Bank Zachodni WBK

# Weekly economic update

## 30 October – 5 November 2006

**In line with expectations, the MPC kept interest rates on hold again. The communiqué after the meeting was more hawkish than the last one, and the new *Inflation report* showed higher inflation projection than in July, predicting CPI acceleration to 3.5% at the end of 2008. However, the MPC did not refer directly to the new projection and did not say explicitly how it assessed medium-term inflation prospects. It is clear that the Council is deeply divided in opinions. Leszek Balcerowicz and Dariusz Filar were emphasising mostly hawkish arguments and a need for fast rate hikes, while apparently the majority of the Council members do not fully share such views. This was confirmed by a lack of rate hike last week and reflected in comments of other central bankers, e.g. Andrzej Wojtyna, Jan Czekaj, Mirosław Pietrewicz. In our view, although the MPC sees a risk of exceeding inflation target in 2007, most of its members believe this would be only temporary phenomenon, which does not require reaction in form of interest rate hike.**

**The nearest week should go by in rather peaceful atmosphere on the Polish financial market, amid lack of domestic data publications and market holiday (All Saints' day) on Wednesday. Therefore, the events and tendencies on core markets, where the calendar of data releases is particularly thick, will have dominant impact. Beside indicators of economic activity (ISM, PMI) and inflation data (core PCE, HICP), monthly report on US non-farm payrolls will be crucial, as it usually affects expectations regarding perspectives of Fed's monetary policy. The next ECB meeting is likely to end up with no rate change, but the bank's statement could be for investors an important hint about pace of future interest rate hikes in the euro zone.**

### Economic calendar

| Time GMT | COUNTRY | INDICATOR (importance level*) | PERIOD | UNIT | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (30 October)** | | | | | |
| 13:30 | USA | Core PCE | Sep | %MoM | 0.2 | - | 0.2 |
| | | **TUESDAY (31 October)** | | | | | |
| 10:00 | EMU | Preliminary HICP | Oct | %YoY | 2.2 | - | 2.2 |
| 15:00 | USA | Chicago PMI | Oct | | 59.0 | - | 62.1 |
| 15:00 | USA | Consumers confidence | Oct | | 106.0 | - | 104.5 |
| | | **WEDNESDAY (1 November)** | | | | | |
| | **POL** | **All Saints' Day** | | | | | |
| 15:00 | USA | Manufacturing ISM | Oct | | 53.0 | - | 52.9 |
| | | **THURSDAY (2November)** | | | | | |
| **09:00** | **POL** | **Auction of 2Y bonds** | | | | | |
| 09:00 | EMU | Manufacturing PMI | Oct | | 56.7 | - | 56.6 |
| 12:45 | EMU | ECB meeting – decision | | % | 3.25 | - | 3.25 |
| 13:30 | USA | Unit labour cost | Q3 | % | 3.9 | - | 4.9 |
| 13:30 | USA | Productivity | Q3 | % | 1.5 | - | 1.6 |
| 15:00 | USA | Factory orders | Sep | %MoM | 1.0 | - | 0.0 |
| | | **FRIDAY (3 November)** | | | | | |
| 13:30 | USA | Non-farm payrolls | Oct | k | 125.0 | - | 51.0 |
| 13:30 | USA | Unemployment | Oct | % | 4.6 | - | 4.6 |
| 15:00 | USA | Non manufacturing ISM | Oct | | 54.0 | - | 52.9 |

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

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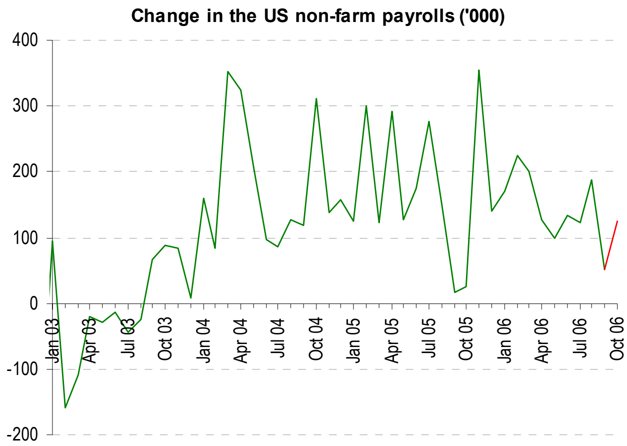
## What's hot this week – Under influence of events abroad



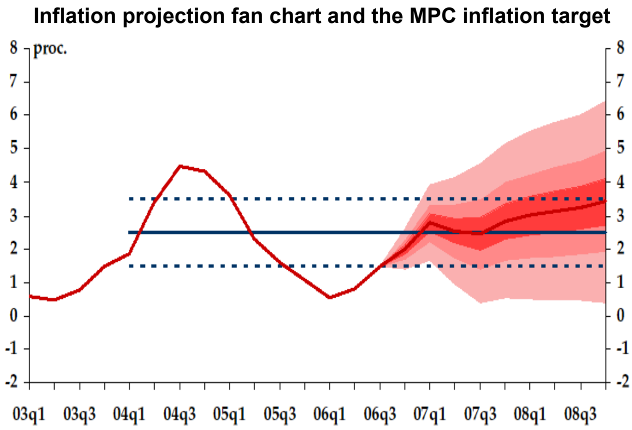

▪ This week, given the lack of data releases and major events in Poland, and amid All Saints' holiday in the middle of the week, activity on the Polish financial market should be rather limited.

▪ Information and tendencies abroad, where the calendar of important data publication will be very rich, will have a key impact on the market.

▪ The most important figure in the US will be non-farm payrolls, but economic activity indicators (ISM, Chicago PMI, factory orders) and inflation (core PCE) can also have an influence on the market.

▪ In the euro zone, apart from figures concerning activity (PMI) and inflation, ECB's meeting will deserve some attention, more precisely the communiqué, which will be a clue concerning pace of further monetary tightening.

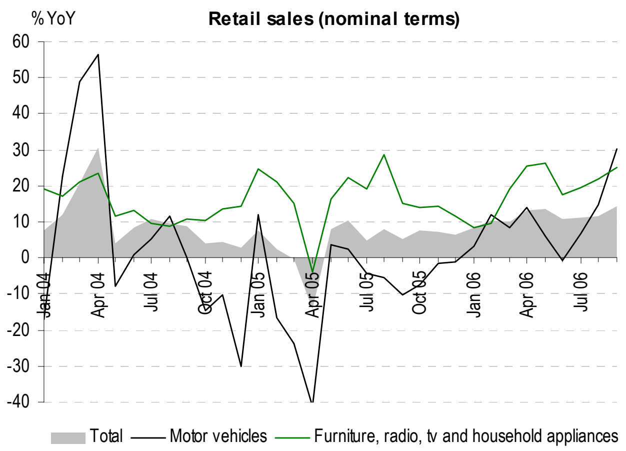
## Economy last week – Interest rates unchanged despite hawkish projection




▪ In line with expectations, MPC left the rates unchanged, though the statement was slightly more hawkish than before, just as the new inflation projection, according to which inflation will rise to 3.5% by the end of 2008.

▪ Decision about keeping the rates on hold suggested that the Council did not really accept conclusions of the new projection. It seems that the majority of MPC members think that CPI can periodically exceed the target in 2007, but it does not have to mean a rate hike, because there is no risk for the target in the medium term.

▪ We deem chances for rate hike before the year-end to be very small. MPC decisions at the start of 2007 will be data-dependent. If the statistics from the labour market show much stronger results than expected, rate adjustment cannot be excluded. Still, this is not the base case scenario in our view.




▪ Retail sales rose by 14.5% YoY in September in nominal terms and 14.4% in real terms, faster than expected. All in all, in Q3 sales growth accelerated, which indicates further consumption demand expansion.

▪ Combined with data on good industrial and construction production, it allows expecting GDP growth in Q3 to be at least as fast as in Q2 when it amounted to 5.5%. This was confirmed by CSO chief last week.

▪ Unemployment rate fell in September to 15.2% by 2.4pp within 12 months. The amount of unemployed fell by 14.4% to 2.36 m people, fastest pace of reduction since1998.

▪ Core inflation measures were quite stabile in September. Two of the five measures remained unchanged (among others net inflation a 1.4%), one fell and two rose. The figures confirmed that the inflation pressure remains well contained.

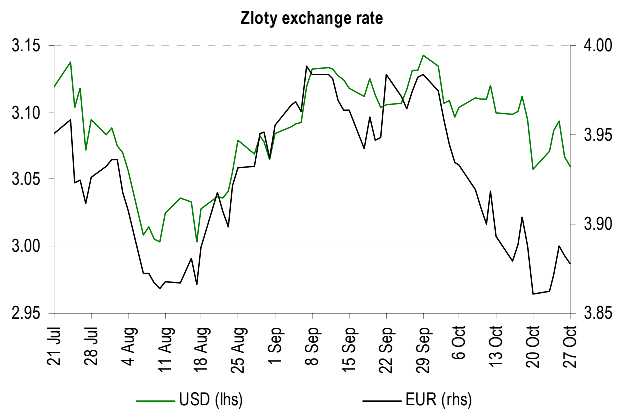
## Quote of the week – New central bank governor less hawkish?

**Urszula Grzelońska; candidate for NBP governor,** Reuters, 26 October

*There is no huge need for rate hikes for the moment. I think that the MPC can wait for, at least, a half of a year. We have to watch carefully what happens in the world. I am afraid that growth can be a little lower than 5% next year. I think that investments should be the motor of Polish economy growth.*

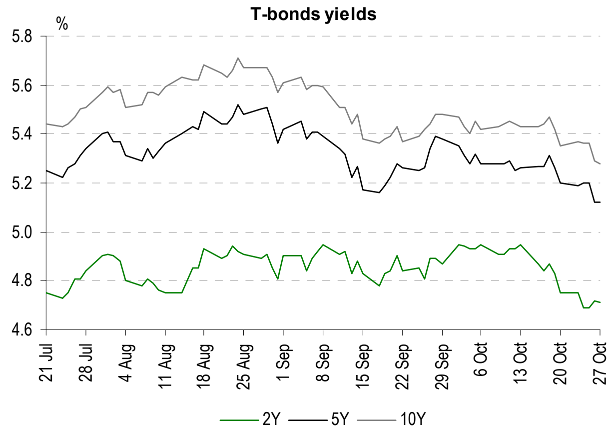
More and more often declarations of Urszula Grzelońska concerning monetary policy suggest her candidacy for head of NBP is indeed very likely. Her last statement suggested Grzelońska's view on economic situation and monetary policy perspectives is close to the one defended by a major group of the Council. Thus, change on the governor position should not provoke substantial change in monetary policy.

## Market monitor



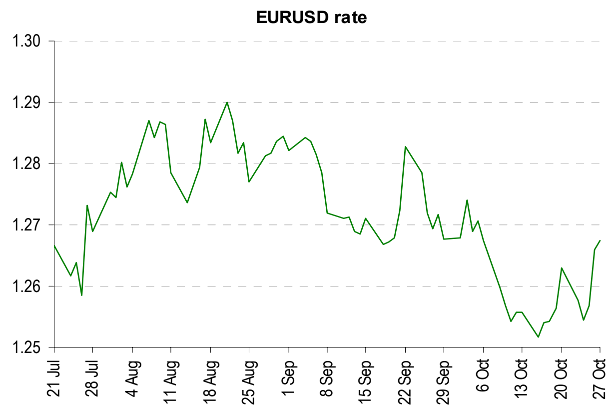

### Zloty still strong

- At the beginning of the week, zloty tried to force the crucial resistance level at 3.8550, but it did not succeed and zloty began to weaken gradually against euro, among other things due to strengthening of the single currency against the dollar. Slight weakening has been stopped on Wednesday, when improvement of attitude towards currencies in the region had a favourable impact combined with domestic bonds purchases after MPC's meeting.
- In the next week, there will be no crucial domestic events, and market activity can be low because of the holiday on Wednesday. Figures abroad will be key. We expect the EURPLN rate to be within the 3.82-3.92 range, and rate 3.02-3.12.



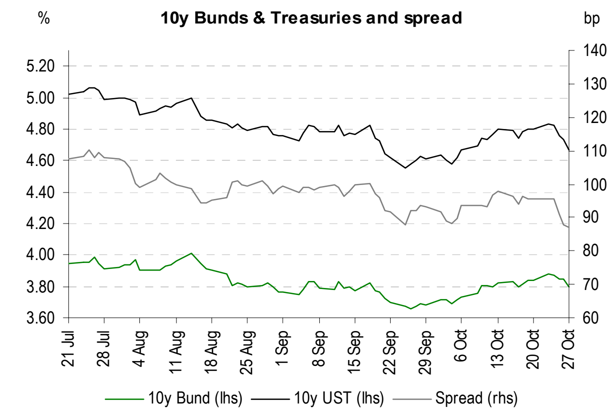

### Domestic debt

- The past week has brought further strengthening to the domestic debt market. Yields of the bonds fell by a few points across the curve. By the end of the week, a slight correction of 2Y bonds occurred, but before that 2Y yields managed to go under 4.7%, that is the lowest level since mid-June. It was favoured, among other things, by not so hawkish tone of the central bankers' communiqué after MPC meeting, which resulted in further bonds purchase, despite relatively high prices.
- After a strong debt market strengthening trend lasting since the beginning of October, a correction is getting more and more likely. Auction 2Y bonds and behaviour on the core markets will be important in the next week.




### Bad week for the dollar

- After a good Monday for the dollar, when the EURUSD rate fell again under 1.26 and got close to 1.25, next days of the past week brought gradual weakening of the "greenback", which was favoured by less hawkish than expected tone of the Fed statement. By the end of the week, high resistance has stopped the dollar-weakening tendency at 1.27, but it managed to break it after the release of lower than expected data about US GDP growth for Q3.
- As usual in the beginning of the month, figures about employment will be key for the dollar quotation, though there will be a few other publications.




### Good week for core debt markets

- In the beginning of the last week yields kept growing on the core markets, as since the beginning of October, but the situation changed after Wednesday Fed's communiqué which was less hawkish than expected. Another impulse for bonds prices growth on core markets was weak American GDP growth data for Q3. After this release, 10Y yields of Treasuries and Bunds decreased by 5bp and amounted to 3.8% and 4.67%, respectively, at the end of the week.
- As concerning the EURUSD rate, debt markets will be awaiting this week for data about non-farm payrolls in the US, but other figures can also impact the market, as they influence further Fed moves.

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