Bank Zachodni WBK

Eyeopener – Risk aversion rises again

16 October 2008

4

- **Amid increased risk aversion the zloty clearly depreciated and local bonds substantially weakened; FRA and IRS rates went up**
- **Local labour market statistics slightly stronger than expected; MPC members talk of neutral bias**
- **Today major data from the US (CPI, industrial output)**

After the zloty strengthening on Monday and Tuesday, yesterday there was a depreciation of local currency. Due to resurgence in risk aversion and worsening of investors' attitude towards our region (yesterday in the evening S&P's announced it mulls downgrade in rating of Hungary), wave of zloty weakening was continued after close of Polish session and today in the morning, when the EURPLN exceeded temporarily 3.62 versus 3.48 yesterday in the morning. In turn, USDPLN peaked at 2.71 in the morning versus 2.59 yesterday at close. Later on, zloty slightly recovered due to information that the ECB will supply the Hungarian central bank with the euro. A rise in risk aversion and depreciation of currencies in the region was accompanied by decline in EURUSD. Today in the morning, it was at 1.336, while at yesterday's close it was at 1.358, and even higher during the day.

Data on wages and employment in enterprises sector, released yesterday, proved slightly higher than predicted by the market. Average wage increased 10.9%YoY in September versus market consensus of 10.8%. Employment rose 4.1%YoY, slightly down from 4.2% in August, amid predicted 4.0%. Please see more details on the data in our *Instant comment* released yesterday.

After the data release, MPC's Halina Wasilewska-Trenkner said that wage pressure is not weakening and inflation will depend on the zloty exchange rate and situation in world markets. Jan Czekaj said that he would not support interest rate hikes any more and his bias would be neutral if output data for September confirm economic slowdown. Also Andrzej Wojtyna mentioned a need to move to neutral bias although he did not rule out a possibility of rate cuts, if there is such a necessity. In Wojtyna's view, economic slowdown in Poland will be deeper than currently expected, but it is important whether it will pass through to wage claims and inflation expectations. He also said that important thing for monetary policy will be not only the inflation target but also all convergence criteria.

The NBP president said yesterday that there are many facts that show a need to cut rates. Sławomir Skrzypek added that stabilisation of commodities and food prices is a factor allowing reduction in inflationary pressure. Moreover, economic slowdown next year may be significant. These factors may result in lowering inflation projections of the NBP. According to NBP president, every political decisions (including change in the constitution) concerning the euro should be made before entering the ERM2 and it should take place after stabilisation of situation abroad. Moreover, NBP chief said that he hopes that we will fulfill inflation criterion before entering the ERM2.

Yesterday, the PAP agency said that according to an unnamed source close to the FinMin the euro adoption schedule assumes that Poland will enter the ERM2 at the turn of Q1 and Q2 of the next year and the parity rate may be set already this month. In the afternoon the FinMin denied the news on setting the central parity in October stating this is the last element of the procedure of joining the currency mechanism. According to anonymous source of Reuters, the government should approve the schedule on Monday.

The domestic data have not influenced the domestic debt market, which amid still low liquidity weakened due to high risk aversion. FRA and IRS rates increased. In our view the market does not fully price in Poland's entry to ERM2 next year and the necessity of meeting inflation criteria. Market play for deep rate cuts resulted from expectations on substantial economic slowdown and negative influence of the market turmoil on plans of fast euro adoption.

Data on inflation in the euro zone were in line with expectations and showed HICP increase by 3.6%YoY against 3.8%YoY in August. The US retail sales in September fell by 1.2%MoM (the strongest in 3 years) against expected -0.7%MoM. The New York Fed manufacturing index was also much lower than forecasted as it fell to –24.6pts in October from –7.4pts in September against expected decline to –10pts. The PPI index fell by 0.4%MoM, and core PPI rose by 0.2%. Despite weak data from the US economy, the debt weakened again. At the close of the Polish session yields of 10Y Treasuries and Bunds were at 4.07% and 4.12% against 4.02% and 4.10% on Wednesday morning. Today in the morning, after increase in risk aversion, yields in the core debt markets were at 3.95% and 4.08%, respectively.

According to the Beige Book released yesterday in the evening by the Fed, in all 12 region in the US there was a weakening of the economic activity and an increase in pessimism regarding future. This supported expectation for a 25 bp rate cut by the Fed at the next meeting on 29 October.

A number of major data releases in the US is scheduled today. At 12:30 GMT we will get the US CPI data for September (expected no change in monthly terms). At 13:00 GMT the capital flows report will be released. At 13:15 GMT next data from industrial sector will be released. The capacity utilisation is expected to has fallen to 78.3% and the industrial output to has declined by 0.5%MoM. At 14:00 GMT the Philly Fed index will be published.

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F/X rates (today's opening)

EURUSD	1.3364	CADPLN	2.2570
USDPLN	2.6956	DKKPLN	0.4842
EURPLN	3.6025	NOKPLN	0.4111
CHFPLN	2.3533	SEKPLN	0.3590
JPYPLN*	2.6974	CZKPLN	0.1448
GBPPLN	4.6455	HUFPLN	1.3393

Financial market review - 15 Oct 08

The zloty trading ranges

	min	max	open	close	fixing
EURPLN	3.4716	3.5429	3.4780	3.5143	3.5304
USDPLN	2.5539	2.6098	2.5566	2.5543	2.5998
EURUSD	1.3564	1.3610	1.3617	1.3581	-

T-bonds

TERM	BOND	Yield (%)	Change (bp)	Last auction	Average yield
2Y	OK0710	**6.18**	**12**	6.08	6.471
5Y	PS0413	**6.28**	**17**	1.10	5.926
10Y	DS1017	**6.24**	**9**	8.10	5.859

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	6.00	-5	3.02	6	4.51	-9
2Y	**5.63**	**-2**	2.94	-12	4.25	-10
3Y	5.47	-1	3.37	-13	4.43	-10
4Y	5.41	-1	3.73	-10	4.42	-9
5Y	**5.38**	**-1**	3.99	-14	4.46	-9
8Y	5.37	-3	4.40	-14	4.60	-5
10Y	**5.38**	**-2**	4.64	2	4.67	-6

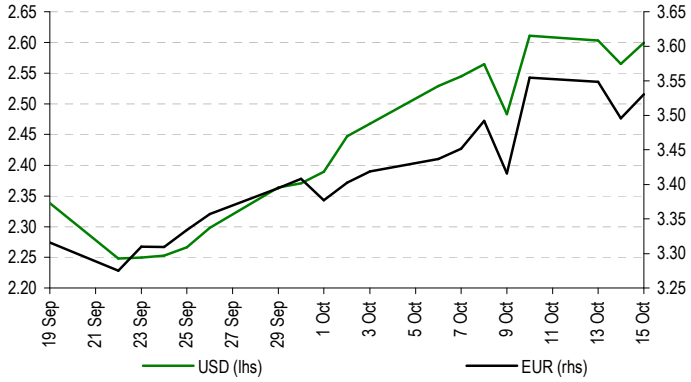
WIBOR rates

TERM	%	Daily change (bp)
O/N	6.33	-1
T/N	6.35	-1
SW	6.45	-1
2W	6.50	0
1M	6.59	1
3M	6.80	0
6M	6.85	-1
9M	6.86	0
1Y	6.87	0

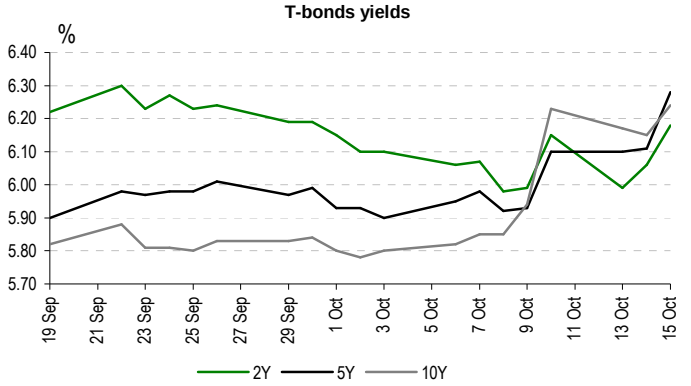
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	6.44	0
3X6	6.05	-4
6X9	5.53	-4
9X12	5.12	-5
3X9	5.88	-10
6X12	5.36	-9

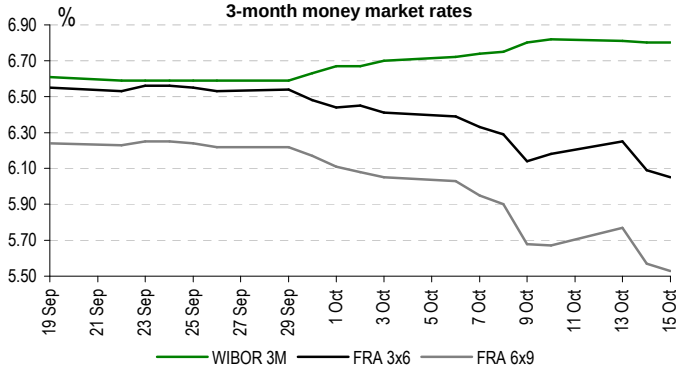
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



* for 100 JPY

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