Bank Zachodni WBK

Eyeopener – New records, new data

14 July 2008

- **Zloty strengthening again, especially against dollar**
- **US dollar weakening due to geopolitical risk and deteriorating credit market situation**
- **Positive moods on debt market**

After one day stabilisation on the Polish foreign exchange market on Thursday, the last day of previous week brought a significant zloty appreciation. The Polish currency broke new record levels against both the euro (EURPLN below 3.26) and the dollar (2.05). Zloty strengthening against the American currency was more significant, which was connected with a substantial rise in EURUSD rate. Dollar weakening was caused by geopolitical factors like fears regarding situation in the Middle East. Additionally, the situation in the credit markets worsened again with negative effect on the equity markets. The EURUSD rate exceeded 1.59 on Friday, though today in the morning it was slightly below this level. Today's opening on the Polish foreign exchange market showed EURPLN and USDPLN at 3.259 and 2.052, respectively.

Higher risk aversion in the international markets supported fixed income markets. Nevertheless, the scale of bonds strengthening in both Polish and core markets has diminished at the end of the week. Yields of Polish papers fell by 3-4 bp on Friday and yields of ten-year Treasuries and Bunds fell even less.

During the weekend a significant weakening on the core bond markets was observed. This was connected with announcement of US government's plans aimed to help mortgage finance companies Fannie Mae and Freddie Mac. US Treasury Secretary Paulson said about buying stakes of the companies and special credit lines. This caused a sharp rise in yields – today in the morning ten-year Treasuries and Bunds were at 3.99% and 4.47%, respectively.

Import price data published on Friday in the US showed higher inflationary pressure, as they rose in June by 2.6%MoM against market forecast at 2%. The US trade deficit fell in May to $59.79bn from $60.5bn in the previous month. Analysts forecasted higher trade gap at the level of $62.5bn. Preliminary Michigan consumer optimism index rose in July to 56.6 pct from 56.4 in June. Though it was higher than market consensus at 55.5, it was one of the lowest levels in 28 years.

We have next hot summer week ahead. Although the weather in Warsaw is forecast to be moderately good, temperature in the financial market will rise because of crucial data releases. The hottest day will be Tuesday when data about CPI, wages, employment and balance of payments will be released. Inflation and labour market figures, as well as possible comments of MPC members following them, will be key in assessment of monetary policy perspectives. We predict slightly higher CPI than the market, but lower growth in wages and employment suggesting that labour market tensions are abating. Food prices in June may give important hint about CPI behaviour in the summer holiday period. We predict food prices to decline 0.8%MoM.

Data about inflation and labour market situation, together with MPC members' comments that may follow, will be crucial for the assessment of monetary policy prospects. Already today in the *Gazeta Wyborcza* daily, a very important statement of Andrzej Wojtyna appeared. The influential MPC member said that he is afraid of strengthening second round effects, especially if crops will be weak. Moreover, in Wojtyna's opinion a 50 bp rate hike may be required to signal the Council is determined in fighting inflation.

After two days break, also production data may be important for the market, as they will be a hint whether a long-awaited economic slowdown is finally starting to take shape. Current account data are likely to show a clear slowdown in export growth and deepening of current account deficit in May.

Even though last week the zloty strengthening was uninterrupted by volatile moods abroad and generally high risk aversion, we think that further zloty appreciation is limited and we would even expect a correction on the market, which may be caused by data showing deterioration in external trade and confirming a few months break in interest rate hikes. We see the trading range for this week at 3.24-3.34 for EURPLN (asymmetric on the upside) and 2.03-2.13 for USDPLN.

If June's data show no significant surprise, yields should be maintained close to current levels. A negative impact of moderate inflation increase should be offset by lower tensions in the labour market, lower than consensus industrial production growth, as well as positive impact of strong zloty on inflation prospects. On the other hand, a possible change in moods abroad and more hawkish comments of the MPC members may be negative factors. The situation of the global fixed income market is hard to predict for the next couple of days. On the one hand, data to be released (production and sales, plus housing market figures) will confirm weakness in the American and euro zone's economy, which should increase demand for bonds. The risk of conflict in Iran will work in the same direction. At he same time, however, data on inflation in the US and the euro zone and the new record-high oil price may increase investors' fears regarding monetary tightening. Similarly as for the foreign exchange market, comments of Fed governor and minutes of the last Fed meeting will be important. With a host of companies due to report half year earnings, the performance of stock markets will be closely watched as well.

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F/X rates (today's opening)

EURUSD	1.5885	CADPLN	2.0316
USDPLN	2.0522	DKKPLN	0.4369
EURPLN	3.2593	NOKPLN	0.4040
CHFPLN	2.0082	SEKPLN	0.3438
JPYPLN*	1.9255	CZKPLN	0.1391
GBPPLN	4.0725	HUFPLN	1.4090

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.2576	3.2755	3.2706	3.2585	3.2690
USDPLN	2.0465	2.0760	2.0743	2.0481	2.071
EURUSD	1.5766	1.5937	1.5775	1.5909	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0710	**6.62**	**-4**	2.07	6.917
5Y	PS0413	**6.49**	**-3**	7.05	6.155
10Y	DS1017	**6.44**	**-2**	9.07	6.5

IRS rates (Mid)

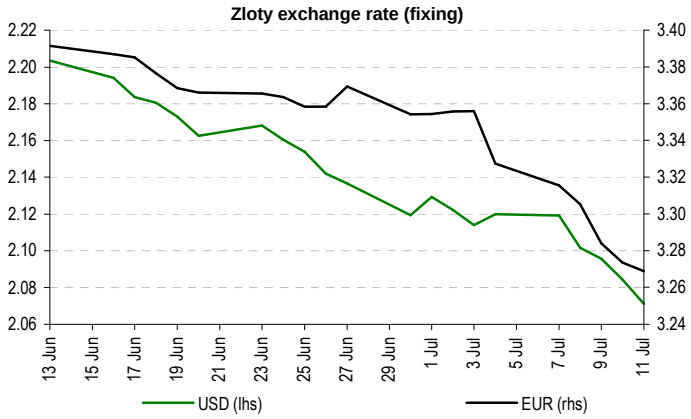
TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	6.84	1	3.07	6	5.24	-4
2Y	**6.64**	**-2**	3.47	13	5.17	-1
3Y	6.53	-4	3.80	14	5.05	-5
4Y	6.47	-3	4.02	15	5.05	1
5Y	**6.41**	**-3**	4.17	17	4.99	1
8Y	6.27	-3	4.49	13	4.94	4
10Y	**6.16**	**-2**	4.63	13	4.96	4

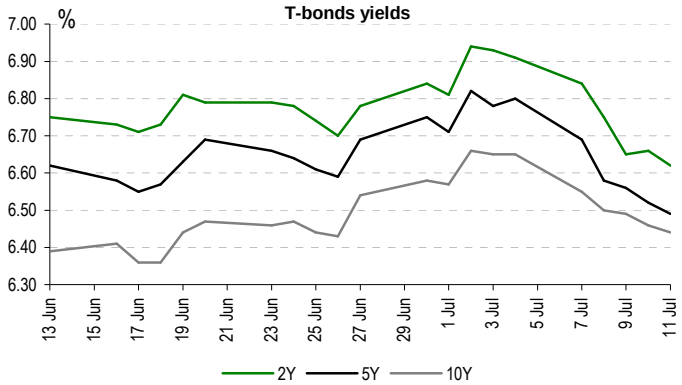
WIBOR rates

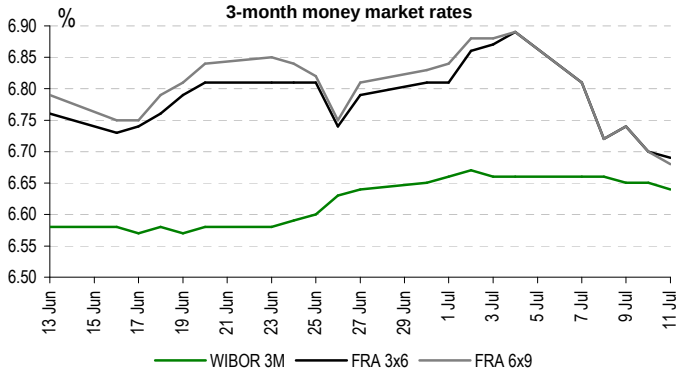
TERM	%	Daily change (bp)
O/N	6.11	40
T/N	6.11	2
SW	6.16	0
2W	6.19	0
1M	6.27	0
3M	6.64	-1
6M	6.78	0
9M	6.85	0
1Y	6.89	0

FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	6.34	0
3X6	6.69	-1
6X9	6.68	-2
9X12	6.61	-4
3X9	6.74	-5
6X12	6.69	-8







* for 100 JPY

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