

Eyeopener – Sales lower than forecast

23 April 2008

- Zloty stronger, minor changes in bond prices despite weaker than predicted retail sales data
- Switch tender today and economic climate indices abroad

On Tuesday the zloty fluctuated in a narrow range against the major currencies. It slightly depreciated against the euro and the dollar to 3.422 and 2.159 respectively, though later on during the day there was a recovery. The zloty strengthening went in line with the appreciation of other emerging market currencies and the currencies in our region. At the end of the session the EURPLN rate was at 3.412, while the USDPLN rate was at 2.135 and both exchange rates were below levels from the opening.

Despite next data from the Polish economy were much weaker as compared to market expectations there were small moves in the interest rate market, and bond yields hardly changed. Investors might have taken advantage of softer figures to reduce the long bond positions.

The retail sales growth decelerated in March to 15.7%YoY from almost 24% in February as compared to market expectations at 21%. This is another argument for the MPC supporting putting off the interest rate hike decision until the new data releases, which may answer the question whether the weaker than expected data for March is only a temporary effect or a herald of economic slowdown. The rate of registered unemployment continued its falling trend. The details of the figures were presented in our *Instant comment* note. In the afternoon the NBP released core inflation indices. Net inflation slightly rose to 2.7%, in line with our forecast. Other measures of core inflation stayed near 4%. The forecasted core inflation path shows transferring of inflation pressure to the net inflation growth to 4% at the end of 3Q08, which should be followed by a gradual decline. The data did not change our prospects on inflation and monetary policy.

MPC member Jan Czekaj said yesterday that if data for March heralded a weakening of the economic growth, further rate hikes would not be justified. In his opinion, an argument against hikes is also strengthening zloty, which may negatively affect production and exports. According to him, effects of seven rate hikes delivered so far have already been visible in the zloty exchange rate performance. On the other hand, Andrzej Wojtyna said in the afternoon that it would be incorrect to delay a decision on another rate hike by one month and resume tightening later. He thinks that the key issue for the Council is to counteract cementing of high inflation expectations and even taking into account risk of possible economic slowdown the MPC should strengthen the message increasing rates once again in order to show that inflation is under control. In Wojtyna's opinion, in the near time the Council should focus on leading indicators and if they suggest "a reversal of moods", it would be a more important argument for him than output

figures for one month. Marian Noga from a hawkish camp in the MPC repeated yesterday that he also supports a rate hike in April. He also said that if there was a rate hike in April, there would be a possibility of interest rate reduction in the second half of 2009 in case the economy started to slow down. Meanwhile, if the MPC put off another rate hike this year, there would be no change in rates in 2009. Such an argumentation does not seem particularly convincing, because if the economy was to slow down the question arises whether another hike is needed. All in all, we keep our view there will be a pause in hikes at the MPC meeting in April. An important support for our view are comments from MPC's Sławiński and Czekaj, which suggested that they are not likely to support a hike this month and without their votes (and without support from NBP governor) the motion to increase borrowing costs will not be passed.

Yesterday the EURUSD rate fluctuated in a narrow range. After a slight strengthening of the dollar at the start of the European session there was a correction in the afternoon and dollar was depreciating against the euro, reaching to the weakest levels in the history – 1.599 at the end of the session. An important psychological level of 1.60 was broken just after the close of the Polish session, though today in the morning the EURUSD rate was again at 1.597. The hawkish comments of the ECB members as well as high oil prices contributed to the euro strengthening. Christian Noyer from the European Central Bank said the bank would act if it was necessary to curb inflation to the target. Yves Merch said the ECB had to ask the question every day, whether an interest rate hike was needed in order to control inflation. The housing data were released in the United States. The existing home sales fell from 5.03m to 4.93m, while the market expected a slightly deeper decline to 4.92m. The data did not significantly influence the market expectations.

In the core debt markets there was initially an increase in yields due to further weakening of aggressive rate cuts by the Fed and ahead of bond auctions in the US this week. Therefore, a rise in yields took place despite weak sentiment in the stock markets. However, later in the day a rebound took place in the core debt markets. At the end of the Polish session yields of 10Y Treasuries and Bunds reached 3.72% and 4.14%, respectively, versus 3.73% and 4.13% at the opening.

At today's switch auction, the Ministry of Finance will offer to buy-back bonds PS0608 and OK0808 worth PLN25.8bn, in exchange for papers PS0413 and DS1017. During the day, there will be also a publication of preliminary PMI indices for the euro zone's manufacturing and services sectors. The market predicts a fall in indices to 51.6 in manufacturing and 51.4 in services, from 52.0 and 51.6 correspondingly in the previous month. At 11:00 GMT we will see the mortgage applications index in the US.

ECONOMIC ANALYSIS UNIT

ul. Marszałkowska 142, 00-061
email: ekonomia@bzwbk.pl

Maciej Reluga (Chief Economist)
Piotr Bielski
Piotr Bujak
Cezary Chrapek

fax +48 022 586 83 40
Web site: <http://www.bzwbk.pl>
+48 (0) 22 586 83 63
+48 (0) 22 586 83 33
+48 (0) 22 586 83 41
+48 (0) 22 586 83 42

New business queries:

Treasury - Frank O'Connor

+48 (0) 22 586 8402
frank.o'connor@bzwbk.pl

Corporate Banking – Rashid Khan

+48 (0) 22 586 8050
rashid.khan@bzwbk.pl

Branch/ Mortgages - Carl Coates

+48 (0) 22 586 8059
carl.coates@bzwbk.pl

F/X rates (today's opening)

EURUSD	1.5964	CADPLN	2.1185
USDPLN	2.1375	DKKPLN	0.4573
EURPLN	3.4119	NOKPLN	0.4309
CHFPLN	2.1268	SEKPLN	0.3657
JPYPLN*	2.0750	CZKPLN	0.1361
GBPPLN	4.2519	HUFPLN	1.3567

Financial market review - 22 Apr 08

The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.4107	3.4218	3.4184	3.4120	3.4178
USDPLN	2.1349	2.1589	2.1551	2.1349	2.1444
EURUSD	1.5843	1.5990	1.5863	1.5982	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0709	6.15	-1	2.04	6.193
5Y	PS0412	6.07	1	5.03	6.167
10Y	DS1017	5.94	1	9.04	6.054

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	6.43	1	2.93	0	4.86	6
2Y	6.19	2	3.10	2	4.60	4
3Y	6.00	1	3.36	2	4.49	4
4Y	5.90	2	3.58	2	4.44	3
5Y	5.83	2	3.76	-2	4.42	3
8Y	5.72	1	4.14	-4	4.52	2
10Y	5.69	1	4.31	-5	4.62	2

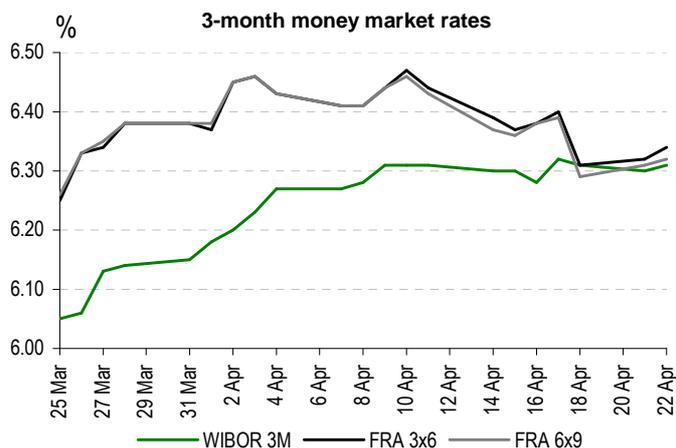
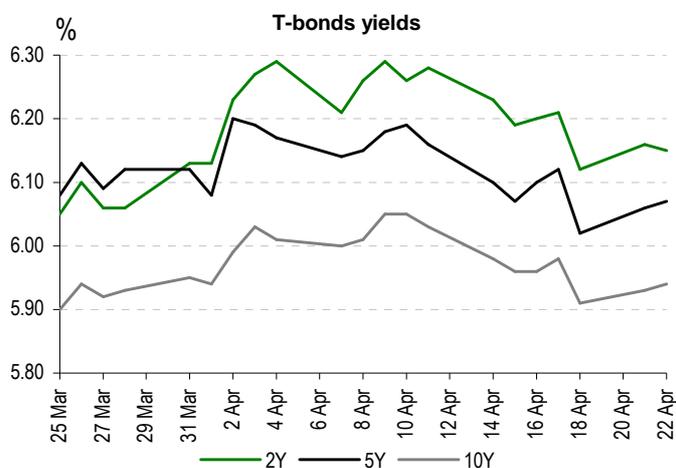
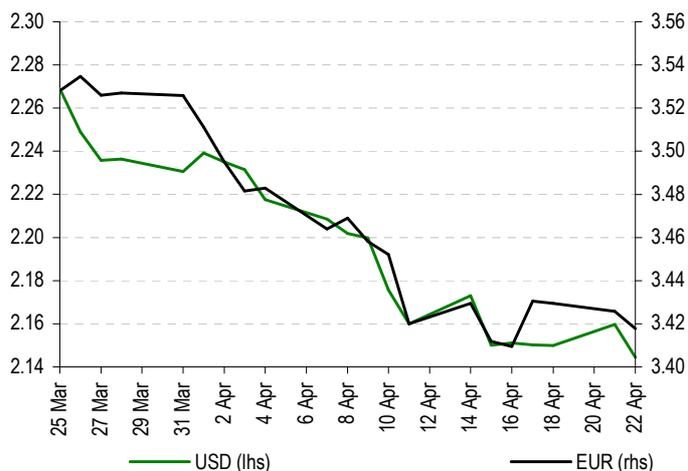
WIBOR rates

TERM	%	Daily change (bp)
O/N	5.98	5
T/N	5.98	4
SW	5.99	1
2W	6.01	1
1M	6.11	1
3M	6.31	1
6M	6.51	0
9M	6.56	0
1Y	6.65	0

FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	6.13	1
3X6	6.34	2
6X9	6.32	1
9X12	6.16	0
3X9	6.38	2
6X12	6.29	1

Zloty exchange rate (fixing)



* for 100 JPY

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Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, <http://www.bzwbk.pl>



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