Bank Zachodni WBK

Weekly economic update

2 – 8 February 2009

In line with our expectations, the MPC cut interest rates by 75 bp, more than suggested by market consensus. GDP data were better than one could have expected taking into account recent monthly data. Nevertheless, monthly indicators for the last months of 2008 indicated a need for downward revision of our forecast of 2% GDP growth in 2009. This week we will see PMI index for January and although in this case our forecast is above market consensus, showing a moderate increase, in case of forecast of output and retail sales we are less optimistic than the market (which is shown in the results of the latest *Parkiet* daily survey). Weak data will suggest low forecast of GDP in Q1 and in our view will persuade the MPC to deliver another interest rate cut of 75 bp in February. It will be favoured by a fall in inflation – our CPI forecast of 3.1%YoY is higher than market consensus (2.9%), however we see a downward risk for this figure. After weakening at the end of last week amid a wave of risk aversion, this week the zloty may remain under pressure, however technical situation still shows than a room for further depreciation is limited. The bond auction on Wednesday will be crucial for situation in debt market.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (2 February)					
08:00	PL	PMI manufacturing	Jan	pts	**37.0**	**39.9**	**38.3**
08:58	EZ	PMI manufacturing	Jan	pts	34.5	-	33.9
10:00	**PL**	**Tender of 52-week T-bills worth PLN0.9-1bn**					
13:30	US	Core PCE	Dec	%	0.0	-	0.0
13:30	US	Personal income	Dec	%	-0.4	-	-0.2
13:30	US	ISM manufacturing	Jan	pts	33.1	-	32.9
		TUESDAY (3 February)					
10:00	EZ	PPI	Dec	%YoY	2.1	-	3.3
13:00	**PL**	**Balance of payments**	**Q3**	**-**	**-**	**-**	**-**
15:00	US	Pending home sales	Dec	%	0.5	-	-4.0
		WEDNESDAY (4 February)					
08:58	EZ	PMI services	Jan	pts	42.5	-	42.1
10:00	**PL**	**Auction of bonds OK0711 worth PLN1.5-25bn and PS0414 worth PLN1-2bn**					
10:00	EZ	Retail sales	Dec	%YoY	-1.5	-	-1.5
13:15	US	ADP report	Jan	‘000	-525.0	-	-693.0
15:00	US	ISM non-manufacturing	Jan	pts.	39.0	-	40.1
		THURSDAY (5 February)					
12:00	GB	Bank of England – decision	-	%	1.0	1.0	1.5
12:45	EZ	ECB – decision	-	%	2.0	2.0	2.0
13:30	US	Initial jobless claims	w/e	‘000	-590	-	588.0
13:30	US	Labour productivity	Q4	%	1.0	-	1.3
13:30	US	Unit labour costs	Q4	%	3.0	-	2.8
13:30	US	Factory orders	Dec	%	-3.0	-	-4.6
		FRIDAY (6 February)					
13:30	US	Non-farm payrolls	Jan	‘000	-520.0	-	-524.0
13:30	US	Unemployment rate	Jan	%	7.5	-	7.2

Source: BZ WBK, *Parkiet* daily, Reuters

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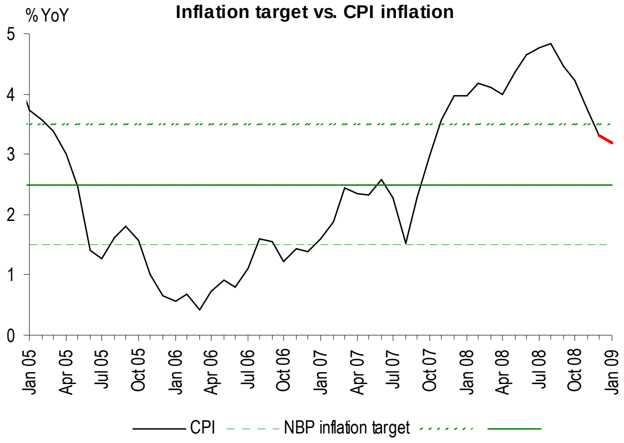
What's hot this week – FinMin's inflation forecast, PMI and bond auction

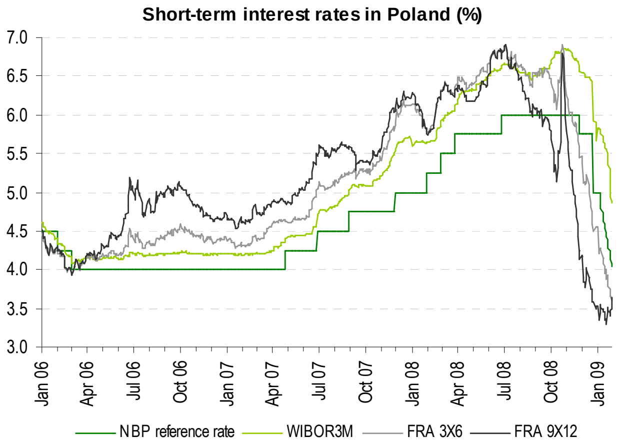


▪ Publication of the January's inflation forecast by the Ministry of Finance will take place on Monday. We forecast that CPI inflation fell in January to 3.1%YoY, market consensus is at 2.9% and indeed we think the risk to our forecast is on the downside.

▪ PMI activity indicator will be released on Monday and another drop is expected by the market. On the hand, we think there is a chance for a better result, after recent releases of slight improvement in euro zone indices. Nevertheless, the set of monthly data to be released later during the month will be disappointing, pointing to very low GDP growth in 1Q09.

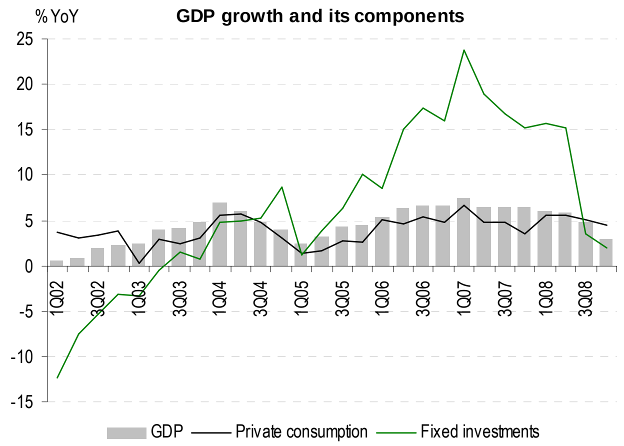
▪ On Wednesday there will be important event for the bond market – auction of two- and five-year bonds, which will show market sentiment towards Polish paper, especially in the environment of rising fears regarding budget performance and supply of papers this year.

Economy last week – Decisive rate cut by the MPC



▪ The Monetary Policy Council has trimmed main interest rates by 75 bp, reference rate to 4.25%. Such scale of reduction was consistent with our expectations, although was higher than market consensus. The next decisive step of the MPC was justified by quickly deteriorating outlook for the Polish economy, which will accelerate disinflation process. In the face of looming next poor economic data, we expect more monetary easing in coming months and one cannot exclude another move by 75 bp.

▪ Retail sales data released before the MPC meeting were better than market consensus (growth by 6.6%YoY), but only moderately and did not change consumption demand prospects. The unemployment rate was at 9.5% at the end of 2008 (11.2% end-2007). Negative signals on the state of the economy were sent by business climate report by NBP and by consumer climate index published by the CSO.



▪ Preliminary data on GDP in 2008 showed growth by 4.8%. This implies GDP growth by nearly 3%YoY in 4Q08, though after releases of data for December we saw a downward risk for this forecast.

▪ Growth rates for fixed investments and private consumption were higher than our forecasts, while contribution of next exports and stockbuilding was more negative. However, one should remember that whole data for 2008 as a whole are tentative while official data for Q4 alone will be published by the stats office only at the beginning of March.

▪ Monthly data for December, as well as our new forecasts for the next couple of months suggested that our growth forecast of 2% for 2009 was too optimistic and we will present new forecast (closer to 1%) in the upcoming monthly report.

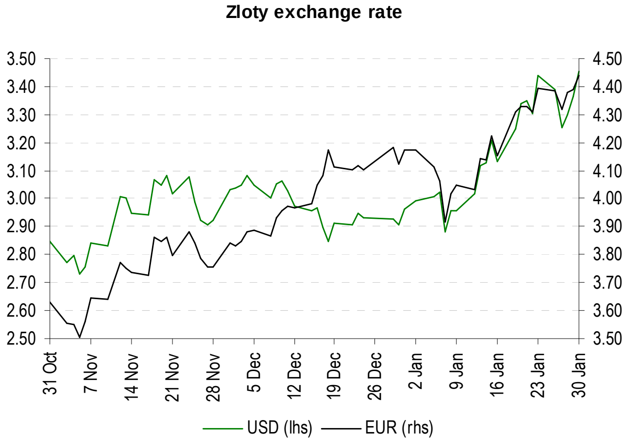
Quote of the week – Interest rates will be gradual?

Andrzej Sławiński, MPC member, PAP, 30 January

The economic growth will be lower in Poland for a few years, which is why the central bank is in a monetary policy easing mode. In December and January interest rate cuts were deep, as there were significant downward revisions of forecasts. Our changes of interest rates will be gradual due to the level of the exchange rate. However, sustaining the balance in the economy is more important. In my opinion the situation will be similar to 2001-2002, and the economic growth significantly weakens though it will be positive and the private consumption will be a stabilising factor. I think that the GDP-growth for the whole year will be at 1-2%.

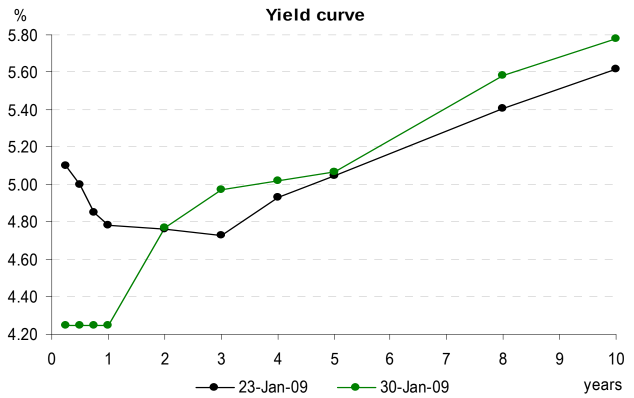
The comment from prof. Sławiński indicates that in his opinion further steps of the MPC should be smaller (more gradual) than „deep cuts" in December and January, which resulted from significant revisions of GDP growth. This suggests that the MPC member expects stabilisation of forecasts of economic activity and his comments show his prediction for Poland's GDP growth in 2009 is in range of 1-2%. A few weeks ago prof. Sławiński was saying about economic growth of ca. 2%, though he pointed to risks of more significant slowdown. Although Andrzej Sławiński opts currently for more gradual moves than 75 bp, he may change view after next round of data and additionally one should remember that majority of MPC members is more willing to ease monetary policy, which is why we see an interest rate cut by 75 bp more probable.

Market monitor



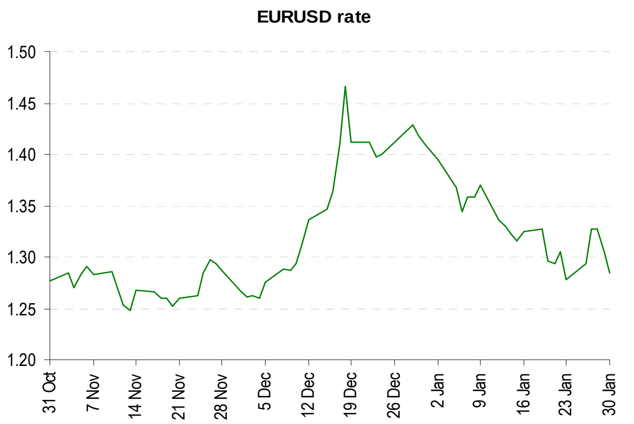
Zloty weaker again

- For the better part of the last week, the zloty exchange rate versus euro remained in wide horizontal range 4.30-4.40. At the end of the week the rate breached the upper end of the band and EURPLN temporarily exceeded 4.47. It took place due to a wave of risk aversion in global markets. At the end of the week, the zloty was 1.1% weaker against euro than one week before. Hungarian forint depreciated even more (3%), while Czech crown slightly appreciated (0.2%).
- This week, the zloty will remain under influence of changes in risk aversion in global markets, however an important factor for the local market may be the result of bond auction. A negative news may lead to rapid surge above 4.50 versus euro, however it still seems that potential for further weakening is currently limited.



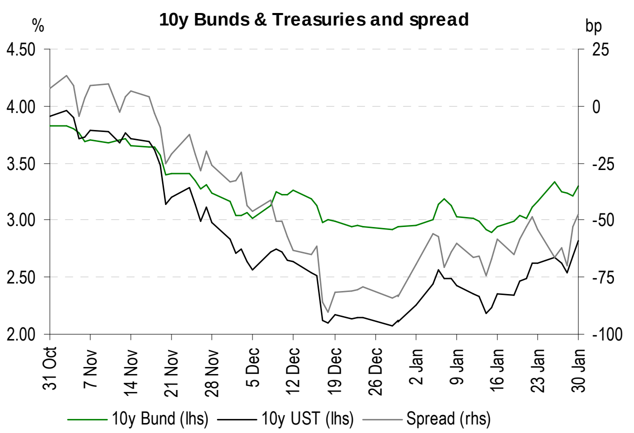
Polish debt curve moving up

- Even though the first half of the week the local yield curve decreased, among others due to decision of the MPC, later on a weakening took place. Apart from profit taking, it was connected with negative impact of concerns over large supply of treasury debt this year and a rise in yields in core markets. In the 5Y segment bond yields went up less than IRS rates, which resulted in a fall in asset swap spread below 60 bp. For 10Y papers the situation was opposite and spread widened to almost 90 bp from 75 one week before.
- This week, local debt markets will be waiting for the bond auction on Wednesday, and will remain under influence of foreign markets. The release of FinMin's inflation forecast and PMI index will probably be in the background.



Large changes in EURUSD

- During the past week there were significant changes in the EURUSD rate, though at the end of the week it was at similar level as compared to the previous Friday. In the first part of the week the US currency weakened along the diminishing risk aversion, and at the end of the week the EURUSD rate recorded a steep fall on rising concerns over global economy. During the week better than expected data from the euro zone (Ifo and economic sentiment index) were supportive for the euro while lower than expected flash HICP inflation was negative.
- This week the EURUSD is going to fluctuate along the changing moods and level of risk appetite in the international financial markets. The most important economic figure for the dollar will be the US non-farm payrolls report.



Further weakening in core debt markets

- The last week brought further rise in yields of bonds in the core markets and the main reason for this has been investors' fear regarding the high supply of treasury papers driven by high budget deficits. This effect was the most visible at the long end of the curve, especially in the US. This tendency was not reversed by the announcement of possibility of buying Treasuries by Fed, and the data on higher-than-expected US GDP growth in Q4 strengthened the correction. During the week yields of 10Y Treasuries and Bunds rose ca. 20 bp and 25 bp to 2.83% and 3.30%.
- This week we can see the upward trend In yields to bring to an end, which would supported by weak economic activity indices (PMI and ISM), as well poor labour market statistics in the US. This may reinforce expectations for further actions by Fed (e.g. buying bonds).

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