

# Weekly economic update

9 – 15 October 2006

This week will be, similarly to the previous one, short of crucial macroeconomic data publications in Poland. On Friday, data on money supply and balance of payments will be released, however investors will be awaiting for data much more important for the Monetary Policy Council – i.e. inflation figures, wages, production etc. – due for publication in the subsequent week. Low current account deficit showed by our forecast (€50m) could be a positive surprise for the market as other analysts' forecasts show substantially higher gap (almost €500m on average). Data on money supply and credit growth, although are likely to be positive for the pace of economic development, will have traditionally scant significance for market behaviour.

After the weekend, when demonstrations for and against the government are planned, new important events could take place on the political stage. The Law and Justice will probably continue its efforts to secure stable backing for the government in the parliament. Friday's declarations of leaders of LPR and Samoobrona parties suggested that it is possible that the three parties will restore the majority coalition that could potentially introduce some stabilisation in political situation. However, uncertainty regarding future scenarios is still substantial. The next Sejm session starting on Tuesday will be an opportunity for new confrontation of the political parties, and thus one could not rule out escalation of political turmoil. It is possible that the deputies will vote this week on the motion submitted earlier by the main opposition party PO on the parliament's dissolution, nevertheless it is still not confirmed whether this point will be included in the Sejm's meeting agenda.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (9 October)</b>							
09:00	POL	Auction of PLN0.8bn 52-week Treasury bills (M)					
<b>TUESDAY (10 October)</b>							
14:00	USA	Wholesale inventories (H)	Aug	%MoM	0.7	-	0.8
<b>WEDNESDAY (11 October)</b>							
9:00	POL	Auction of PLN1.0-3.0bn of 10Y DS1017 bonds (H)					
9:00	EMU	Revised GDP (M)	Q2	%YoY	2,6	-	2,1
<b>THURSDAY (12 October)</b>							
12:30	USA	Trade balance (H)	Aug	\$ bn	-66.8	-	-68.04
<b>FRIDAY (13 October)</b>							
12:00	POL	Current account (M)	Aug	€ m	-490	-50	-794
12:00	POL	Trade balance (M)	Aug	€ m	-432	-300	-761
12:00	POL	Money supply (M)	Sep	%YoY	12.5	12.1	12.8
6:00	JP	BoJ meeting – decision & report (M)					
12:30	USA	Foreign trade prices, import (H)	Sep	%MoM	-1.0	-	0.8
14:00	USA	Preliminary Michigan (H)	Oct		86.0	-	85.4

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

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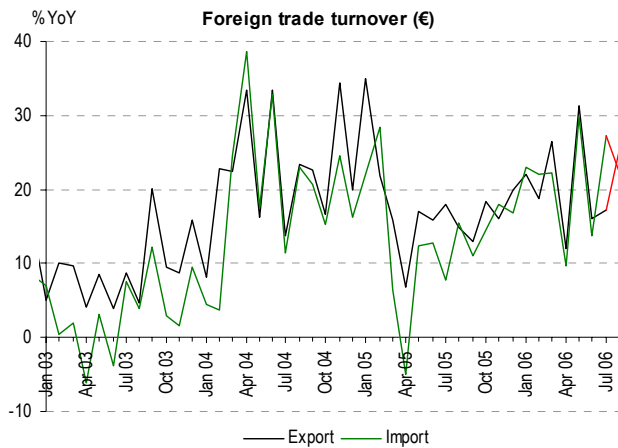
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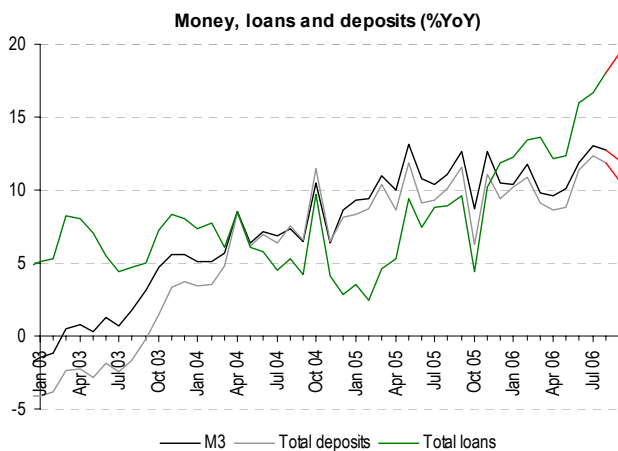
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## What's hot this week – Politics in the spotlight again?

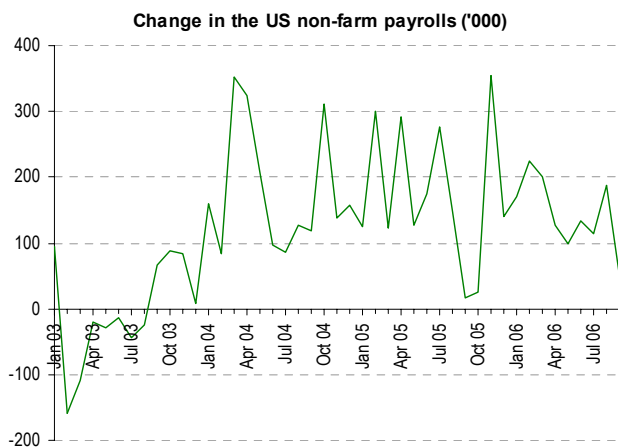


- This week will also go by waiting for the crucial economic data as much as the political events.
- Two monthly data publications will be issued only on Friday, though key figures will be released only next week.
- According to our expectations, current account deficit in August was quite low (€50m), which, if confirmed, can be a considerable positive surprise for the market, as average market forecast shows a deficit ten times as big, close to €500m. Import and export growth should remain high.
- Money supply figures, confirming the continuation of growing trend will be, as usual, of a low interest to the financial market.



- Abroad, this week will also be rather calm concerning economic data releases. It is worth focusing on figures about euro zone GDP, US trade balance and preliminary Michigan index.
- Polish politics can be slightly more tumultuous, which will be favoured by the next parliament meeting and the continuation of attempts to set up a stable parliamentary backing for the government.
- Perhaps, after recent declarations of LPR and Self-defence, the comeback to a majority ruling coalition will be once again more real, and political situation will stabilize a little. Though, frankly speaking, this is very hard to predict. PO wants a vote about its motion concerning parliament dissolution, but we don't know if it will be introduced to the Sejm's agenda.

## Economy last week – Waiting for more decisive news



- US non-farm payrolls increased in September by 51k while analysts were expecting a 125k growth. Meantime, data for August have been revised upwards by 60k to 188k which strengthened the dollar and analysts' convictions that the American labour market is doing fine.
- In the opinion to 2007 budget draft, the MPC was critical about some of the document's assumptions and underscored potential risks resulting from the lack of public finance reform. According to the MPC the draft assumes relaxation in fiscal policy in 2007 and implies that the budget could be procyclical for the economy. The question is whether in such situation the MPC will tend to conduct more restrictive policy to offset this effect? Our answer is not necessarily, as in our view many arguments suggest that in the medium run the inflationary pressure will remain limited and the target is not endangered.

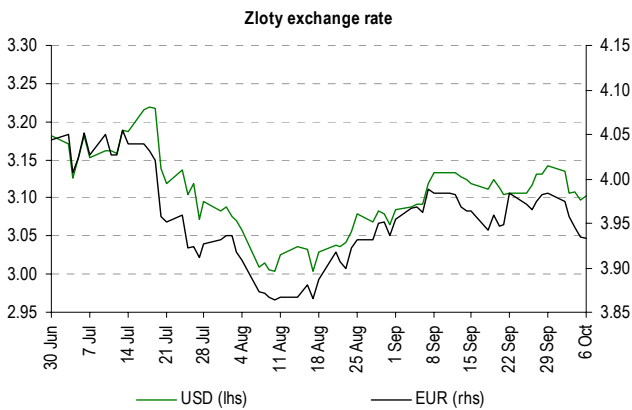
## Quote of the week – No hurry with interest rate hikes

Jan Czekaj, MPC member; PAP, 5th October

*Higher inflation is due, in large scale, to higher food prices, and this is a supply side shock and its consequences will be extinguishing in 2007. We should expect that during the coming year, those supply-side shocks, that took place until now will disappear, contributing to limit price rise. For the moment, one cannot see factors that would provoke a permanent deviation of the inflation above the target, although series of events can cause the inflation go higher for a while. We want to come back to the middle of the target, but in the medium-term, and not through reacting to supply-side shocks, until they don't threaten with second round effects.*

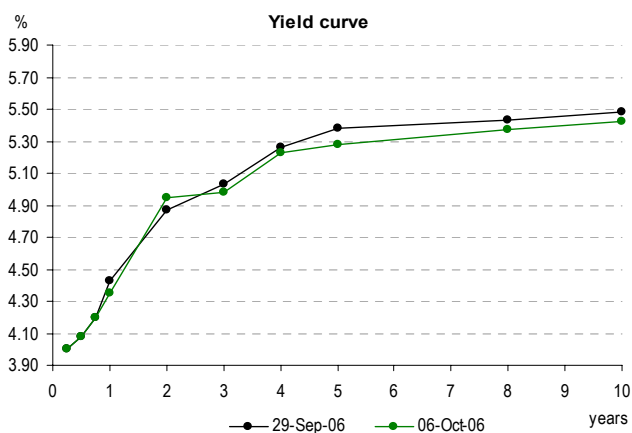
Interview with MPC member Jan Czekaj confirmed our baseline scenario assuming no rate hikes in foreseeable future as the member saw no threat of permanent breaching the inflation target and suggested current interest rates level was appropriate. It would be interesting to see comments of other rate-setters such as Andrzej Sławiński and Andrzej Wojtyła who usually tip the balance during votes on policy actions.

**Market monitor**



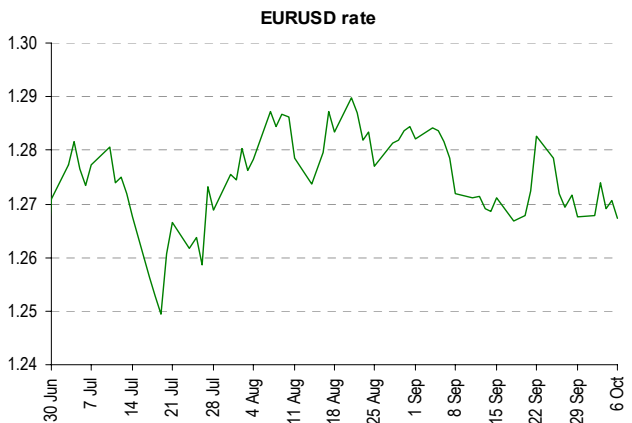
**Zloty strengthens**

- Amid gradual softening of the influence of the political situation on Polish financial market in prospect of some stabilisation with regards to 90-day „good will” pact with PSL zloty slowly strengthened against the main currencies in the last days. This went along the appreciation of emerging market currencies and fall of the euro. Zloty gained ca. 1.2% and 0.6% vs. the dollar.
- With reference to lack of data releases in the domestic market the zloty rate is going to fluctuate in narrow range against the main currencies (3.89-3.99 against the euro with support level of 3.92 and 3.90 and 3.05-3.15 vs. the dollar) and will depend on the other emerging markets. The next week Sejm meeting may be important if it clarifies the current political situation.



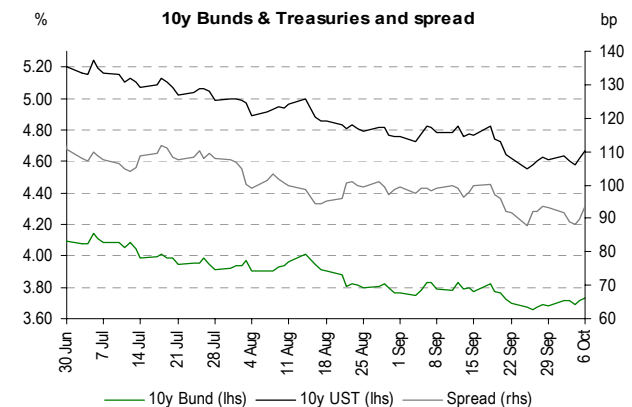
**Debt almost unchanged**

- The domestic debt market featured small fluctuations. Bonds strengthened in the past week by several basis points, and this was mainly a result of calming of investors reaction to the turmoil in politics as of yields drops in the core markets. The results of 2Y bonds auction also positively influenced the market moods.
- Next week the auction of 10Y bonds, moves abroad and comments of central bankers may have some influence on the Polish market. In our view, the bond prices are quite high and the MPC will rather not raise the interest rates in the nearest quarters, with the risk of hike at the beginning of 2007 with regards to situation in the labour market, the change on the post of NBP’s president and the influence of the slowdown of US economy.



**USD gains after falling concern on economic growth**

- After the American ISM index publication the dollar clearly weakened against the euro. But afterwards it started to regain strength, among other things, after a weaker PMI in services and falling oil prices, which diminished concern about considerable slowdown in the USA. Ben Bernanke’s declaration had a bad influence on the dollar, though data from the labour market strengthened the dollar against the euro below 1.26.
- Even despite slower economic slowdown in the US, the dollar can suffer from rate cut and remaining high trade deficit. In the next few days, crucial data for the dollar will be mainly the data from the US concerning foreign trade prices, wholesale inventories and trade balance. We think, the EURUSD rate will go to 1.30 till the year’s end.



**Yields rise on core markets after non-farm payrolls**

- The ISM indicator for the manufacturing sector also positively influenced the core debt markets. Afterwards, bonds prices reached some technical levels, at which investors sold German papers against the US ones (10Y spread fell to 89 bp.). Trichet’s declarations have also weakened Bunds, while data from the American labour market contributed to the significant Treasuries price fall.
- Weakening of the American economy may be softened by falling commodities prices. Meanwhile we think that the Fed can start cutting interest rates in the second quarter of the next year. We also believe that the ECB will also raise rates next year up to 3.75% in the first quarter. Figures about wholesale inventories and Michigan index will be of some interest to core markets.

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