Bank Zachodni WBK

# Weekly economic update

21 – 27 August 2006

**CPI figures published last week were much higher than expected which negatively affected the fixed income market. This was not the only negative inflation surprise last week, as PPI figures were also clearly higher than predicted. Other data published last week (industrial and construction output, average wage and employment in the enterprise sector, monetary statistics) were broadly in line with expectations, confirming strong expansion of the Polish economy. Although worse than predicted inflation data renewed expectations for swift rate hikes, comments from MPC members suggests that this may not necessarily be the case. This is related to reasons for negative inflation surprise. In case of CPI the reason for acceleration in price growth were two categories of goods and services where price hikes are likely to prove one-off and isolated. Price performance of other components of CPI do not shod any signs of stronger inflationary pressure in the Polish economy. In case of PPI, acceleration in price growth is largely an effect of low base effect and high commodities prices while there are still few signs of stronger pressure on prices in manufacturing.**

**The data to be published this week should have similar tone as the data from last week. Given CPI figures we estimate that core inflation will accelerate stronger than earlier expected while retail sales and unemployment figures for July as well as business climate indicators for August should confirm that after very good first half of the year the Polish economy is in excellent shape also in the third quarter of the year. From this point of view, one should expect that deteriorated moods on the fixed income market will be maintained in the nearest week. The situation could change, leading to some rebound of the market, if there were comments from rate-setters, suggesting that medium-term inflation prospects remain good and one should not expect swift rate hikes.**

## Economic calendar

| Time GMT | COUNTRY | INDICATOR (importance level*) | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (21 August)** | | | | | |
| **9:00** | **POL** | **Auction of PLN1.0bn of 52-week T-bills (M)** | | | | | |
| | | **TUESDAY (22 August)** | | | | | |
| 8:00 | EU-12 | Current account (M) | Jun | bn € | -6.0 | - | -8.2 |
| 9:00 | GER | ZEW index (H) | Aug | | 12.0 | - | 15.1 |
| | | **WEDNESDAY (23 August)** | | | | | |
| **12:00** | **POL** | **Core CPI (H)** | **Jul** | **%YoY** | **1.0** | **1.3** | **1.0** |
| **12:00** | **POL** | **Business climate (M)** | **Aug** | **-** | **-** | **-** | **-** |
| 14:00 | USA | Home sales (M) | Jul | m | 6.55 | - | 6.62 |
| | | **THURSDAY (24 August)** | | | | | |
| **8:00** | **POL** | **Retail sales (H)** | **Jul** | **%YoY** | **12.5** | **14.0** | **10.7** |
| **8:00** | **POL** | **Unemployment rate (H)** | **Jul** | **%** | **15.9** | **15.7** | **16.0** |
| **9:00** | **POL** | **Switch auction (M)** | | | | | |
| 8:00 | GER | IFO index (H) | Aug | | 104.8 | - | 105.6 |
| 12:30 | USA | Durable goods orders (H) | Jul | % | -0.5 | - | 2.9 |
| 14:00 | USA | New home sales (H) | Jul | m | 1.1 | - | 1.131 |

* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK

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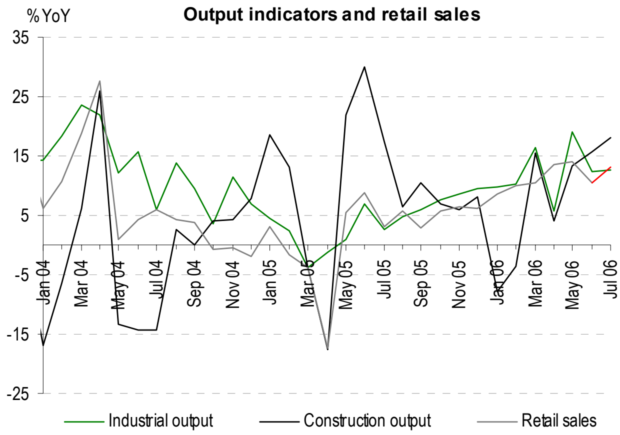
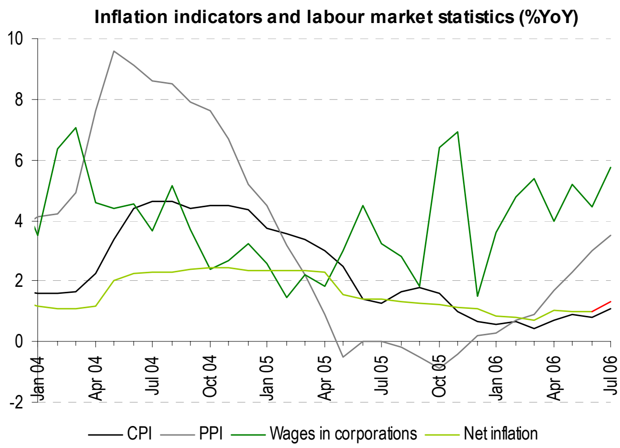
## What's hot this week – Another set of monthly macro data

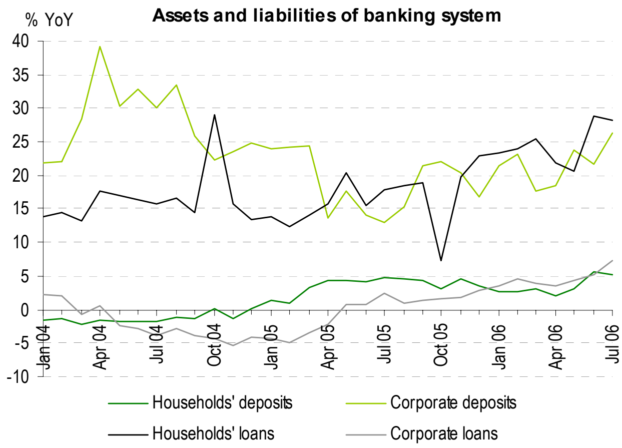



- The nearest week will see another set of monthly macro data. We will get both inflation indicators (core inflation measures) and economic activity indicators (retail sales, business climate indices) as well as labour market statistics (data on the registered unemployment).
- We predict net inflation increased to 1.3%YoY in July, similar to CPI having been affected by price hikes in recreation and culture and in communications.
- We forecast retail sales growth accelerated to 14%YoY in July from 10.7%YoY in June, confirming consumption demand remains strong. This stems from further firming of labour market conditions. We expect the registered unemployment rate fell to 15.7% at the end of July.
- Business climate indicators for August should show that the Polish economy remains in very good shape in the third quarter of the year.

## Economy last week – Unexpected acceleration of current inflation




- The key focus of attention last week was publication of inflation indicators. CPI inflation proved clearly higher than expected, reaching 1.1%YoY versus market expectations for stabilisation at June's level of 0.8%YoY.
- What is interesting, food and fuel prices were slightly lower than predicted, while the reason for unexpected inflation acceleration were price hikes in recreation and culture, and communications. At the same time, however, price performance in other categories of CPI has not indicated strengthening of inflationary pressure.
- PPI was 3.5%YoY in July, higher than expected, but prices in manufacturing still grows at weak pace.
- Wage growth was slightly stronger than market expectations, but it still seems to be lower than productivity growth. Employment growth again proved record high and reached 3.3%YoY.




- Firming situation on the labour market goes hand in hand with high economic activity. Industrial output growth reached 14.3%YoY, as expected. Seasonally adjusted growth in industrial output reached 14.1%YoY. Construction output of 4.8%YoY was weaker than predicted, but all in all output figures confirmed the economy expands robustly.
- Further strengthening of economic activity was also reflected in monetary statistics for July. Money supply grew 13.1%YoY, stronger than predicted. Total deposits growth accelerated to 12.4%YoY from 12.1%YoY in June. What is important, corporate loans in July grew 7.3%YoY versus 5.2%YoY rise in June and average growth of 3%YoY in the last 12 months. If the trend continues, it would suggest that economic activity in the nearest time may be even stronger than to date.

## Quote of the week – Inflation outlook broadly unchanged

**Dariusz Filar, MPC member;** Reuters, 16 August

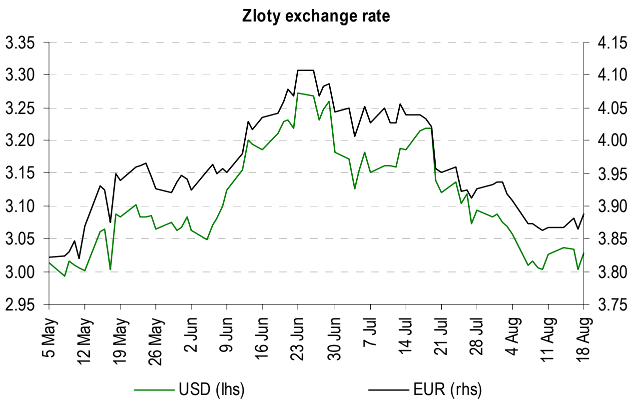
*Today's data do not change fundamentally the outlook for inflation compared to that in the (last) projection. The council should observe carefully inflation indicators for four to five months before it comes to any decision.*

**Marian Noga, MPC member;** PAP, 18 August

*Both CPI and PPI figures does not change my conviction that there is no inflation threat. In my opinion inflation will reach ca. 1.5%YoY in December.*

Comments from Dariusz Filar and Marian Noga show that even these MPC members who usually opted for conservative line of monetary policy are not sure about a need for swift monetary tightening. This suggests that expectations for a rate hike already this year, which were renewed after last week's publication of CPI and PPI figures, are exaggerated. We maintain our view that there will be no rate hike this year.

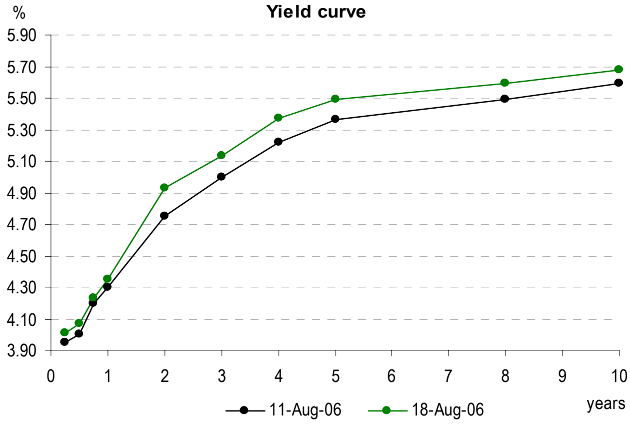
## Market monitor




### Zloty down at the end of week

▪ For the better part of the week the zloty remained stable, e.g. due to long weekend and as investors were waiting for data releases. Later on, the zloty was affected more by information from foreign markets than by domestic factors – on Thursday it gained after weak US data, reducing risk of further Fed hikes, and correction on Friday was triggered by HUF depreciation after news on possible delay in euro entry.

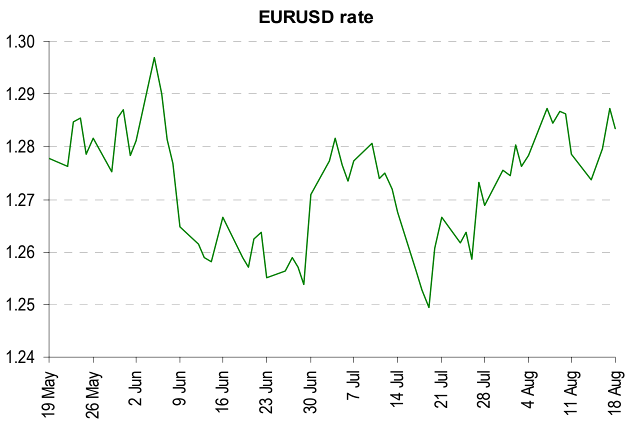
▪ This week, small number of data releases will favour zloty stabilisation, although we still see potential for further correction that could be triggered e.g. by EU data releases or publication of Hungarian convergence report. The EURPLN rate may fluctuate in range of 3.88-3.98, while the USDPLN of 3.00-3.10.




### Yield curve up on July data

▪ Long weekend, holiday moods, and waiting for data caused the market to remain idle in the first part of the week. Higher than expected inflation pushed yields up but even stronger move took place after high PPI and output figures. On Friday, yields increase was also stimulated by weakening in the region after news from Hungary. Strong US debt market gave some support, moderating negative reaction.

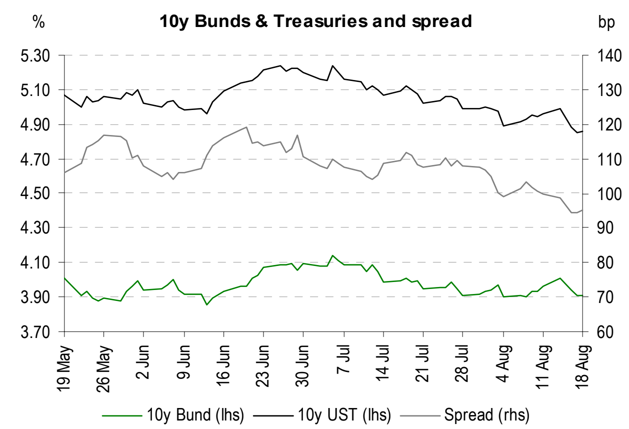
▪ This week, strong retail sales data can be unsupportive for debt market. Also, euro zone members' data confirming strong economic growth driven by domestic demand can have negative impact on yields.




### Dollar under pressure again

▪ The dollar remained under strong pressure last week amid weak US data, showing lower pressure on price growth and slowdown in economic growth. The only support for American currency came on Thursday from Philadelphia Fed report on strong activity in manufacturing that allowed for some EURUSD correction at the end of the week.

▪ It's a very quiet week in terms of US data, with only housing stats likely to provide any fresh direction. With this week's numbers expected to confirm a weakening trend, the risks are skewed towards a weaker dollar. However, 1.29 level could remain a difficult hurdle for the euro.




### US data supported core debt markets

▪ After publication of data on low CPI and PPI inflation rates and weak economic activity in the US, international investors trimmed their expectations for possible further rate hikes by the FOMC. As a result, US Treasuries gained significantly and at the end of week they were followed by Bund market as well.

▪ While new data from US housing market to be released this week should be supportive for US Treasuries, showing continuation of easing in demand, data releases in major euro zone countries (despite forecasted drop in Ifo and ZEW indices) should confirm persistence of economic revival in EU-12, which will prevent Bund yields from falling.

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