

Eyeopener – This is the (coalition's) end?

13 August 2007

- On Friday the zloty and bonds roughly stable despite continuing sale-off on the stock markets
- Today, data about balance of payments due; the key data this week will be about CPI and wages, as well as inflation and house sales in the US
- Prime Minister announcing election in the autumn

On Friday, despite general fall in risk appetite and high uncertainty on world financial markets, local FX and bond markets were quite stable, while deep correction took place on the Warsaw Stock Exchange. The zloty even gained slightly against euro to 3.778 and fell a little against dollar to 2.763. Activity on the bond market was rather limited and yields remained almost unchanged as compared to Thursday's close. Dariusz Filar, the most hawkish MPC member, said on Friday that the Council should act immediately in order to prevent inflation rise in 2008, as the data about wages in 2Q07 showed in his opinion that inflationary pressure was building. Those comments did not have any impact on the market.

After significant fluctuations during the entire week and notable appreciation against the euro on Thursday, the dollar was fluctuating in a narrow range on Friday. At the end of local session the EURPLN stood at 1.369, slightly above opening. Data releases in the US receded to the background amid persisting global risk aversion and high uncertainty on world markets. US import prices rose 1.5%MoM in July against expected 1%. After excluding fuel prices the rise was at 0.3%. The data could be a reason of concern for the American central bank that is still afraid that inflation may not moderate as expected. The major world central banks continued injecting liquidity to the financial markets on Friday in order to maintain normal markets functioning; this allowed for some reduction in short-term money market rates. Because of turbulences on the financial markets and high liquidity injections delivered by the ECB, the market trimmed expectations for an interest rate hike in the euro zone in September. At the same time, there was a rise in expectations for a rate cut in the US. At the end of European session, yields of 10Y Treasuries and 10Y Bunds were at 4.76% and 4.35% correspondingly, slightly above morning levels.

Today at 12:00 GMT, data about June's balance of payments will be released. According to our forecast, the current account gap declined to €917m from €1/2bn in May. Market consensus shows even smaller deficit, at €829m. Improvement in current account balance was in our view accompanied by deteriorating in trade balance and improvement in current transfers. We estimate that trade deficit rose to ca. €817m from €734m, while the market predicts advance to €491m. Rise in trade gap should take place amid slowdown in export growth to 9.4%YoY

and acceleration in import growth to 18.3%YoY. As regards current transfers, the low level in May was probably a one-off effect.

The key data of the week will concern CPI inflation (on Tuesday) as well as wages and employment in enterprises (on Thursday). We estimate that the CPI index rose by 2.3%YoY, presuming that the food prices dropped by 1.5%MoM, and transport prices slightly rose. The market consensus is set at 2.4%YoY, which is in line the MinFin's forecast. Labour market data may be more important for the MPC members, as they will confirm tightening conditions and rising difficulties on the labour costs side. Our forecast points to acceleration of wage growth in July to record-high 9.5%YoY and stabilisation of employment growth at the record-high 4.6%YoY. This would be yet another circumstance in favour of an interest rate hike in August.

The agenda of data releases abroad is also very thick. Today at 12:30 GMT the data about US retail sales will be released. Market consensus shows a sales rise by 0.2%MoM in July against 0.9%MoM drop in the previous month. On Tuesday, GDP data for the euro zone will be released, as well as trade balance and PPI in the US. On Tuesday, the market will focus on US CPI numbers. We will also see NY Fed index, capital inflow data and industrial output figures. On Thursday, HICP inflation in the euro zone will be released, important data from US housing market, and Philadelphia Fed index. On Friday, Michigan sentiment index will be published.

Today, important political decisions may be announced. During the weekend, the PiS' Political Council agreed for snap election scenario and authorised the Prime Minister to take all necessary decisions in this regard. According to press information, today all ministers from coalition League and Samoobrona (LiS) may be dismissed and the motion about parliament's self-dissolution should be backed by both PiS and PO at the Sejm meeting on 6 September. According to the PM Jarosław Kaczyński, the elections could be held on 21 October, or in November at the latest.

We still presume that the sentiment toward the emerging markets currencies may lead to zloty depreciation. However, despite that we decided to lower our forecasted ranges of zloty exchange rates this week to 3.75-3.85 for the EURPLN rate and 2.71-2.81 for the USDPLN rate. CPI data may be supportive for bonds market, but strong data about wages and employment could trigger slight correction at the end of the week. Today in the morning, the zloty was at 3.77 against euro and 2.75 against dollar.

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F/X rates (today's opening)

EURUSD	1.3685	CADPLN	2.6142
USDPLN	2.7533	DKKPLN	0.5062
EURPLN	3.7683	NOKPLN	0.4727
CHFPLN	2.2943	SEKPLN	0.4065
JPYPLN*	24.0000	CZKPLN	0.1344
GBPPLN	5.5675	HUFPLN	1.4963

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.7720	3.7839	3.7830	3.7780	3.7775
USDPLN	2.7526	2.7700	2.7526	2.7625	2.76
EURUSD	1.3641	1.3698	1.3665	1.3677	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0709	5.22	0	1.08	5.185
5Y	PS0412	5.52	-1	20.06	5.48
10Y	DS1017	5.58	-1	11.07	5.658

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	5.34	0	5.13	1	4.62	0
2Y	5.55	1	5.03	1	4.60	-2
3Y	5.61	0	5.09	0	4.61	-4
4Y	5.63	-2	5.17	4	4.62	-3
5Y	5.63	-1	5.26	4	4.64	-3
8Y	5.62	-2	5.43	5	4.70	-1
10Y	5.62	-2	5.52	6	4.75	-2

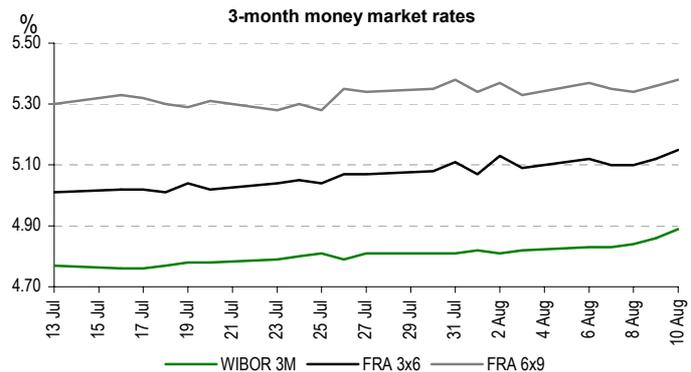
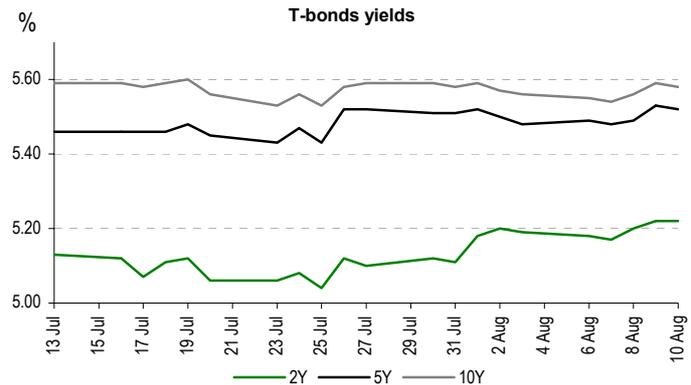
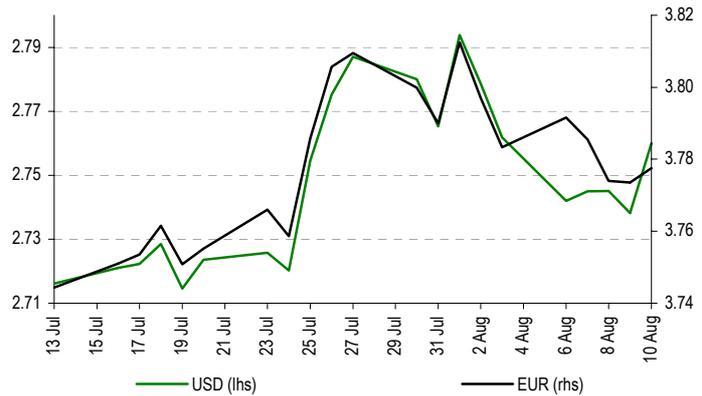
WIBOR rates

TERM	%	Daily change (bp)
O/N	4.65	2
T/N	4.66	1
SW	4.68	1
2W	4.69	1
1M	4.74	1
3M	4.89	3
6M	5.06	4
9M	5.23	4
1Y	5.35	4

FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	4.82	1
3X6	5.15	3
6X9	5.38	2
9X12	5.56	1
3X9	5.30	2
6X12	5.50	1

Zloty exchange rate (fixing)



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