Bank Zachodni WBK

Weekly economic update

2 – 8 March 2009

Last days brought stabilisation of the zloty as compared to previous weeks, following positive influence of co-ordinated intervention of central banks in the region in defence of currencies and announcement of support for the region in the form of loan from the World Bank, EBRD and EIB, which offset negative impact of downgrade in Ukraine's rating. Decision of the MPC to lower rates had no visible impact on the zloty. The MPC statement, the NBP projection of inflation and GDP as well as comments from MPC members indicated a room for further monetary easing. In turn, during social summit at the President's Palace, a chance appeared for consensus of all political forces for euro adoption in 2014. In the local interest rate market there was slight fall in IRS curve and in yields of shorter dated bonds while the long end of the curve weakened. At the beginning of this week the key factor for the interest rate market will be the FinMin's inflation estimate for February. We expect slight increase in the CPI inflation to 3.2%YoY, which is consistent with the market consensus. An important gauge of sentiment in the domestic debt market will be auction of bonds. The Poland's PMI will indicate continuation of a downturn in manufacturing. Locally we will also get GDP data for Q4. As regards sentiment towards the region, an important factor will be outcome of the EU summit, which may concern some aid for some of the bloc's economies. The ECB is expected to cut rates at the meeting this week while the key event in the US will be release of the non-farm payrolls report.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (2 March)					
8:00	**PL**	**PMI**	**Feb**	**pts**	**39.2**	**39.3**	**40.3**
9:00	**PL**	**GDP**	**Q4**	**%YoY**		**2.9**	**4.8**
10:00	**PL**	**Auction of PLN300-500m of 26-week and PLN0.7-1.0bn of 52-week T-bills**					
8:58	EZ	Manufacturing PMI	Feb	pts	33.6	-	34.4
10:00	EZ	Flash HICP	Feb	%YoY	1.0	-	1.1
13:30	US	Core PCE	Jan	%	0.1	-	0.0
15:00	US	Manufacturing ISM	Feb	pts	33.9	-	35.6
		TUESDAY (3 March)					
15:00	US	Pending home sales	Jan	%	-3.3	-	6.3
		WEDNESDAY (4 March)					
10:00	**PL**	**Auction of PLN1.5-2.5bn of OK0711 bonds and PLN1-2bn PS0414 bonds**					
8:58	EZ	Services PMI	Feb	pts	38.9	-	42.2
13:15	US	ADP report	Feb	'000	-610	-	-52.2
15:00	US	Non-manufacturing ISM	Feb	pts	41.0	-	42.9
		THURSDAY (5 March)					
10:00	EZ	Revised GDP	Q4	%	-1.2	-	0.6
12:00	GB	BoE meeting - decision	Mar	%	0.5	-	1.0
12:45	EZ	ECB meeting – decision	Mar	%	1.5	-	2.0
15:00	US	Factory orders	Jan	%	-3.0	-	-3.9
		FRIDAY (6 March)					
13:30	US	Non-farm payrolls	Feb	'000	-640	-	-598
13:30	US	Unemployment rate	Feb	%	7.9	-	7.6

Source: BZ WBK, *Parkiet* daily, Reuters

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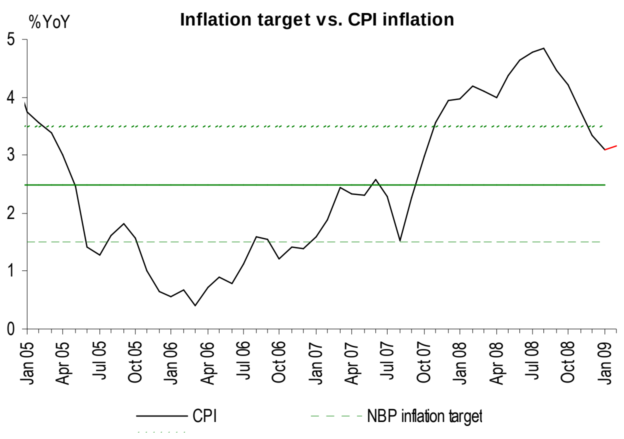
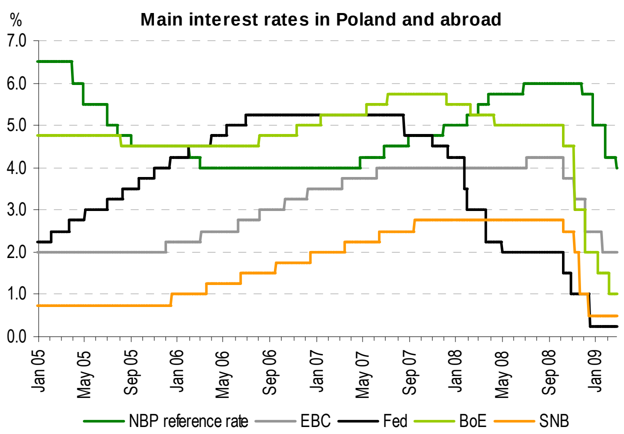
What's hot this week – FinMin inflation forecast, PMI, bond auction, ECB decision



- As usually at the start of the month the Ministry of Finance is going to release inflation forecast. In our view after January decline in February inflation slightly rose to 3.2% r/r, which occurred to be in line with the market consensus.
- The PMI index to be released at the start of the week for domestic manufacturing index is going to show decline, though it will stay above the record low December level.
- According to our estimates the GDP growth rate in Q4 was at 2.9%YoY, with private consumption growth at o 5.4%YoY, investments growth at 3.8%YoYr and negative contribution of net exports. However, in our view there is a risk the GDP growth in Q4 and in the whole 2008 may be below initial estimates.
- Amid stabilisation of the zloty it may be easier for the Ministry of Finance to sell the government securities.

Economy last week – MPC cut rates by 25 bp, possible agreement on euro adoption



- The MPC lowered interest rates by 25 bp, reference rate to 4.0%, and smaller scale of reduction in rates than we assumed may result from weaker zloty. In our view the continuation of interest rate cuts is justified with deteriorating economic situation, which improved inflation prospects (it was confirmed by new CPI and GDP growth projections), even despite weaker zloty. We expect the Council will continue to reduce rates in steps of 25 bp.
- The CSO data on retail sales for January (nominal growth of 1.3%YoY) proved slightly better than expected, but confirmed clear fall in sales growth rate. Also other data, being a hint for consumption demand, were not optimistic. CSO data confirmed record strong monthly rise in unemployment in January (to 10.5%). Moreover, February saw further significant deterioration in consumer confidence, which seems to reflect further weakening in labour market.

Projections in *Inflation reports*

GDP	Feb 08	Jun 08	Oct 08	Feb 09
2009	3.5-6.1	3.4-6.2	1.9-3.7	0.3-1.9
2010	3.6-6.9	3.8-6.8	2.7-4.5	1.2-3.3
2011	-	-	-	2.5-4.8
CPI	**Feb 08**	**Jun 08**	**Oct 08**	**Feb 09**
2009	2.6-4.9	2.5-5.8	3.9-5.7	2.5-3.9
2010	2.1-4.8	0.1-5.7	1.9-4.5	0.5-3.2
2011	-	-	-	-0.9-2.6

Note: According to the NBP projection, GDP growth and CPI inflation will be in the indicated ranges with probability of 50%.

- NBP Inflation Report showed GDP growth this year will reach 1.1% close to our forecast. We are slightly more optimistic regarding the GDP growth assuming 2.8% in 2010 and 4.2% in 2011. The NBP projection envisage widening of demand gap in 2009-2010 and slight narrowing of the gap only in 2011. The inflation projection indicates this year's CPI inflation above our forecast (ca. 2.5%). Predicted inflation drop in next years, along with much lower growth rate in unit labour costs, is quite optimistic and suggest much room for further monetary easing.
- According to press news during a meeting at President's Palace a chance appeared for a joint strategy of all political forces for euro zone entry (with target date of January 1, 2014 after the ERM2 entry in autumn 2010 without referendum and after changes in the constitution already this year).

Quote of the week – One should assume rates will be cut

Andrzej Sławiński, MPC member, Radio PiN, 26 February

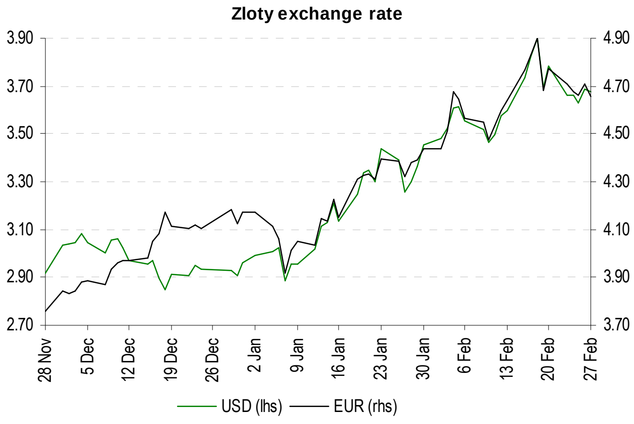
Interest rates are adjusted to forecasts. Unfortunately we have to assume that the forecast may change further. For now one should presume so [that interest rates will be cut] in some perspective. Monetary policy easing is natural in a significant and probably long-lasting slowdown, so as the economy had better chances to go back to potential growth path in some time. The scale of rates reduction is small as compared to what we see in forecasts, due to turmoil in the FX market, constant speculation against emerging market currencies. In this situation the interest rates changes is not a reason but just an pretext for speculation.

Marian Noga, MPC member, Reuters, 25 February

We are still in an easing mode. I do not rule out one or two small interest rate cuts by 25 bp, inter alia due to zloty weakening. I would prefer to take wait-and-see approach after today's rate cut, but I a realist.

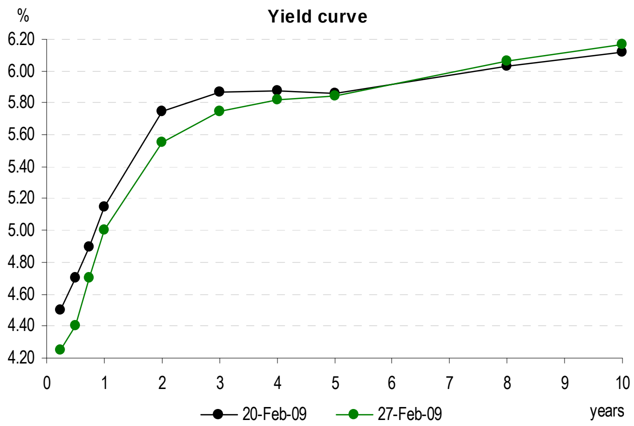
The tone of the Council members comments after the decision to cut rates was rather dovish. In the view of „moderate" A. Sławiński the monetary policy easing should be continued, as this will be an answer to the economic slowdown. In his opinion interest rate cuts are not a reason for zloty weakening, though some market players use them as an argument for speculation. Therefore according to A. Sławiński the dynamic in the FX market influences the scale of each interest rate cuts. „Hawkish" Marian Noga suggests, that there will be majority for further rates reduction at the next meeting, though he would prefer to wait for the development of events. In the opinion of another "hawk" Dariusz Filar one should not create excessive expectations of interest rate cuts as this could lead to further zloty depreciation.

Market monitor



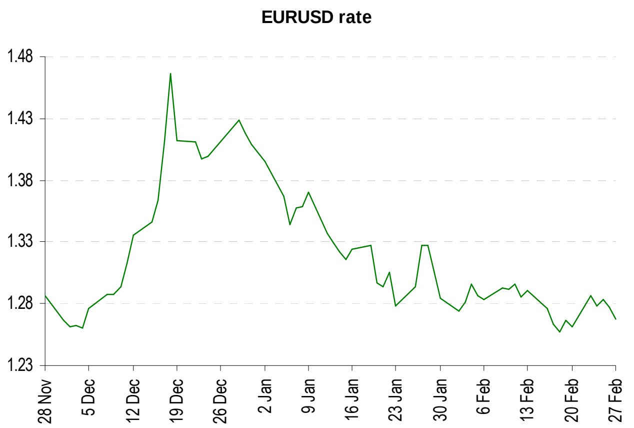
Zloty stabilises after verbal interventions in the region

- At the beginning of the week, the co-ordinated verbal intervention of central banks in the region led to strengthening of currencies in the region with euro rebound versus the dollar. Later in the week the zloty lost due to downgrade in Ukraine's rating and weak data from the US with dollar's gains to the euro. Towards the end of the week the domestic currency was supported by information about financial aid for the region from World Bank, EIB and EBRD.
- We keep our view that the zloty should become more stable in the near term being supported by verbal interventions, sale of foreign currency by the FinMin and later the zloty should appreciate with EURPLN moving towards 4.40. However, if there is intensification of the risk aversion, one cannot exclude new record lows of the zloty.



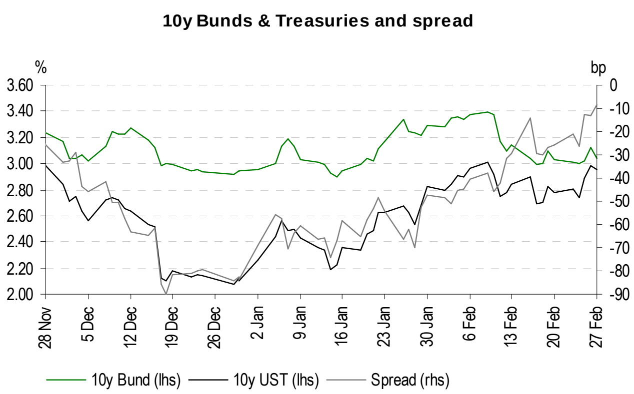
Strengthening at the short end thanks to the zloty

- In the local interest rate market there was strengthening in the first part of the week, which was connected with the zloty rebound. Retail sales data and MPC decision consistent with market consensus had little impact on the market. In the second part of the week there was fall in IRS curve and at the same time weakening of longer dated bonds
- Our scenario of further rate cuts (in 25bps moves to 3% by June) should be supported by weak economic data (this week's PMI). The debt market will be also driven by the FinMin's inflation estimate and results of the bond auction, which will show the ministry's ability to cover the state's borrowing needs. However, the key factor will be a level of global risk aversion and sentiment towards the region as well as the zloty performance. With gradual zloty gains, the local interest rate market should strengthen.



Dollar stronger again to the euro

- EURUSD was traded within relatively narrow range over the past week. After strengthening of the single currency at the beginning of the week, later on the dominating tendency was fall in EURUSD due to worsening moods in the global markets and publication of weak macro data in the euro zone and the US as well as news from S&P that the number of downgrades in rating this year may be higher than in the previous one. Negative news were partly offset by positive influence of comments from B. Bernanke about no need to nationalise US banks and positive tone of B. Obama's comments. At the end of the week EURUSD was 1.266.
- We expect that the dollar will remain strong and EURUSD will fluctuate around the current level for longer time amid publication and next weak macro figures and rate cuts by the ECB and the Bank of England.



Core debt markets little changed

- In the core debt markets there was weakening for the better part of the week due to persisting concerns about large debt supply (large bond issuances in the US last week), even despite new lows in the US stock market. Information towards the end of the week about purchase of a part of Citigroup by the US government increased appetite for safe assets and large downward revision in the US GDP data for Q4 strengthened bonds. Yields of 10Y Treasuries and Bunds rose to 2.96% and 3.04% from 2.77% and 3.03% a week earlier.
- This week the key events for the core debt markets will be decision and statement from the ECB, economic activity indices from the euro zone and the US, and of course the US non-farm payrolls report.

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