will be the ECB decision (we expect 75bps) and comments from the bank's president.

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