Bank Zachodni WBK

Weekly economic update

15 – 21 December 2008

Last week saw significant movements in financial markets. The zloty considerably weakened against the euro and gained versus the dollar amid significant rise in EURUSD. The local debt market experienced clear correction of earlier rapid drop in yields, despite further intensification of expectations for rate cuts by the MPC – rising probability that the MPC will decide to trim rates by 50bps in December. Domestic data released on Friday had no impact on the market. Abroad we saw rise in risk aversion after Thursday's rejection by the US Senate of the rescue plan for automakers , but shortly later there was a breath of optimism thanks to better than expected data from the US - retail sales and Michigan index showed that rapid fall in oil prices positively affected consumers.

This week we will get a large set of important domestic data, which will help to assess better prospects for MPC policy. There will be also crucial events abroad with attention focused on the Tuesday's FOMC meeting.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (15 December)					
10:00	**PL**	**Auction of Treasury Bills 13-week PLN0.3-0.5bn, 26-week PLN0.3-0.5bn and 52-week PLN1.2-1.5bn**					
13:00	**PL**	**CPI**	**Nov**	**%YoY**	**3.8**	**3.8**	**4.2**
13:00	**PL**	**Average wage in enterprises**	**Nov**	**%YoY**	**8.6**	**7.5**	**9.8**
13:00	**PL**	**Average employment in enterprises**	**Nov**	**%YoY**	**3.3**	**3.3**	**3.6**
13:30	US	NY Fed index	Dec	pts	-27.0	-	-25.43
14:00	US	TICS capital flows	Oct	$bn	-	-	66.2
14:15	US	Industrial output	Nov	%	-0.9	-	1.3
14:15	US	Capacity utilization	Nov	%	75.6	-	76.4
		TUESDAY (16 December)					
09:00	EZ	Flash PMI manufacturing	Dec	pts	34.3	-	35.6
09:00	EZ	Flash PMI services	Dec	pts	41.2	-	42.5
13:30	US	CPI	Nov	%	-1.4	-	1.0
13:30	US	House starts	Nov	m	0.74	-	0.791
13:30	US	Building permits	Nov	m	0.7	-	0.73
19:15	US	FOMC decision announcement	-	%	0.5	0.5	1.0
		WEDNESDAY (17 December)					
10:00	**PL**	**Auction of bonds – unscheduled earlier (details to be released on December 15)**					
10:00	EZ	Final HICP	Nov	%YoY	2.1	-	3.2
		THURSDAY (18 December)					
13:00	**PL**	**Industrial output**	**Nov**	**%YoY**	**-5.3**	**-5.8**	**0.2**
13:00	**PL**	**Construction output**	**Nov**	**%YoY**	**6.9**	**6.9**	**10.5**
13:00	**PL**	**PPI**	**Nov**	**%YoY**	**2.4**	**2.4**	**2.4**
13:00	**PL**	**Minutes of MPC meeting in November**	**-**	**-**	**-**	**-**	**-**
09:00	DE	Ifo index	Dec	pts.	84.0	-	85.8
13:30	US	Initial jobless claims	w/e	'000	563.0	-	573.0
15:00	US	Leading indicators	Oct	%	-0.5	-	-0.8
15:00	US	Philly Fed index	Dec	pts.	-40.5	-	-39.3
		FRIDAY (19 December)					
-	JP	Bank of Japan decision announcement	-	%	0.3	0.3	0.3

Source: BZ WBK, Parkiet, Reuters

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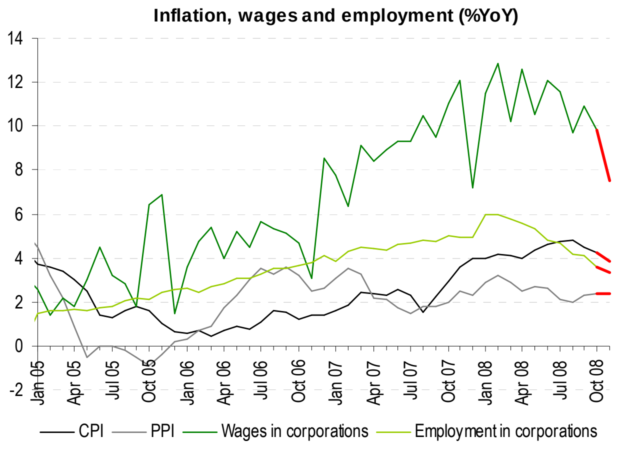
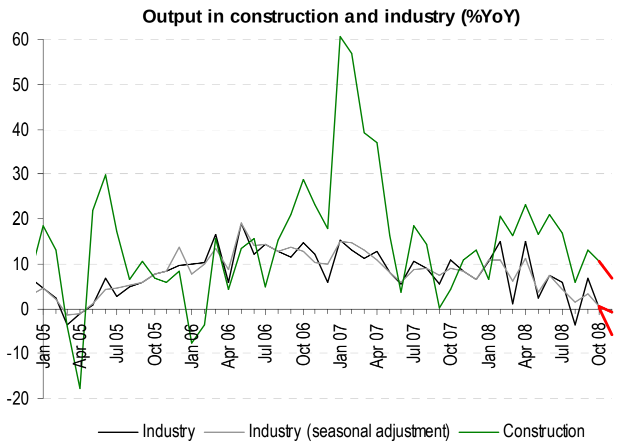
What's hot this week – Many important data locally, focus on FOMC meeting abroad

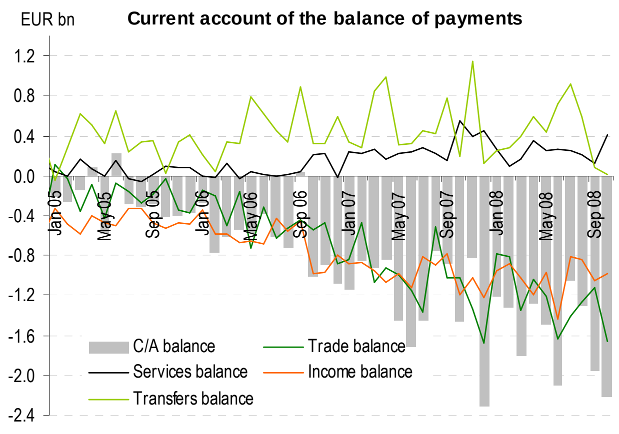


- This week, we will receive a large set of local data that will be important hint regarding next steps of the MPC, including monetary easing in December (there is no doubt that there will be a rate cut this month, the question is about its size).
- At the start of the week we will see data about CPI and labour market figures. We predict that CPI growth fell in November to 3.8%YoY after 0.3%MoM rise in prices, which is in line with FinMin's estimate and median market forecast (forecasts range between 3.6% and 4%).
- As regards wages, we predict a slowdown from 9.8% to 7.5%YoY in November, which is below market consensus. Employment growth is forecast to slow from 3.6% to 3.3%YoY, which is connected with continuation of labour shedding in manufacturing that lasts since May (effect of worse situation in export sector).



- The second pack of economic data will be released on Thursday, including particularly important in current situation industrial output growth (see Jan Czekaj's comments below). Our current forecast of output (-5.8%YoY) is below market consensus (-5.3%YoY), although the latter was formed before the release of terrible PMI figure for November. After this release, we revised our forecast from -3.7%YoY, and one may suspect that a scale of reduction in other market forecasts could have been be similar.
- Apart from industrial output, also production in construction sector will be important, as it performed surprisingly well in the previous months.
- Also, a number of important data will be released abroad. However, the most important even for the market will be the FOMC meeting.

Economy last week – Slump in exports growth



- Current account deficit in October was higher than predicted, despite better result in services, income, and transfers accounts. Trade deficit unexpectedly grew (€1.66bn) amid deeper than expected slump in exports (-1.2%YoY versus our forecast 6.3%YoY). Deceleration in import growth was also stronger than expected (4.5%YoY), however in this case difference between our forecast (5.4%) was smaller, which suggests downward risk for our estimate of net exports' contribution to GDP growth in Q4.
- Positive aspect in balance of payments data was maintaining high FDI inflow (over €900m).
- Money supply figures for November showed there was no significant effects of credit policy tightening visible. Loan growth remained at solid 31.4%YoY, deposits increased 19.2%YoY, and M3 increased 18%YoY.

Quote of the week – Rate cut as soon as possible, possibly more than 25bps

Jan Czekaj, MPC member, Bloomberg, 10 December

I do not exclude that the MPC will have to decide for more significant rate cut, i.e. more than 25 bp. I do not know it this happens already in December. I think that data about industrial output will be important. (...) I would not be surprised if November data (about industrial output growth) are below zero. This would be a serious signal that the MPC must act immediately, and the reaction should be deeper.

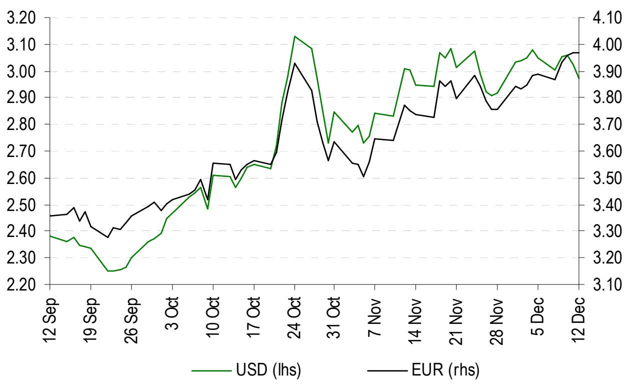
Andrzej Wojtyna, MPC member, TVN CNBC, 10 December

I think the MPC will agree and the motion will be approved. I would opt for well-balanced (decision). Situation in Poland is different than abroad (...) there is FX risk. We should not lead to zloty depreciation. Significant rate cut would give signal that the situation in MPC's assessment is worse than expected.

The latest comments from MPC members leave little doubts that there will be another rate cut in December. Although the most radical hawks (Filar, Wasilewska-Trenkner) still claim that a cut should be delayed until the next year, their arguments will rather not convince other members. Particularly, Wasilewska-Trenkner's opinion that there should be no change in rates in December as this is the period of settlement in companies' books, is unconvincing, as in December 2006 and 2007 she supported motions to raise rates. Moderate hawk, A. Wojtyna, thinks that the MPC will decide to cut rates in December. Jan Czekaj's comments suggest that a move by 50 bp is increasingly likely, and industrial output data will have significant impact on the central bank's decision.

Market monitor

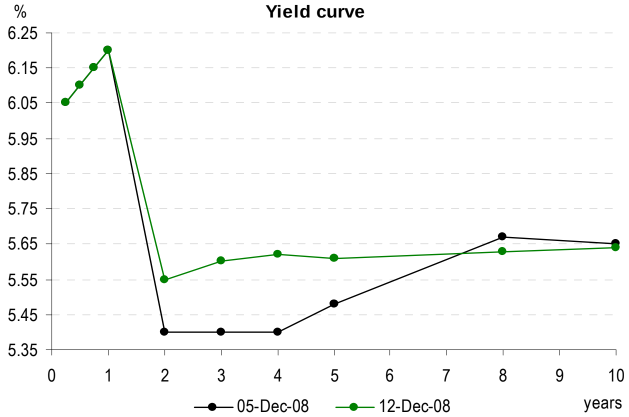
Zloty exchange rate



Zloty under pressure

- Zloty depreciation trend was dominating the market last week. Polish currency weakened substantially versus euro however gained slightly against dollar that was loosing strength abroad. After significant weakening last week (despite temporary rebound on Thursday) the zloty is one of the worst performing currencies since the end of November. A specific factor that temporarily hurts the zloty is closing positions connected with FX options.
- This week we expect the zloty to remain highly volatile. One cannot exclude either testing 4.0 level again or strengthening below 3.9. Local data, in particular drop in industrial output, will be negative for the zloty.

Yield curve



Correction in debt market

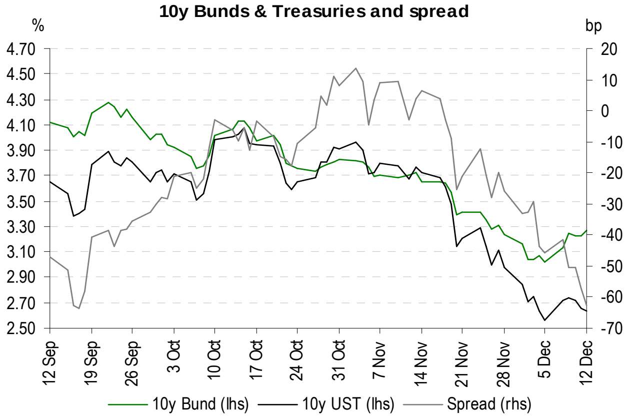
- After several weeks of rapid decline in yields, last week saw upward move in yield curve. Correction was connected with profit taking by some investors amid approaching multi-year lows in yields (last seen in the period of interest rate cuts in 2005 when reference rate fell to 4%). A negative factor was FinMin's information about additional auction of bonds on 17 December. The long end of the curve was also negatively affected by rise in yields in core debt markets.
- This week, important events for the market will be bond auction and new data releases that may help in assessment of next MPC moves. Lower CPI, sizeable drop in production, and clear slowdown in wage growth should lead to further decline in yields of Polish treasuries.

EURUSD rate

EURUSD sharply up

- The dollar clearly weakened versus other currencies last week. EURUSD reached 1.34 at the end of the week versus 1.275 one week before. Dollar reached the lowest level in 13 years versus yen (below 90), which strengthened expectations for BoJ intervention. A factor negatively affecting the dollar at the end of the week was realisation of stop-loss orders after breaching important thresholds and rejection of bailout plan for car industry by the US Senate, which worsened outlook for American economy.
- This week, the key factor for the dollar will be FOMC decision about interest rates and a statement after the Fed meeting, which will give hints regarding further moves of the US central bank.

10y Bunds & Treasuries and spread



in core debt markets

- Last week saw a rise in 10Y yields in core debt markets. It was connected with a rise in risk appetite in global markets in the first part of the week. Later, after rejection of bailout package for US car producers, yields in core markets fell sharply (10Y Treasuries to only 2.48%, the lowest level since 1954), but it was a temporary effect. Better than predicted US data released on Friday introduced more optimism and limited risk aversion, hurting safe assets. At the end of the week, 10Y Treasuries and Bunds were at 2.73% and 3.31% respectively, versus 2.56% and 3.02% one week before.
- This week in core debt markets will be dominated by Fed decision. For Bunds, also flash PMI data will be important.

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