

(Tri)Weekly economic update

22 December 2008 – 11 January 2009

The last week brought pessimistic news about economic situation in Poland and abroad, and the incoming data releases are likely to be in similar tone. Amid low liquidity in the market, the zloty has been under pressure and with such a high volatility it is difficult to predict what will happen in next weeks. Despite the zloty weakness, we think the MPC has no other option but to trim rates decisively (at least by 50bps) in December.

Due to the holiday period, we will publish the next *Weekly Economic Update* on January 9. We wish all our readers Merry Christmas and Happy New Year!

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (22 December)							
10:00	PL	T-bills auction 39-week PLN1.5-1.8bn					
13:00	PL	Net inflation	Nov	%YoY	4.7	4.7	2.9
13:00	PL	Business climate indicators	Dec	pts.	-	-	-
TUESDAY (23 December)							
9:00	PL	Retail sales	Nov	%YoY	6.1	5.0	7.9
9:00	PL	Registered unemployment rate	Nov	%	9.0	9.1	8.9
	PL	MPC meeting – decision	-	%	5.25	5.25	5.75
13:30	US	GDP final	Q3	%	-0.5	-	-0.5
13:30	US	Core PCE	Q3	%	2.6	-	2.6
14:55	US	Michigan index final	Dec	pts.	58.5	-	55.3
15:00	US	Home sales	Nov	m	4.9	-	4.98
15:00	US	New home sales	Nov	m	0.42	-	0.433
WEDNESDAY (24 December)							
13:30	US	Core PCE	Nov	%MoM	0.0	-	0.0
13:30	US	Durable goods orders	Nov	%MoM	-3.4	-	-6.9
TUESDAY (30 December)							
9:00	EZ	M3 money supply	Nov	%MoM	8.5	-	8.7
13:00	PL	Current account balance	Q3	€ bn	-	-4.33	-4.87
14:00	US	Case/Shiller report	Oct	%YoY	-17.8	-	-17.4
14:45	US	Chicago PMI	Dec	pts.	32.0	-	33.8
15:00	US	Consumer confidence	Dec	pts.	45.0	-	44.9
FRIDAY (2 January)							
8:00	PL	PMI manufacturing	Dec	pts.	-	37.2	40.46
9:00	EZ	PMI manufacturing	Dec	pts.	34.5	-	35.6
15:00	US	ISM manufacturing	Dec	pts.	35.4	-	36.2
TUESDAY (6 January)							
9:00	EZ	PMI services	Dec	pts.	42.0	-	42.5
10:00	EZ	HICP flash	Dec	%YoY	1.8	-	2.1
15:00	US	ISM non-manufacturing	Dec	pts.	-	-	37.3
15:00	US	Factory orders	Nov	%MoM	-3.3	-	-5.1
15:00	US	Pending home sales	Nov	m	-1.0	-	88.9
-	US	FOMC minutes	-	-	-	-	-
FRIDAY (9 January)							
10:00	EZ	Retail sales	Nov	%MoM	0.2	-	-0.8
13:30	US	Non-farm payrolls	Dec	k	-480.0	-	-533.0
13:30	US	Unemployment rate	Dec	%	7.0	-	6.7
15:00	US	Wholesale inventories	Nov	%MoM	-1.1	-	-1.1

Source: BZ WBK, Parkiet, Reuters

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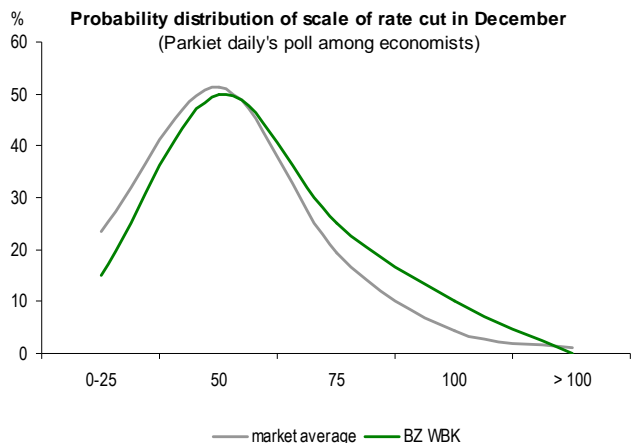
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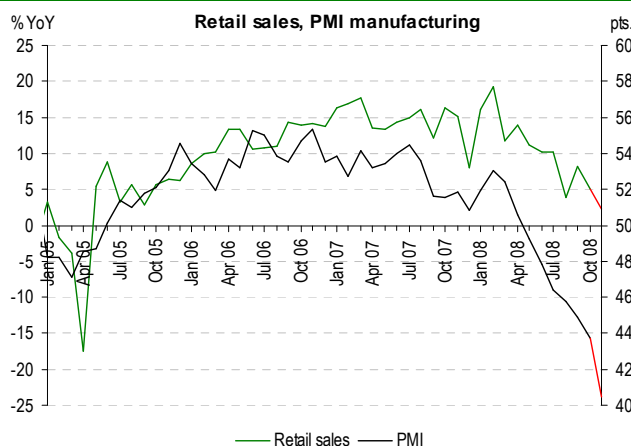
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What's hot this week – Next week data, deep rate cut for Christmas

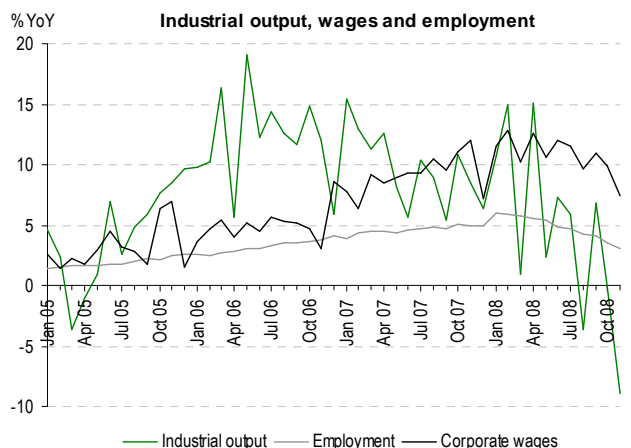


- Last days before Christmas will be rich in important events. Locally, the key focus of attention will be on the MPC meeting. After a series of weak data and decisive rate cuts abroad, it seems the Council will deliver a nice gift to borrowers and trim rates by at least 50bps.
- As usual not only the MPC decision, but also its statement will be important as it may include hints regarding further steps of the Council. It is also interesting whether the MPC will refer to the new idea of Prime Minister to enter the ERM2 before changes in the constitution.
- Before the MPC decision we will get a few macro figures for November. Most of core inflation measures should follow the CPI's move down, although the net inflation and CPI less food and energy prices remained high, according to our estimates (2.9% and 4.7%). Nevertheless, they should start falling quickly in first months of the next year.



- Retail sales data are likely to confirm weakening in consumption demand before year-end (suggested among others by clear fall in Ipsos consumer confidence indicators) and business climate indicators of the stats office should show further deterioration in enterprises' moods.
- After Christmas there will be some pause in domestic data releases. Only on Friday after the New Year there will be important publication of the FinMin's estimate of inflation in December (our forecast is 3.5%YoY) and Poland's PMI for December, which is important hint for industrial output.
- The next three weeks will be full of major data releases abroad. Given rising concerns about global recession, the market's attention will be focused on economic activity indicators (PMI, ISM). Besides, the key factor for markets will be the US non-farm payrolls report.

Economy last week – As economy weakens, so does inflationary pressure



- The latest data confirmed that slowdown in Polish economy gained momentum in Q4. Industrial output dropped by nearly 9%YoY in November, much below forecasts, mainly due to deterioration in exports. Construction output growth rate was still above zero (5.5%YoY), but activity weakening in this sector seems to be just a matter of time.
- In November employment in enterprises decreased on a monthly basis for the first time in 3 years. Rapid adjustment in labour market (wage growth down to 7.4%YoY) will have negative impact on households' financial stance and consumption demand (although to some extent it will be dampened by personal tax reduction since January).
- CPI inflation fell to 3.7%YoY in November and PPI inflation fell to 2.4%YoY, stronger than expected in both cases. The weakening domestic demand and worse labour market conditions will continue to decrease inflationary pressures.

Quote of the week – There will be no referendum. ERM2 before changes in constitution?

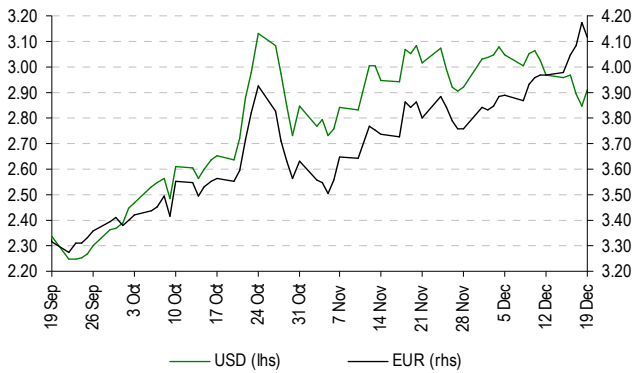
Zbigniew Chlebowski, head PO caucus, PAP, 17 December
Today all parliamentary caucuses (except for the Law and Justice) clearly said there is no support for a referendum on Poland's euro zone entry. (...) [Two roads remain] First option is an attempt to change constitution anyway, and then fast entry to EMR2. Second option, also considered, is entry to ERM2 without change in constitution. The constitution would be changed only during the next parliament's term.

Stanisław Żelichowski, head of PSL caucus, PAP, 18 December
Prime Minister is ready to enter the ERM2 without change in constitution. Our partners (EC and the ECB) understand our difficult cohabitation. In 2011 there will be early elections. Most likely in spring, as Poland gets the EU presidency in the second half of the year. Thus, the constitution would be changed by next parliament.

Decisive rejection of the referendum option by the government means that realisation of the swift euro adoption plan becomes more distant in our view. We think that the entry to the ERM2 before the constitution change seems not only a risky solution (there may be no majority for change in constitution after elections and before them market volatility may be increased due to political uncertainty), but also not very likely (Poland may not receive approval of the EC and the ECB without political consensus; such solution is also against stance of the MPC). While in the short-term influence of these news on the FX market may be limited, as the zloty is anyway under strong pressure currently, this may have negative impact on scenario of the zloty performance next year.

Market monitor

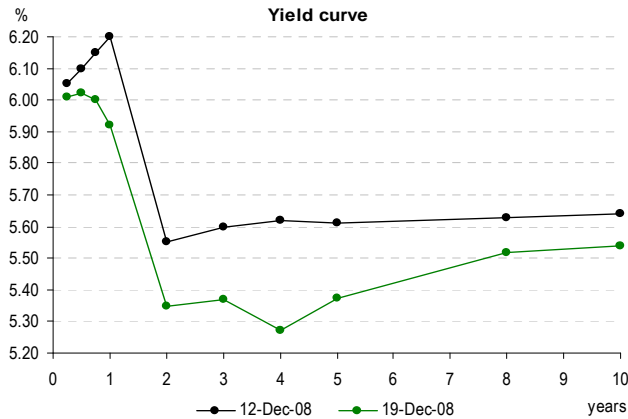
Zloty exchange rate



Very weak zloty at the year-end

- Higher risk aversion on global markets had negative impact on most of currencies in the region last week. However, the Polish zloty was underperforming others, which was probably mainly connected with market's perception of the FX options problem in Polish enterprises. After the EURPLN rate topped 4.18, the zloty erased part of losses and ended the week at ca. 4.08. At the same time, last week showed zloty appreciation against the dollar, as the US currency lost a lot on international markets.
- Market liquidity should be limited during pre- and post-holiday period and thus even small transactions may cause relatively significant changes in the rates. Nevertheless, we think that EURPLN rate should trade within 4.00-4.20 range until year-end and we expect strengthening in January.

Yield curve



Clear fall in domestic bond yields

- With very limited market activity, yields of Polish bonds clearly dropped over the past week due to intensifying view that the scale of rate cuts by the MPC will be large and thanks to strengthening in the core debt markets. Successful auction of bond auction carried out by the FinMin was also positive for the local debt market.
- The key focus of attention this week for the Polish interest rate market will be the MPC meeting on Tuesday, both decision and official statement. The market is pricing-in a rate reduction of 50bps, so only a deeper cut or statement suggesting larger moves in future could lead to market strengthening. After the New Year local bonds may be influenced by PMI for December and the FinMin's estimate of inflation for December.

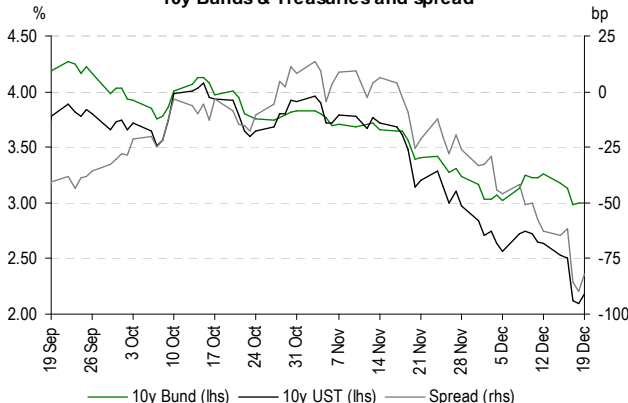
EURUSD rate



Dollar depreciation continues

- Deep rate cut by FOMC, problems of American enterprises, as well as concerns regarding the scale of US recession and questions over rescue measures by authorities led to dollar weakening in global markets. The greenback depreciated sharply against the euro (temporarily above 1.47) and against Japanese yen (the weakest level in 13 years). At the end of the week the American currency regained part of losses on profit-taking, but another wave of rising EURUSD trend may appear if US data disappoint.
- In the next couple of weeks a number of data releases will take place in the euro zone and the US including important information on housing market and labour market. We think they might not be optimistic, confirming a further deterioration in economic climate. This may lead to further dollar depreciation.

10y Bunds & Treasuries and spread



Rapid fall in yields in the core debt markets

- Weak data from the US, increasing concerns about depth of recession and larger than expected rate cut by the Fed as well as the Fed's announcement about possible purchase of Treasuries lead to significant strengthening of US bonds. Fall in yields in the European debt market was weaker, among others due to comments from ECB president Trichet suggesting a pause in rate cuts in January.
- The scale of strengthening in the core debt markets, especially in the US, was so large that one may expect some correction in the near term. On the other hand, next weak data would be supportive for the core debt markets, similar as the Fed's suggestions about purchases of long-term papers.

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