

Eyeopener – CPI driven up by food prices

15 November 2007

- Zloty slightly weaker, bond yields higher
- October's annual inflation higher than expected, in line with our forecast in monthly terms
- Today, inflation data in the US and euro zone plus American regional activity indices

The Wednesday session in the domestic market was determined by the release of the CPI inflation data. Zloty slightly weakened against the euro and remained unchanged versus the dollar. At the end of the day the EURPLN rate amounted to 3.646, while the USDPLN rate amounted to 2.48. Despite a slight strengthening at the start of the session, at the end of the day bond yields were above the levels recorded at Tuesday closing, as after the release of the inflation data the FRA rates and bonds yields rose by a few basis points.

Inflation in October increased by 3%YoY after a prices rise by 0.6%MoM against a market consensus (according to Reuters) respectively at 2.9%YoY and 0.7%MoM. Our monthly estimate was in line with the released result, though in the annual terms we expected a consumer prices growth of 2.8%. In our view, yesterday's data did not change the assessment of the medium term inflation prospects and did not change our forecasted scenario of monetary policy. The monetary statistics released by the NBP confirmed continuation of recent tendencies. They showed a slowdown of money supply growth in October to 13.6%YoY from 14.4%YoY in September, total deposits to 15.1%YoY from 15.4%, and of loans to 30.4%YoY from 31% (amid a slight slowdown of households credit growth and stabilization of businesses credits). Yesterday the Monetary Policy Council released its opinion to the budget draft for 2008, where it points that the risk of too soft fiscal policy may increase inflationary pressure and contribute to a rise of the restrictiveness of monetary policy. The details of the data released yesterday were presented in our *Instant comment*.

After the release of the inflation data, the MPC member Mirosław Pietrewicz said that it is not certain whether the rising trend in food prices is a long-lasting phenomenon. The MPC member added that the Council does not have to react as there are factors, such as the zloty appreciation, which ease the inflation pressure. One of the most dovish MPC members also said that the MPC could change interest rates again after the release of annual data for the whole 2007, which would be near February, if the trend of rising inflation was confirmed. On the other hand Stanisław Owsiański said that "such level (of inflation) requires rethinking the situation". According to the central banker's opinion, which belongs to the "dovish" camp in the Council, further data are needed to fully assess the

performance of the economy. Earlier, before the CPI data release, MPC member Halina Wasilewska-Trenkner took the floor saying that rate hike in November is very likely and one should take into account further rate hikes. She said that there might be 3-4 rate hikes and the reference rate at the level of 5.75% in realistic. Wasilewska-Trenkner is afraid that inflation may exceed the upper end of the allowed margin of inflation fluctuations around the target in 1Q08. Today in the morning her views were supported by MPC's Dariusz Filar who said that "there is need for decisive and condensed in time actions", because the observed rise in food prices is not a classical supply shock and might be prolonged. Despite more hawkish rhetoric from conservative rate-setters (earlier similar comments were made by MPC's Marian Noga), we do not change the expected monetary policy scenario and predict that after 25bps rate hike this month, the next two hikes of the same size will take place in the first half of 2008.

At yesterday's auction the Ministry of Finance sold PLN0.5bn of 12Y inflation-lined bonds and PLN2.5bn of 10Y floating coupon bonds. Investors' demand was at PLN2.4bn and PLN6.4bn respectively. At the supplementary tender the ministry sold additional PLN78m of IZ0816 and PLN500m of WZ0118 bonds amid demand at PLN78m and PLN923m.

On Wednesday, the dollar depreciation against euro was continued, and EURUSD rate rose during the day to 1.47 from 1.466. Data released in the US did not affect the markets significantly, as they did not differ from forecasts too much. US retail sales increased 0.2%MoM in October, slightly more than expected, which confirmed a slowdown in Q3. In turn, PPI growth reached 0.1%MoM, slightly less than predicted. Core PPI was also below expectations and remained unchanged MoM, although in annual terms it rose from 2% to 2.5%YoY. The data releases had mixed impact on the core debt markets. During the day the prices fluctuated significantly, and at the end of the day yields of 10Y Treasuries and Bunds were at 4.27% and 4.15%.

Today at 10:00 GMT the release of HICP index in the euro zone is planned. According to market expectations it increased 2.6%YoY in October. At 13:30 GMT the CPI data in the United States will be released, predicted to show 0.3%MoM rise. At the same time, New York activity index will be published. According to analysts' forecasts, it declined to 21.1 from 28.75 in October. In turn, Philadelphia index for November will be released at 17:00. Market consensus shows slight decline to 5.5 from 6.8.

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F/X rates (today's opening)

EURUSD	1.4681	CADPLN	2.5797
USDPLN	2.4821	DKKPLN	0.4890
EURPLN	3.6445	NOKPLN	0.4598
CHFPLN	2.2123	SEKPLN	0.3955
JPYPLN*	2.2284	CZKPLN	0.1368
GBPPLN	5.1056	HUFPLN	1.4352

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.6311	3.6470	3.6385	3.6457	3.6345
USDPLN	2.4728	2.4825	2.4817	2.4823	2.475
EURUSD	1.4645	1.4717	1.4662	1.4691	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0709	5.76	8	7.11	5.676
5Y	PS0412	5.86	2	17.10	5.718
10Y	DS1017	5.68	3	10.10	5.699

IRS rates (Mid)

TERM	PL	US	EA
	%	%	%
	Change (bp)	Change (bp)	Change (bp)
1Y	5.76	4.43	4.55
2Y	5.88	4.27	4.42
3Y	5.90	4.36	4.38
4Y	5.86	4.48	4.38
5Y	5.84	4.58	4.40
8Y	5.73	4.84	4.48
10Y	5.66	4.98	4.54

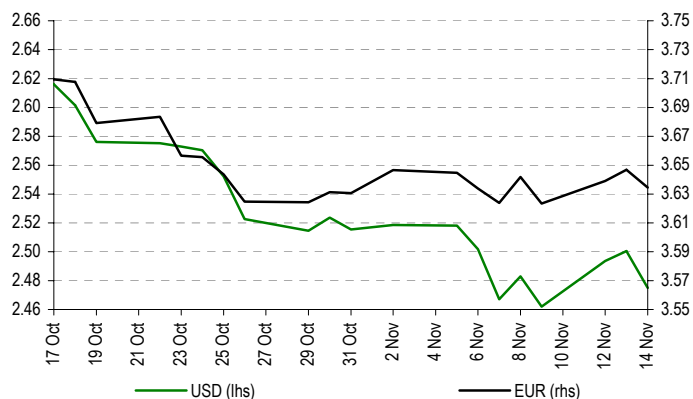
WIBOR rates

TERM	%	Daily change (bp)
O/N	4.89	0
T/N	4.90	1
SW	4.94	0
2W	4.95	0
1M	5.05	0
3M	5.30	1
6M	5.52	0
9M	5.58	0
1Y	5.68	1

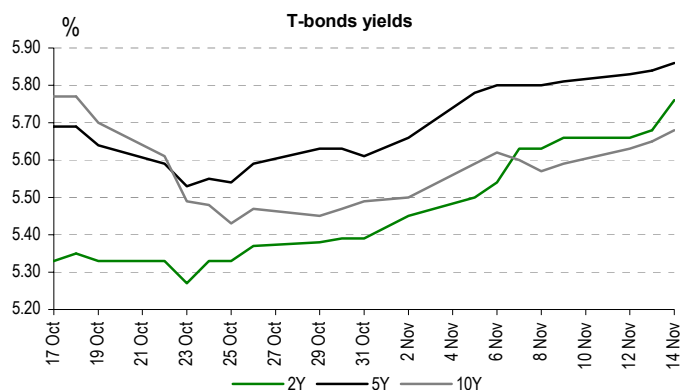
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	5.28	1
3X6	5.56	-1
6X9	5.73	-2
9X12	5.80	3
3X9	5.70	-1
6X12	5.84	1

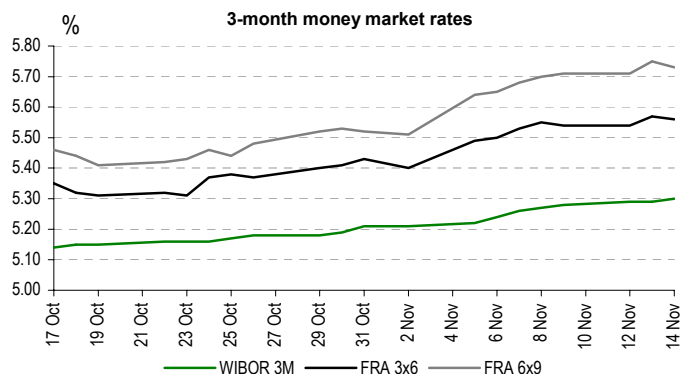
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



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