

Eyeopener –CPI weakens expectations of hikes

14 September 2007

- Slight weakening of the zloty, significant strengthening in the domestic fixed income market in reaction to much deeper than expected fall in inflation
- Today we will get monetary statistics for August, but the key focus of attention will be the US data

On Thursday the zloty experienced a slight weakening. Before noon the domestic currency slightly depreciated against the euro and the dollar, to 3.782 and 2.723 respectively, and then remained stable till the end of the day.

Yesterday the key event in the Polish financial market was release of CPI data for August. The numbers showed inflation deceleration to 1.5%YoY from 2.3% in July after a drop in prices by 0.4%MoM. This result was much below analysts' forecasts, also ours, though our forecast was below the market consensus. The much deeper than expected fall in inflation led to significant strengthening in the domestic fixed income market. FRA rates and bond yields fell by a dozen or so basis points against the Wednesday closing and against levels before the data release. The figures did not have much influence on the zloty. The CPI figure was covered in detail in our *Instant comment*, which was released yesterday. The deputy finance minister Katarzyna Zajdel-Kurowska said that the ministry's estimates point to increase of inflation to 1.9%YoY in September (our preliminary forecast points to 1.8%YoY), while at the end of the year inflation may be below the inflation target (we predict inflation will be slightly above the target).

After the inflation data were released two MPC members, Mirosław Pietrewicz and Marian Noga were interviewed by the Thomson Financial. The former, one of the "dovish" members of the MPC, said that it may turn out that the rises in interest rates the MPC made this year would be enough, as the released data give the Council a comfortable position and time to observe the situation calmly. Marian Noga, which is perceived as a "hawk" in the Council kept his view that interest rates should be raised to 5.5% from the current 4.75% level till the middle of the next year, as in his opinion the released data did not change the picture of the economic situation. However, in an interview with Reuters Noga stated that he saw possibility of interest rate cuts in the second half of 2008.

The deputy finance minister Elżbieta Suchocka-Roguska said yesterday that due to higher than expected revenues and lower spending the central budget recorded a surplus of PLN275m after August. Better budget realisation enables limiting the deficit for the whole year to PLN23bn against the planned PLN30bn.

Thursday morning the dollar saw a further depreciation against the euro with the EURUSD rate reaching 1.392, the highest level in history. As stock indices continued rising trend and risk appetite slightly increased, the core bond market saw increase in yields. This was also connected with better than expected data from the US labour market. The initial jobless claims amounted to 319 thousands last week as compared to 315 a week before. Expectations pointed to a rise to 325 thousands from 318. What is more, the biggest player on the US mortgage credit market, Countrywide Financial Corp, informed about a possibility of finding additional source of funding, which limited concerns as regards the credit market. Yields have been increasing also in awaiting for the auction of 10-year bonds. 10-year papers saw increases in yields to 4.49% from 4.41% and to 4.17% from 4.11% as regards Treasuries and Bunds.

Yesterday the Swiss central bank quite unexpectedly decided to hike interest rates by 25 bp to 2.75%, while the market consensus pointed to no change in rates.

Today at 14:00 local time money supply data for August will be released. We expect a continuation of fast growth in money supply and total deposits, which be mainly driven by a significant growth in enterprises' deposits. Our forecast indicates money supply to increase by slightly above 15% YoY, which is inline with average market expectations. At the same time, we see a chance for moderate weakening in credit activity, but the annual growth rate should maintain at the level above 30% until the end of the year.

At 09:00 GTM the final inflation data for the euro zone will be released, which according to market analysts should be consistent with preliminary data and would indicate 1.8%YoY in August. Also today, at 12:30 GMT, US import prices data will be published with market expectations pointing to a slowdown from 1.5%YoY to 0.6%YoY. At the same time the most important data release today will take place i.e. US retail sales. Market consensus indicates that retail sales growth accelerated to 0.4%MoM in August from 0.3%MoM in July. The figure will be important as given the crisis in the housing and credit markets, the vital question is as regards possible influence of these factors on consumer confidence. Also, we will get to know capacity utilisation, which according to Wall Street analysts rose moderately to 82% from 81.9%, and data on industrial output, which is expected to show a rise by 0.3%MoM. At the end of domestic session the preliminary Michigan index for September will be released with market consensus at 83.5 pct (up from 83,4 pct in the previous month).

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F/X rates (today's opening)

EURUSD	1.3869	CADPLN	2.6371
USDPLN	2.7274	DKKPLN	0.5078
EURPLN	3.7830	NOKPLN	0.4820
CHFPLN	2.2980	SEKPLN	0.4080
JPYPLN*	2.3687	CZKPLN	0.1378
GBPPLN	5.5122	HUFPLN	1.4894

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.7661	3.7854	3.7747	3.7818	3.7756
USDPLN	2.7116	2.7273	2.7168	2.7235	2.7126
EURUSD	1.3867	1.3924	1.3892	1.3882	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0709	5.15	-13	6.09	5.327
5Y	PS0412	5.51	-15	20.06	5.48
10Y	DS1017	5.59	-13	11.07	5.658

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	5.28	-12	4.99	1	4.64	2
2Y	5.40	-17	4.76	6	4.48	5
3Y	5.45	-17	4.73	4	4.44	5
4Y	5.49	-16	4.78	5	4.44	5
5Y	5.50	-17	4.84	6	4.44	4
8Y	5.51	-16	5.03	6	4.50	3
10Y	5.51	-16	5.12	6	4.55	3

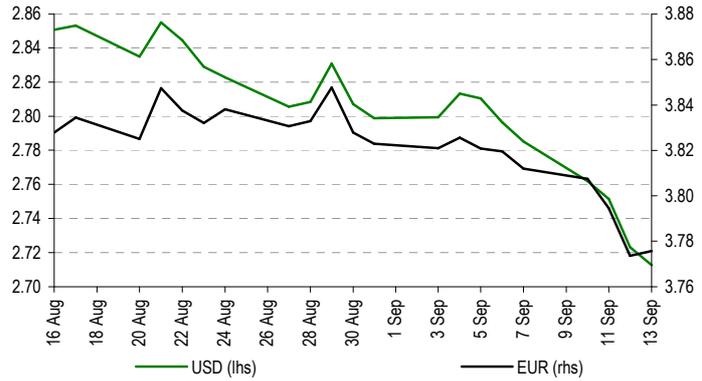
WIBOR rates

TERM	%	Daily change (bp)
O/N	4.90	0
T/N	4.90	-1
SW	4.94	1
2W	4.94	1
1M	4.98	1
3M	5.09	0
6M	5.24	1
9M	5.39	0
1Y	5.50	0

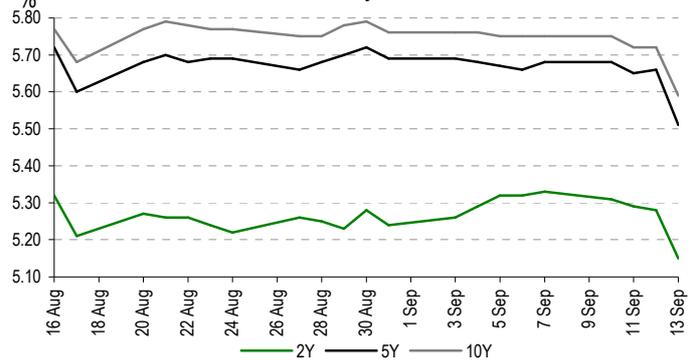
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	4.95	-5
3X6	5.14	-12
6X9	5.21	-17
9X12	5.26	-20
3X9	5.23	-12
6X12	5.28	-17

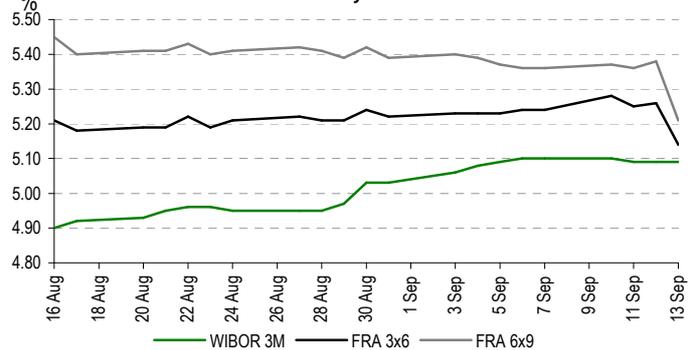
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



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