Bank Zachodni WBK

Weekly economic update

20 – 26 August 2007

Last week passed under the sign of rising panic on the world financial markets. Amid surge in global risk aversion and flight to quality, stock markets around the globe plummeted the most in several years, currencies and bonds on emerging markets weakened, while core debt markets gained. Our expectations for zloty depreciation materialised, however the USDPLN rate broke through the upper end of band predicted by us for this week amid sharp dollar strengthening. In the nearest week, the market may see some rebound after unexpected Fed decision on Friday to cut discount rate by 50 bp and facilitate access to financing loans, in order to ease situation on the credit market.

This week, we will receive the last set of data and information before the MPC meeting. Even though inflation measures are predicted at quite low levels (expected slowdown in core inflation and PPI growth in July), one should not expect this would be enough to prevent the MPC from raising interest rates one more time in August. Data about situation on the labour market released in the last weeks confirmed that risk for future inflation from wage pressure and demand pressure may be rising, which will be among major hawkish arguments for the central bank. The data regarding economic activity due for release this week (industrial output, retail sales for July, enterprises' financial results for the first year-half) should be also quite strong, confirming that the economy remains on a path of solid expansion. In the middle of the week, the minutes of the MPC meeting in July will be released, and may deliver some hints regarding moods and opinions within the Council. The economic calendar abroad will be quite thin, with important data releases in the US scheduled only on Friday. On 22 August, the Sejm will resume work after holiday break, however the vote on the parliament's dissolution is scheduled on 6 September.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 August)					
12:00	**POL**	**Industrial production**	**Jul**	**%YoY**	**11.1**	**12.1**	**5.6**
12:00	**POL**	**PPI**	**Jul**	**%YoY**	**1.5**	**1.6**	**1.8**
		TUESDAY (21 August)					
12:00	**POL**	**Financial results of enterprises**	**H1**		**-**	**-**	**-**
9:00	GER	ZEW index	Aug		0.0		10.4
9:00	EMU	Trade balance	Jun	€ bn			1.7
		WEDNESDAY (22 August)					
	POL	**Switching auction**					
		THURSDAY (23 August)					
	JAP	Bank of Japan meeting - decision		%			0.5
12:00	**POL**	**MPC minutes**	**Jul**		**-**	**-**	**-**
12:00	**POL**	**Core inflation**	**Jul**	**%YoY**	**1.6**	**1.6**	**1.8**
12:00	**POL**	**Business climate**	**Aug**		**-**	**-**	**-**
		FRIDAY (24 August)					
8:00	**POL**	**Retail sales**	**Jul**	**%YoY**	**17.4**	**18.1**	**16.2**
8:00	**POL**	**Registered unemployment**	**Jul**	**%**		**12.2**	**12.4**
12:30	USA	Durable goods orders	Jul	%	1.0		1.3
14:00	USA	New home sales	Jul	m			

Source: Reuters

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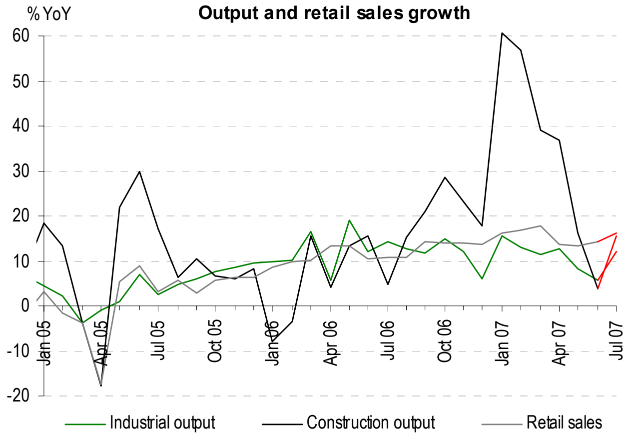
What's hot this week – Large set of new data

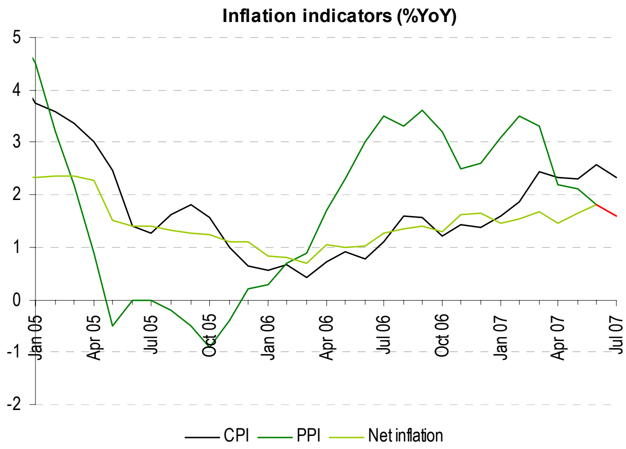


▪ This week's data about economic activity should present a revival in industrial output and retail sales growth in July, confirming that the economy has entered the second half of the year on solid footing.

▪ We forecast industrial production to rise 12.1%YoY after two months of single-digit growth (partially as an effect of one working day more). Retail sales growth should reach 18.1%YoY. Both forecasts are above market consensus.

▪ Unemployment figures should confirm continuation of rapid revival in the labour market, supportive for further growth in consumers' optimism and demand strengthening.

▪ Business climate indices for August should confirm persistently good sentiment in Polish companies and expectations for further economic expansion.

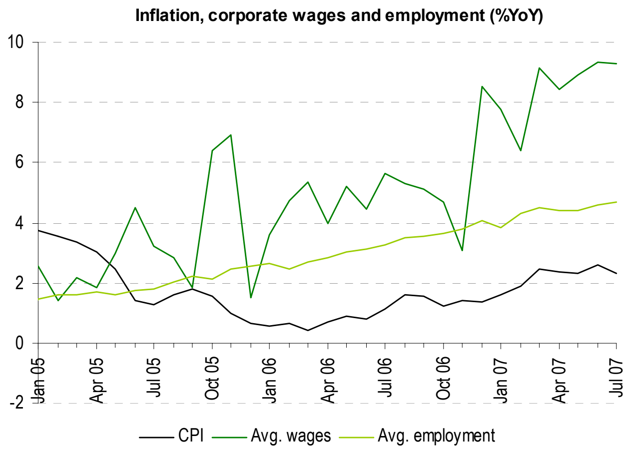


▪ Apart from activity indicators, we will receive some inflation measures. Producer prices growth is predicted to slow down to 1.6%YoY, amid quite low prices of fuels and energy in July and high statistical base.

▪ Most of core inflation measures should go down as compared to June's levels. Net inflation may decline to 1.5-1.6%, although one should be aware that the scale of the decline will result largely from statistical base effect (rise in internet access fees in July 2006).

▪ The release of MPC minutes may help in ultimate shaping of market expectations regarding the result of the nearest MPC meeting. Expectations for rate hike in August may cement if the script reveals some hawkish comments in the July's discussion, particularly concerning the situation on the labour market.

Economy last week – Strong labour market data more important than low CPI



▪ In line with our forecast, CPI growth decelerated in July to 2.3%, which was below market consensus, among others due to low prices of food and fuels.

▪ Price growth remained at June's 9.3%YoY, while employment growth accelerated to new record 4.7%YoY. The data confirmed high tensions on the labour market, which may feed into inflationary pressure in future, and create arguments for the MPC to hike rates in August.

▪ Current account deficit rose in June to €1.2bn and was higher than forecasted. Strong export growth was a positive element, although it was outpaced by import expansion. For the second straight month the net inflows from the EU were very low, widening the C/A deficit.

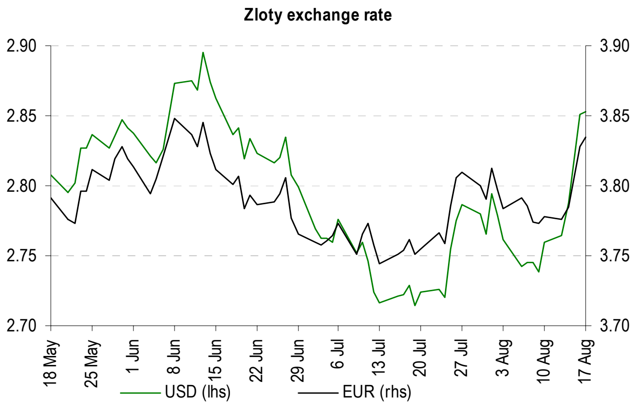
Quote of the week – The end of coalition, snap election looming

Jarosław Kaczyński, Prime Minister, PAP, 13 August

If PO and PiS are truly determined to hold election, it will definitely happen. (...) I am talking about election in the autumn, not in the spring, as the latter timing is quite distant. I do not see a chance for maintaining minority government and the current one is unacceptable. November is absolutely the furthest time (of election) one could imagine.

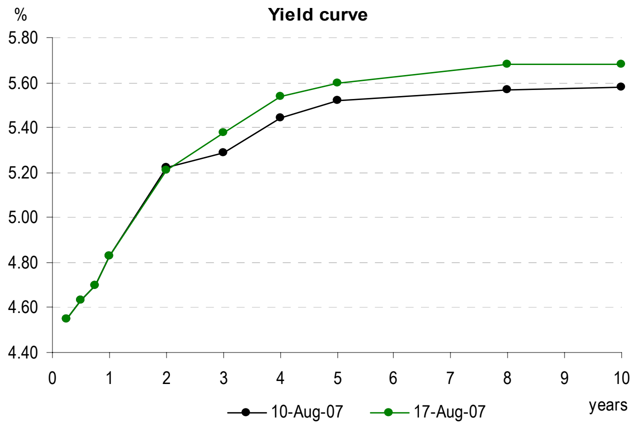
The Prime Minister dismissed four ministers from LPR and Samoobrona, which was a formal break-up of the coalition. However it remains uncertain how long the new ministers will remain in their posts, as the elections are coming. The key decisions in this regard will be made in 2-3 weeks, after the end of parliament's holiday break. Another new information was a motion about constructive no confidence for the government vote submitted by the LiS (with Janusz Kaczmarek as a candidate for the new PM). Thus far, it is hard to say which parties could support such motion, and also little is known whether there will be enough constitutional majority in order to dismiss the parliament.

Market monitor



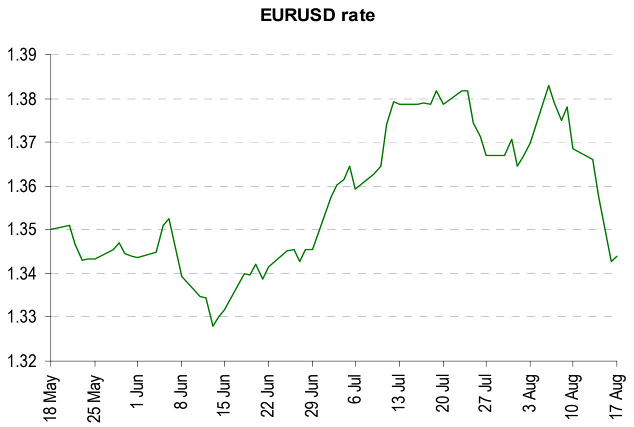
Risk aversion weighed down the zloty

- Turmoil in the financial markets hurt the zloty exchange rate in the second half of the week. The zloty depreciated, which we had anticipated, although against dollar it went much above our predicted band due to sharp fall in EURUSD.
- In the near time, the most important factor for currencies in the region will be general risk aversion. Surprise Fed decision to reduce discount rate by 50 bp on Friday (main rate unchanged) and to ease access to financing loans, should help markets recover in the near term, although it is hard to say for how long. We predict this week the EURPLN rate will be in 3.77-3.87 range, while USDPLN should stay in 2.78-2.88 range.



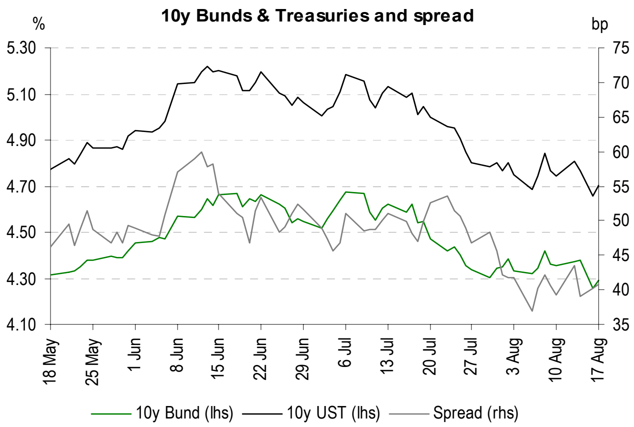
... as well as bond market yields

- Global rout in the financial markets affected also local bonds. After a period of stabilisation, bond yields rose significantly in the middle of the week and then erased part of the losses on Friday, after Fed decision.
- Local data releases due this week will have mixed impact on the debt market – on one hand, we will see drop in PPI and core inflation numbers, on the other hand strong rise in sales and production. Recovery in world markets after cut in Fed discount rate may be positive for local bonds, however we do not expect sharp drop in yields. The market will remain under pressure of increased risk aversion and expectation for the MPC's rate hike in the next week.



Dollar gains amid flee from risky assets

- On the back of general flee from risky assets, the US dollar gained last week, going to the strongest level against euro since June. On Friday, EURUSD rebounded from 1.338 to ca. 1.35 after Fed decision to cut deposit rate.
- Further dollar moves will depend on the sentiment on world financial market. Unexpected Fed decision may improve investors' confidence for some time and strengthen hopes for cut in main rates. Both factors may weaken the dollar in near term. On the other hand, Fed decision raised concerns that the situation is serious enough to pose a risk of further perturbations. So, despite Friday's move by the Fed, sentiment remains volatile.



Government debt gains on core markets

- Government bonds on major markets gained amid flight to quality and desperate seek for possibly least risky assets. Yields of 10Y Treasuries and Bunds fell during the week by ca. 10 bp and then pared some of the gains after Fed decision. As global rout was getting stronger, investors became more convinced that it would affect interest rate decisions of the major central banks (lower chances for ECB rate hike, more likely rate cut from Fed). Surprise Fed decision on Friday strengthened this view, resulting in steepening of the yield curves in core markets.
- For better part of this week, bond markets will not receive any hints for further direction from new important data. Thus, yields will be reflecting changes in global risk aversion.

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