

# Weekly economic update

27 August – 2 September 2007

Last week brought a stabilisation on the markets after turmoil in the previous week. Risk aversion receded to some extent, but markets remain vulnerable to any negative news, which was seen on Thursday in the evening in the reaction to comments from head of the largest US mortgage lender that difficult situation on the housing market may cause a recession. However, Friday's data from the US on durable goods orders and new home sales again improved sentiment on global markets.

This week we keep expected ranges of zloty fluctuations at 3.77-3.87 for the EURPLN rate and 2.78-2.88 for the USDPLN rate and market sentiment will depend mainly on news from the US. Besides, an outcome of MPC meeting will be crucial factor. Although a part of domestic data released last week was weaker than expected (this applies to output, retail sales, PPI inflation and PPI) but results of LFS survey for Q2 joined a series of very strong data from the labour market, pointing to risk of mounting inflation pressure. Basing on LFS numbers, we estimate that unit labour costs growth accelerated to almost 8%YoY in Q2. This confirms our view that the MPC is going to raise interest rate again at the meeting next week. Especially that minutes of the MPC meeting in July suggested that already then majority of rate-setters was convinced about a need for further monetary tightening, but just wanted to wait with next hike until receiving confirmation threats to inflation prospects in data due for release in August.

## Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (27 August)</b>							
14:00	US	Home sales	Jul	m	5.7	-	5.75
23:50	JP	Minutes of the Bank of Japan meeting	-	-	-	-	-
-	UK	Market holiday	-	-	-	-	-
<b>TUESDAY (28 August)</b>							
08:00	GER	Ifo index	Aug	pts	106.0	-	106.4
08:00	EMU	Money supply M3	Jul	%YoY	11.1	-	10.9
14:00	US	Consumer confidence	Aug	pts	106.0	-	112.6
18:00	US	Minutes of FOMC meeting on August 7	-	-	-	-	-
<b>WEDNESDAY (29 August)</b>							
-	POL	MPC – decision on rates	-	%	4.75	4.75	4.5
<b>THURSDAY (30 August)</b>							
08:00	POL	GDP	Q2	%YoY	6.0	6.0	7.4
08:00	POL	Private consumption	Q2	%YoY	6.0	6.1	6.9
08:00	POL	Fixed investment	Q2	%YoY	20.1	19.0	29.6
12:30	US	GDP – preliminary data	Q2	%	4.0	-	3.4
12:30	US	Core PCE	Q2	%	1.4	-	1.4
12:30	US	PKB deflator	Q2	%	2.7	-	2.7
<b>FRIDAY (31 August)</b>							
09:00	EMU	Economic sentiment	Aug	pts	110,3	-	111.0
09:00	EMU	HICP – flash estimate	Aug	%YoY	1.9	-	1.8
12:30	US	Core PCE	Jul	%	0.2	-	0.1
13:45	US	Chicago PMI	Aug	pts	53.5	-	53.4
14:00	US	Michigan index – final reading	Aug	pts	85.0	-	90.4

Source: Parkiet, Reuters, BZ WBK

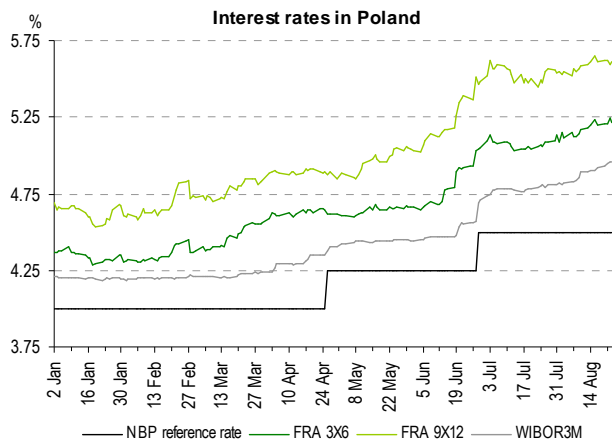
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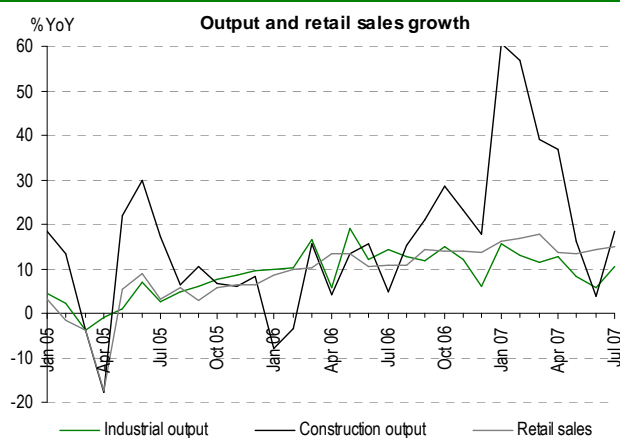
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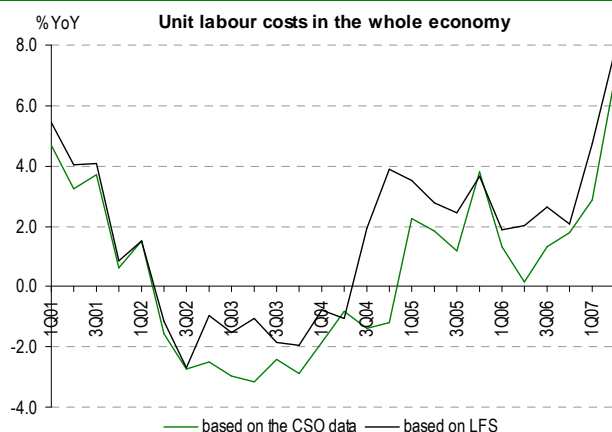
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**What's hot this week – MPC decision, GDP data and news from abroad**

- There will be not many important local events next week, but they will be crucial. On Wednesday the MPC will announce its decision on rates and on Thursday we will get GDP data for Q2.
- In our opinion, even without knowledge of official data on GDP for Q2 that are due for release after MPC meeting, central bankers have enough information to decide about another rate hike of 25pb this week.
- GDP data for Q2 should show clear deceleration of economic growth as compared to Q1. However, economic growth of around 6% predicted by us would be sufficiently high to add to a list of argument for a rate hike by the MPC
- Amid persisting uncertainty in the global markets, a series of major data from the US and the euro zone as well as publication of minutes of FOMC meeting will not be less crucial drivers of the local market.

**Economy last week – Next strong data from the labour market**

- Data on industrial and construction output and retail sales figures for July were slightly weaker than expected, but not to such an extent so that negatively affect our estimates pointing to only slight slowdown in economic growth to 5.9% in Q3 from ca. 6% in Q2.
- Business climate indicators for August suggest positive tendencies in the economy remain intact.
- PPI inflation and majority of core inflation measures decreased in July, as expected, but it was connected to a large extent with high base effects. In the forthcoming months we predict gradual acceleration of both PPI inflation and core inflation.
- The CSO said that fixed investment in the largest companies rose over 30%YoY in the first half of the year, which confirms our estimates that fixed investment in the whole economy grew nearly 20%YoY in Q2.



- Among all data published last week, the most important for evaluation of medium-term inflation prospects were next labour market statistics.
- Results of Labour Force Survey for Q2 showed fall in the unemployment rate to 9.6% (one-digit level for the first time in ten years) and strong rise in the number of working people by 4.8%YoY.
- Based on LFS data and our estimates of value added growth, we estimate that growth in unit labour costs accelerated to almost 8%YoY, i.e. even stronger than indicate estimates based on employment data.
- Although central bankers suggested in the past that using LFS data may lead to overestimating unit labour costs, the tendency is clear and this strengthens our belief that the MPC will deliver a rate hike this week.

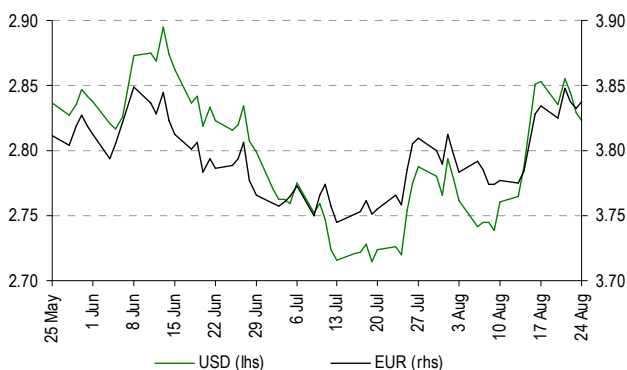
**Quote of the week – No fear in the Council of raising rates****Jan Czekaj, MPC member, Reuters, 20 August**

*If nothing extraordinary happens, hikes of 25 basis points each are the most probable. If rate hikes take place and by how much will depend on developments in Poland's and world economy. There is no fear in the Council of raising interest rates if necessary.*

Comments from Jan Czekaj, whose vote determined results of votes at MPC meeting this year, in interview conducted after turmoil in the global markets, show that his readiness for counteracting treats to medium-term inflation prospects has not eroded. Czekaj said policy actions depend on developments in the economy, and not in the financial markets alone. This suggests that at the meeting this week recent turmoil in the markets will not prevent the Council from raising rates because economic data – mostly from the labour market – indicate a need for monetary tightening.

## Market monitor

Zloty exchange rate

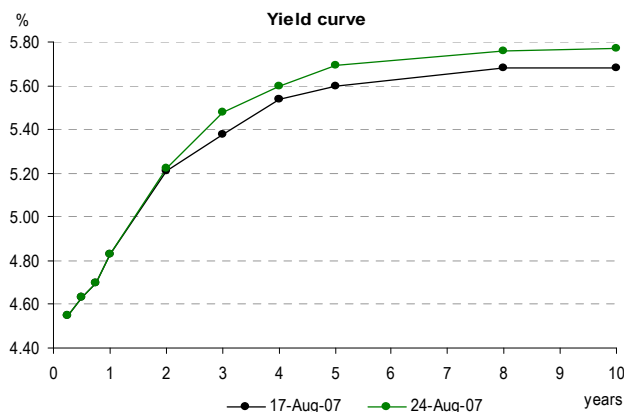


## The zloty takes a breather

▪ Last week brought stabilisation of the zloty exchange rate. It was traded in the range of 3.82-3.855 against the euro and 2.81-2.865 versus the dollar. Within these ranges the zloty fluctuated along changes in moods on global markets. When risk aversion significantly receded on Wednesday, the EURPLN reached the lowest level during the week, i.e. 3.82, but when negative news from the US appeared on Thursday in the evening the EURPLN transitory topped 3.855 at Friday's opening. Then, strong data from the US strengthened the zloty.

▪ This week we keep expected ranges of zloty fluctuations at 3.77-3.87 for the EURPLN rate and 2.78-2.88 for the USDPLN rate and market sentiment will depend mainly on news from the US.

Yield curve

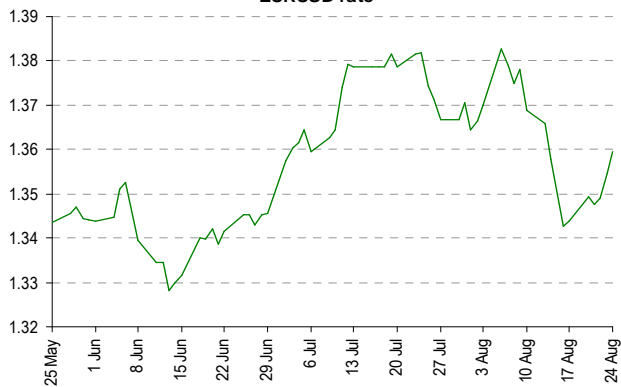


## Local debt market slightly weaker

▪ Opening of the week at the local debt market brought a weakening and later on the situation stabilised. There was lack of clear-cut signals from the core markets. Domestic bonds were fluctuating in relatively narrow ranges along with changes in moods on the global markets. Slightly weaker than expected data on output, retail sales, PPI inflation and core inflation did not strengthen the fixed income market, as labour market statistics confirmed expectations of continuation of rate hikes by the MPC, including 25bp move widely expected this week.

▪ Apart from MPC decision, trading of local bonds this week will depend heavily on performance of core markets that will see many important events.

EURUSD rate

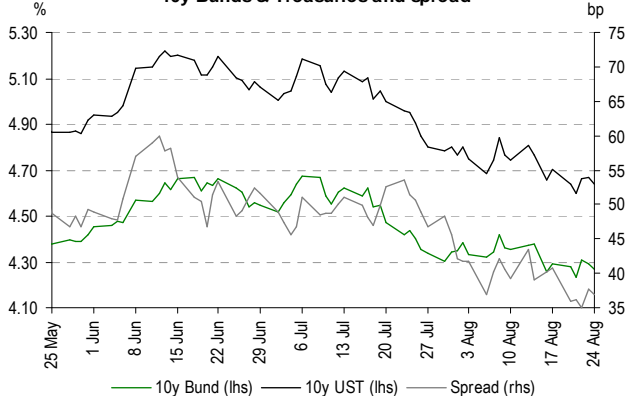


## Dollar weakens as risk aversion recedes

▪ As some stabilisation of moods was equivalent to decrease in capital flow to the US treasuries, the last week was not as good for the dollar as the previous one. American currency was gradually depreciating during the week and on Friday the EURUSD was above 1.36. Even much stronger than forecasted data about durable goods orders and new house sales were not enough to support the greenback.

▪ This week the dollar will be under influence of various factors. On the one hand, potential rise in risk aversion may attract capital to safe US government bonds and strengthening the dollar, while concerns on condition of American economy will work in opposite direction.

10y Bunds &amp; Treasuries and spread



## Safe assets still desired by investors

▪ The interest in least risky assets, i.e. the Treasury papers issued by the governments of the US and Germany was mixed last week. At the start of the week yields were falling, especially in case of US Treasury bills, which recorded the largest strengthening in many years. Later the return of the risk appetite weakened core markets, though at the end of the week the tendency of flight to risky assets dominated and yields of US Treasuries and Bunds were falling, to 4.62% and 4.24% at the end of the Friday session against 4.70% and 4.29% a week earlier.

▪ This week the core markets will be under influence of the minutes from the last decision meeting of the FOMC and the number of important data from the United States and the euro zone.

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