Bank Zachodni WBK

Weekly economic update

23 – 29 March 2009

Decision to increase measures of quantitative monetary easing by Fed had only temporary positive impact on markets, which after reconsideration saw more threats than benefits of the central banks' decision, pushing stock prices lower again. In effect, after a period of zloty strengthening, last week saw a correction and profit taking that we anticipated last Friday. One should be aware that in the short fun volatility of the zloty may remain high, and a main factor determining currency movements will be moods in international markets and risk aversion. However, we still expect that the zloty should be gradually gaining strength.

Data released in Poland last week confirmed that economic growth decelerated sharply in recent months, although at the same time they delivered some arguments for hawks (production slightly above forecasts, surge in PPI). In our view, there is still enough arguments in favour of continuation of monetary easing, so that the MPC may decide to apply another 25 bp rate cut. Data that will be released one day before the MPC decision are expected to confirm a clear deceleration in retail sales (consumption demand) and rise in unemployment, which will be also in favour of next interest rate cut.

As regards data abroad, US housing market data will be in the foreground, together with German Ifo index and euro zone's PMI activity indices.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (23 March)					
09:00	**PL**	**Auction of PLN1.3-1.6bn of 26-week T-bills**					
14:00	US	Home sales	Feb	m	4.45	-	4.49
		TUESDAY (24 March)					
8:58	EZ	PMI manufacturing – flash	Mar	pts.	33.6	-	33.5
8:58	EZ	PMI services – flash	Mar	pts.	39.2	-	39.2
10:00	EZ	Industrial new orders	Jan	%YoY	-28.9	-	-22.3
13:00	**PL**	**Retail sales**	**Feb**	**%YoY**	**-1.3**	**0.3**	**1.3**
13:00	**PL**	**Registered unemployment rate**	**Feb**	**%**	**10.8**	**10.9**	**10.5**
14:00	US	Home price	Jan	%YoY		-	-8.7
		WEDNESDAY (25 March)					
	PL	**MPC meeting – decision**		**%**	**3.75**	**3.75**	**4.00**
9:00	DE	Ifo index	Mar	pts.	82.2	-	82.6
12:30	US	Durable goods	Feb	%MoM	-2.0	-	-4.5
14:00	US	New home sales	Feb	m	0.3	-	0.309
		THURSDAY (26 March)					
7:00	DE	GfK index	Apr	pts.	2.6	-	2.6
9:00	EZ	M3 money supply	Feb	%YoY	5.6	-	5.9
12:30	US	Jobless claims	w/e	k	650.0	-	646.0
12:30	US	Core PCE	Q4	%	0.8	-	0.8
12:30	US	GDP final	Q4	%	-6.5	-	-6.2
12:30	US	GDP deflator	Q4	%	0.5	-	0.5
		FRIDAY (27 March)					
12:30	US	Core PCE	Feb	%MoM	0.1	-	0.1
13:55	US	Michigan index final	Mar	pts.	56.8	-	56.3

Source: BZ WBK, *Parkiet* daily, Reuters * market consensus before release of CPI data

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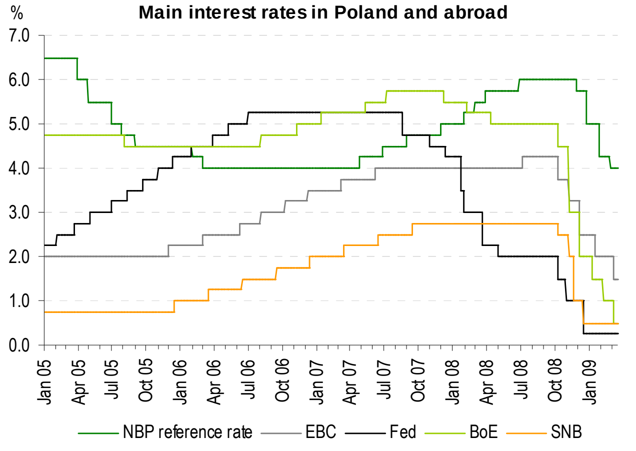
What's hot this week – Next weak data and MPC decision



▪ The key event on the domestic market this week will be the MPC meeting. A series of economic data confirmed a significant slowdown of the Polish economy at the beginning of the year, Also, we saw another set of changes in forecasts by international institutions(IMF, World Bank), as well as information on further monetary easing abroad. Therefore, we expect the MPC to continue cutting rates – 25 bp reduction would be consistent with market consensus.

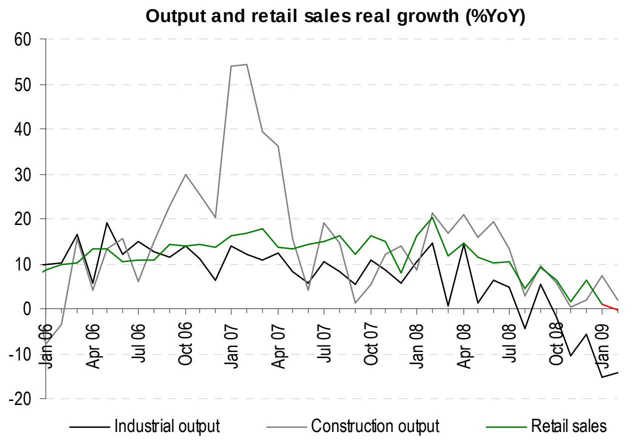
▪ This week's data on retail sales and unemployment will support such a decision, as they will confirm (even if we see a bit higher sales figure as compared to consensus) a significant weakening in consumption demand amid deterioration in labour market conditions.

▪ It cannot be ruled out that the MPC will also take a decision to lower obligatory reserve requirement, which was suggested recently by a few MPC members

Economy last week – Economy loosing steam

▪ Data from the labour market were roughly consistent with market consensus, confirming a continuation of negative tendencies. In February, for the first time since end-2004, the negative annual rate growth of employment was recorded (-0.2%). At the same time wage growth slowed down significantly to 5.1%YoY. It is clear that deterioration of economic situation on companies level transfers into the households' sector, which will affect consumption growth in the remainder of the year.

▪ February's fall in industrial output (by 14.3%YoY) was a bit lower than forecasted, but significant enough to confirm a sharp slowdown in economic activity in 1Q09. This was mainly connected with a slump of external demand, as in export-oriented branches the fall was at 20-30%YoY. Domestic demand slows down as well, which was shown by construction output growth of a mere 1.2%YoY.



▪ Data on financial results of companies In the fourth quarter showed a significant deterioration. Net profit fell to below zero from PLN20bn recorded in 3Q08.

▪ PPI increase in February exceeded all expectations, accelerating to as much as 5.4%YoY (market consensus was at 3.4%). This was influenced by several factors: increase of commodity prices denominated in PLN, strong statistical effect of zloty depreciation on export prices denominated in PLN, higher fuel prices. Though there are some effects of weak zloty on domestic manufacturing prices, the impact on consumer prices should be limited amid low demand.

▪ Core inflation measure defined as CPI excluding fuel and food prices amounted to 2.2% in January and 2.4% in February.

Quote of the week – Exchange rate won't stop MPC from cutting

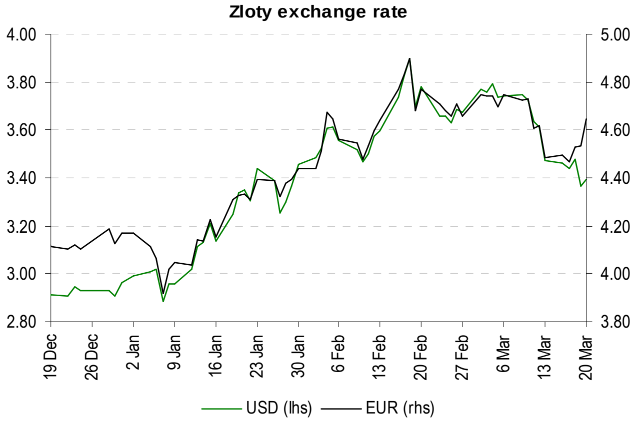
Andrzej Wojtyna, MPC member, Rzeczpospolita, 18 March
As long as the zloty strengthening is not more significant, room for monetary policy form the point of view of further easing is limited. The range for decisions is between keeping rates unchanged and rate cut by 25 bp.

Jan Czekaj, MPC member, Reuters, 17 March
Taking into account tendencies In the real sphere of the economy, it seems to me that maintaining easing bias In monetary Policy is reasonable. This does not mean that we will decide to cut rates on each meeting. As regards the next decision, we will take it basing on production figure. Also, Exchange rate fluctuations will be important for the Council's decision.

Marian Noga, MPC member, Gazeta Prawna, 16 March
W are In the cycle of interest rates reductions. From this point view reduction in March is quite possible. However (...) I personally see no particular reasons to say that next rate should take place in March.

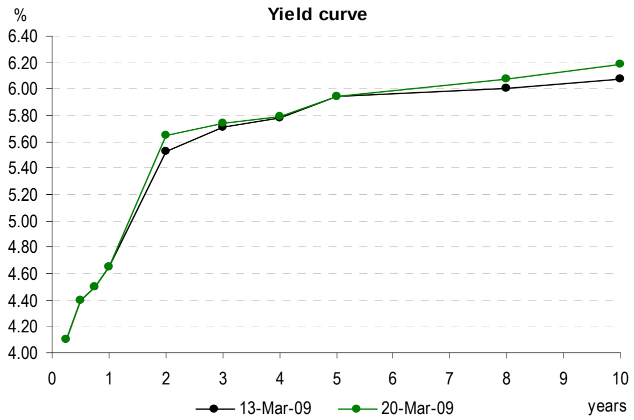
Just before one-week black out period for MPC members in terms from their media activity, ahead of the MPC meeting, a few comments by MPC members appeared. They showed that the situation on the foreign exchange market will have important impact on the decision. Minutes of the February's meeting showed that this was the case also in the previous month. Comment by Wojtyna suggests that if not weak zloty the Council could have considered a reduction deeper than 25 bp. However, the zloty recovery observed last month proved only temporary and the Polish currency is still very vulnerable. Though it is worth to notice that today the EURPLN is below levels observed at the end of February, when the MPC decided on rates. Then it was not argument significant enough to stop MPC from cutting rates and we think this time the outcome of the meeting will be the same.

Market monitor



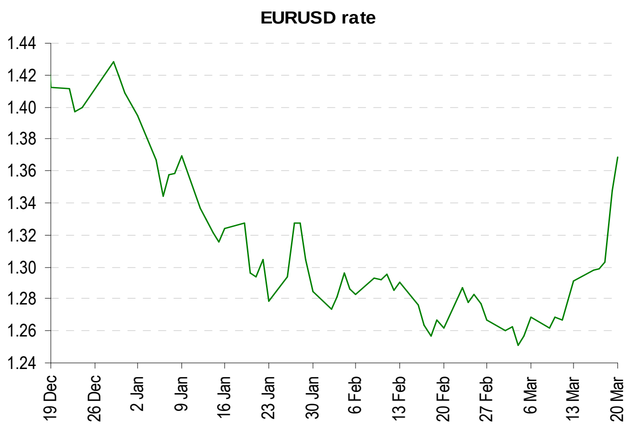
Ups and downs of the zloty

- Foreign exchange market witnessed swinging moods last week. After good start of the week and positive impact of Fed decision on currencies in the region, there was a sharp sale-off and profit taking that we anticipated last week. In effect, EURPLN swung between 4.42 on Monday and 4.68 on Friday noon; afterwards, the zloty returned to 4.57 at the end of the week.
- Amplitude of zloty fluctuations will remain high, however we still believe that a trend of gradual appreciation should predominate. EU decision about doubling funds for fighting crisis in non-eurozone member states should favour improvement in moods in near term.



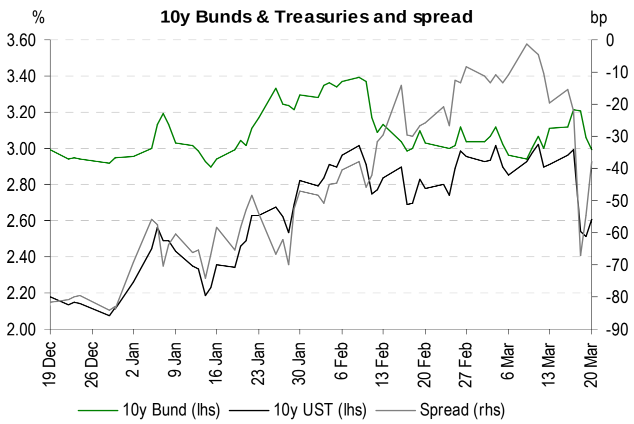
Bond yields higher

- Weakening of the zloty triggered also a rise in bond yields in the domestic debt market. Also, IRS and FRA rates went up during the week. At the end of the week, there was a rebound and in effect almost all losses from the previous days were erased.
- Until Wednesday, money market and fixed income market will remain idle in expectation for the MPC decision. Interest rate cut by 25 bp predicted by us and a statement that will probably not rule out further cuts should be positive for the yield curve. Yields may additionally decrease if the zloty appreciation that we anticipate takes place.



Dollar sinks after Fed decision

- Dollar plummeted last week after announcement of Fed decision that induced investors to seek other places to invest capital. The biggest appreciation versus the dollar took place in case of currencies of commodities-producing countries (e.g. Norwegian crown), as prices of crude oil, gold, and other commodities surged after Fed decision.
- Recently, EURUSD was relatively little responsive to publication of macroeconomic data. However, publications planned for this week will be important for outlook of US and euro zone's economies (in Europe Ifo and flash PPI, in US home sales).



... and bond yields in core markets falling down

- After FOMC decision about expanding scale of Treasuries purchases in quantitative easing operations, bond yields in the US fell down dramatically, being followed by similar moves in the core European markets.
- Concerns about size of debt supply in developed countries are still high, which remains factor putting a pressure on core debt markets. On the other hand, awareness of Fed's future purchases of Treasuries will create a cap for bond yields. Further moves will depend heavily on moods in stock markets and risk aversion, and the latter will be influenced by data about US home sales and economic activity in the US and euro zone.

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