Bank Zachodni WBK

Eyeopener – Bernanke will speak

18 July 2007

- **Zloty stable, bonds after slight strengthening returning to Monday's levels**
- **Switch auction today, international markets will focus on Bernanke's speech and US CPI data**

Situation in the domestic FX market was quite stable throughout the day. At the start of the session there was a slight depreciation of the zloty and till the end of the day Polish currency was slightly weaker than at the opening. The EURPLN rate rose to 3.752, while the USDPLN rate increased to 2.722.

On the other hand in the fixed income market bonds prices were quite significantly above the Monday closing level. However at the end of the session the market weakened and yields partly returned to the levels recorded the day before. The market reaction to Monetary Policy Council members' comments was limited.

Andrzej Sławiński, which is perceived by the market as a moderate member stated yesterday that high economic growth was maintained and high level of capacity utilisation may make running of monetary policy difficult, while high wage growth was going to be a challenge as well. In his opinion a strong inflation growth is not a threat, however the monetary policy most probably would have to be tightened. Andrzej Sławiński emphasized the importance of unit labour costs, which were crucial for the prospect of the long term economic growth and he pointed that the relation between wages and productivity gains may deteriorate. Another MPC member Mirosław Pietrewicz said that one could not exclude more rate hikes, however it does not mean that it may occur in July. On the other hand Dariusz Filar informed he took into account that the full set of data for July may argument in favour of continuation of monetary policy tightening, though after the rate hike in June the Council has more leeway. Dariusz Filar emphasized the importance of data for Q2, the GDP and wages growth in the whole economy as well as inflation expectations. In his view the monetary policy tightening cycle would probably be continued in the first part of 2008, while the GDP growth would reach potential level at the end of 2008. In an interview for PAP, Andrzej Wojtyna said that the rate hikes delivered so far may be not enough, and the bias of monetary policy was still restrictive. He pointed that "there was no time patterns, as far as the date of interest rate hikes is concerned, e.g. if rates were raised in April and June it does not automatically mean that next one was going to be in August". On the other hand Wojtyna underlined that the current state of the economy does not arouse much concern, as the economic growth is balanced (despite symptoms of overheating in construction) and it is likely that the scale of interest rate hikes is going to be moderate. Wojtyna would prefer rate hikes in 2008 were not necessary any more. Comments of the MPC members seems to prepare the market for the next interest rate hike, however the main question is whether it is in July or in August. In this context it is worth to notice the Wojtyna comment on the lack of time pattern, which may suggest earlier decisions. In our view however it is more probable next rate hike will follow in August, as the MPC members will acquaint with large part of quarterly data for Q2, which may confirm asymmetric distribution of risks for medium-term inflation prospects to the upside.

Despite many data publications on the international markets the dollar exchange rate did not change much during Tuesday's European session. In the morning economic activity index for the German economy (ZEW) was released and it fell to 10.4 in July in comparison with 20.3 in the previous month and expectations at 19.0. The figure led to moderate and short-term euro depreciation. Data on US producer prices showed a fall by 0.2%MoM in June, which was the result of decrease in energy and food prices. The market expected increase by 0.2%. The core PPI index rose by 0.3%MoM, which was slightly above expectations at 0.2%. On annual basis the indices amounted to 3.3% and 1.8%, respectively. Also, industrial production was released and it rose in June by 0.5%MoM (and 3.4%YoY), which was slightly above market consensus at 0.4%. Capital flows data showed high inflow of long-term capital to the US in May - US$126.1bn as compared to 80.3bn in the previous month and expectations pointing to a fall to 70bn. Overall, the data published in the US were quite positive for the stock exchange and investors decided to buy equities, while mood for bonds deteriorated. Yields of ten-year Treasuries rose from 5.05% to 5.09% during the day, while the change for Bunds was slightly lower - rise by 2 bp to 4.59%. However, the trend reversed after the close in the European market, as another wave of negative information as regards American hedge funds caused increase in global risk aversion. As a result, bond markets recovered and today in the morning yields of ten-year Treasuries and Bunds amounted to 5.03% and 4.55%, respectively. Also, overnight the dollar significantly depreciated and the EURUSD rate hit the new record-high at 1.3833.

Today at 9:00 GMT the switching auction will take place. Local investors will be awaiting Thursday's data about production and PPI and MPC minutes. Investors on international markets will focus on the US CPI data for June. Analysts predict a rise by 0.2%MoM after 0.1% in May. At the same time, data from the American housing market will be released. Market consensus shows a decline in new house sales in June to 1.46m units from 1.474. Sentiment abroad could be also affected by the speech of Fed governor Ben Bernanke who testifies in the Congress at 14:00 GMT. Bernanke could retail a hawkish tone, however any potential remarks about slowdown in economic activity or improvement in core inflation could negatively affect the dollar.

Today in the morning the EURPLN was at 3.752 and USDPLN 2.71.

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F/X rates (today's opening)

EURUSD	1.3813	CADPLN	2.5978
USDPLN	2.7162	DKKPLN	0.5033
EURPLN	3.7520	NOKPLN	0.4731
CHFPLN	2.2608	SEKPLN	0.4084
JPYPLN*	2.2292	CZKPLN	0.1327
GBPPLN	5.5280	HUFPLN	1.5242

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.7479	3.7540	3.7489	3.7490	3.7535
USDPLN	2.7227	2.7262	2.7192	2.7194	2.7223
EURUSD	1.3763	1.3796	1.3786	1.3786	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0709	**5.07**	**-5**	4.04	4.694
5Y	PS0412	**5.46**	**0**	20.06	5.48
10Y	DS1017	**5.58**	**-1**	11.07	5.658

IRS rates (Mid)

TERM	PL %	PL Change (bp)	US %	US Change (bp)	EA %	EA Change (bp)
1Y	5.26	-1	5.43	2	4.67	1
2Y	**5.49**	**1**	5.39	3	4.79	3
3Y	5.56	-2	5.43	3	4.82	3
4Y	5.60	-3	5.49	3	4.84	3
5Y	**5.62**	**-4**	5.53	3	4.85	3
8Y	5.63	-4	5.68	5	4.88	4
10Y	**5.63**	**-4**	5.72	3	4.92	4

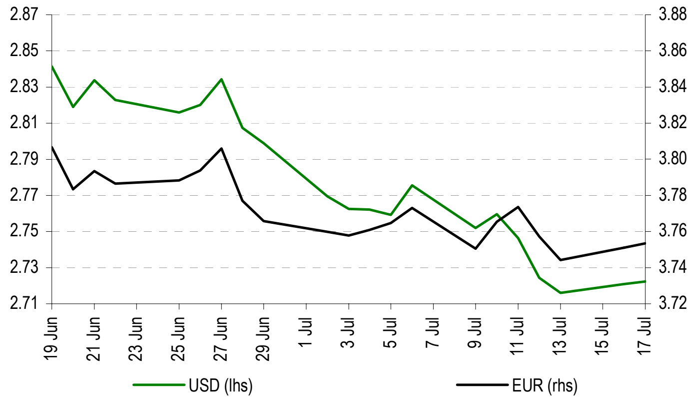
WIBOR rates

TERM	%	Daily change (bp)
O/N	4.63	1
T/N	4.63	0
SW	4.65	1
2W	4.66	0
1M	4.68	0
3M	4.76	0
6M	4.93	0
9M	5.12	0
1Y	5.25	1

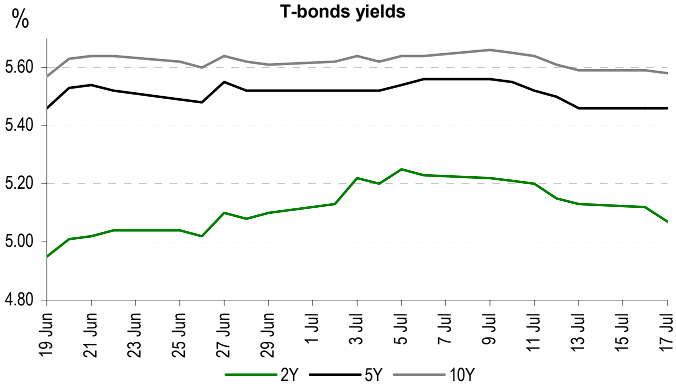
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	4.75	-2
3X6	5.02	0
6X9	5.32	-1
9X12	5.45	-5
3X9	5.19	-2
6X12	5.42	-3

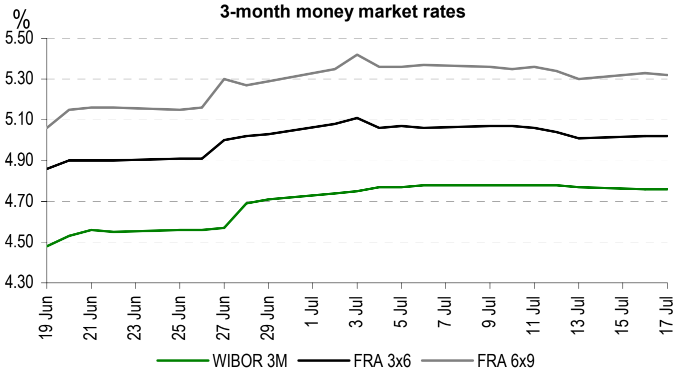
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



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