Bank Zachodni WBK

Weekly economic update

1 – 7 October 2007

In line with expectations the MPC has not changes monetary policy parameters at its meeting last week. The Council said in the official statement that although the balance of risks for the inflation target improved, it is still asymmetric on the upside, which means that informal restrictive bias in monetary policy was kept and suggests continuation of rate hikes. The MPC said that a more comprehensive assessment of the scale of the risk of inflation overshooting the target will only be possible after analysing the upcoming data. Given that one of factors on which central bankers are focused are labour market developments and fiscal policy and taking into account that important new information in this respect will only be available after October meeting, we keep our view that the next rate hike will take place in November. Today's decision and the statement had no impact on the markets.

After the meeting comments of hawkish MPC members appeared, which suggested that they have become less prone to next hikes, but in our opinion gradual inflation acceleration in forthcoming months and new data from the labour market, which will show persisting threat to medium-term inflation outlook, will induce the MPC to continue monetary tightening.

Last week, there was no clear direction in both the domestic FX and fixed income markets. Given that this week there are no major domestic events in the agenda, expect auction of 2-year bonds, local markets will search for direction in the international markets. The key days of the week will be Thursday and Friday when will get, respectively, comments of ECB President Jean Claude Trichet after the decision meeting, but the key focus of attention will be, as usual at the beginning of a month, the US non-farm payrolls report.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (1 October)					
08:00	EMU	PMI manufacturing	Sep	pts	53.2	-	54.3
14:00	US	ISM manufacturing	Sep	pts	52.5	-	52.9
		TUESDAY (2 October)					
09:00	EMU	PPI	Aug	%YoY	1.7	-	1.8
14:00	US	Pending home sales	Aug	%	-2.5		-12.2
		WEDNESDAY (3 October)					
09:00	**POL**	**Auction of 2-year bonds**					
-	GER	Market holiday	-	-	-	-	-
08:00	EMU	PMI services	Sep	pts	54.0	-	58.0
09:00	EMU	Retail sales	Aug	%YoY	0.5	-	0.5
12:15	US	ADP report	Sep	'000	60.0	-	38.0
14:00	US	ISM services	Sep	pts	55.0	-	55.8
		THURSDAY (4 October)					
11:00	UK	The Bank of England decides on rates	-	%	5.75	-	5.75
11:45	EMU	The ECB decides on rates	-	%	4.0	-	4.0
14:00	US	Factory orders	Aug		-2.5	-	3.7
		FRIDAY (5 October)					
12:30	US	Non-farm payrolls	Sep	'000	90.0	-	-4.0
12:30	US	Unemployment	Sep	%	4.7	-	4.6

Source: Reuters

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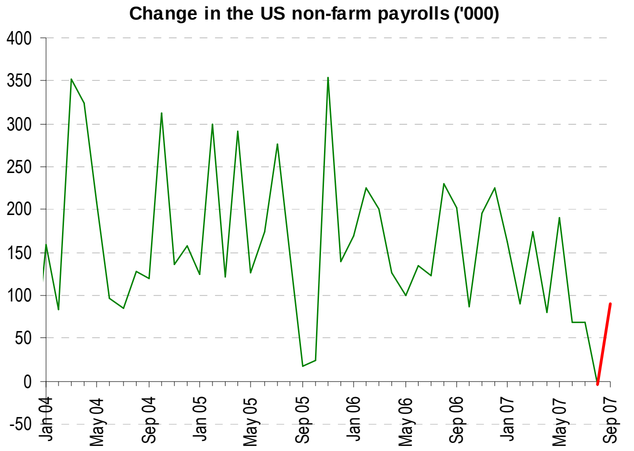
What's hot this week – Focus on US data



- This week, with no major domestic events, attention of market participants will be focused on developments in the international markets, mostly on data from the US.
- As usual at the beginning of the month, the crucial event is release on the US non-farm payrolls report. Wall Street analysts predict a clear rebound in employment after the unexpected drop recorded in August. A plenty of attention will be also paid to ISM indices and next data from the housing market.
- In Poland, the only important event scheduled for this week is auction of 2-year bonds, but in a week after the MPC meeting one may expect comments from central bankers. Possibly, they would shed more light on whether rate-setters have actually become less prone to hikes, which was suggested by recent comments from MPC members Dariusz Filar and Halina Wasilewska-Trenkner.

Economy last week – Economic expansion continues, rates unchanged

Selected fragments of MPC statement after September meeting
In August the annual growth of consumer prices in Poland amounted to 1.5%. The decline in inflation observed in 2007 Q3, although deeper than previously expected, is of temporary nature. The Council assesses that in 2007 Q4 inflation will be close to the inflation target of 2.5%.
In the Council's assessment, in the medium term the probability of inflation running above the inflation target decreased to a certain degree due to the previously implemented monetary policy tightening, though it is still higher than the probability of inflation running below the target. A more comprehensive assessment of the scale of the risk of inflation overshooting the inflation target will only be possible after analysing the data released in the future.
The Council will be closely monitoring the growth and structure of domestic demand, including the degree of the expansionary fiscal policy stance, developments of the current account balance, the relation between wage and labour productivity growth, zloty exchange rate, the impact of globalisation on the economy and developments in international financial markets.

MPC statement after the meeting, concluded with no rate hike as expected, was not surprising.

The list of factors, which according to the Council are going to limit inflation in the medium term, was extended with a "possible slowdown of the global economy". The list of factors in favour of rising inflation remained unchanged.

Deeper than expected fall in inflation in Q3 is regarded by the Council as a one-off, which suggests that this will not affect monetary policy prospects.

- Although the Council said that balance of risks to inflation had improved, the same statement appeared in July and one month later a rate hike took place. We think, however, this time the Council will defer decision on next hike longer, given that crucial information regarding labour market and fiscal policy, i.e. key areas for the MPC, will only be available in November.

Retail sales rose 17.4% in August, more than expected, being supported by accelerating growth in households' income. In real terms retail sales grew 16.1%YoY, faster than in July when increased 15%YoY.

The registered unemployment rate fell to 12% at the end of August, in line with expectations. In the following months further decline in the unemployment rate is very likely and we forecast it at the level of 11.5% in December.

Predicted further improvement in the labour market allows predicting continuation of fast consumption rise in the following quarters, which will be an important driver of strong economic growth in Poland. At the same time, despite ongoing consumption boom, the price growth remains subdued, which was indicated this week by low level of core inflation measures and retail sales deflator.

Quote of the week – Will next hikes be necessary?

Halina Wasilewska-Trenkner, MPC, Thomson Financial, 27 Sep

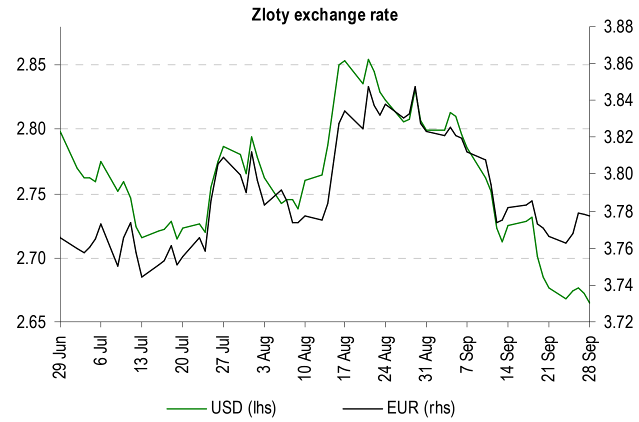
In this position, I do not know if further rises in interest rates will be necessary, although I cannot rule them out (…) In so much as in August I believed that another 1 or 2 interest rate hikes were needed in the course of a year, currently I am inclined to revise my earlier view. It may turn out that the tightening to date is sufficient to stifle pressure on inflation. We have to be careful not to damage the economy with our decisions.

Dariusz Filar, MPC, Reuters, 28 Sep

I am not sure whether there will be enough data already in October to back a rate hike. Maybe there will be enough data only till the end of the year. And maybe data indicating a need for a hike will only appear at the start of 2008.

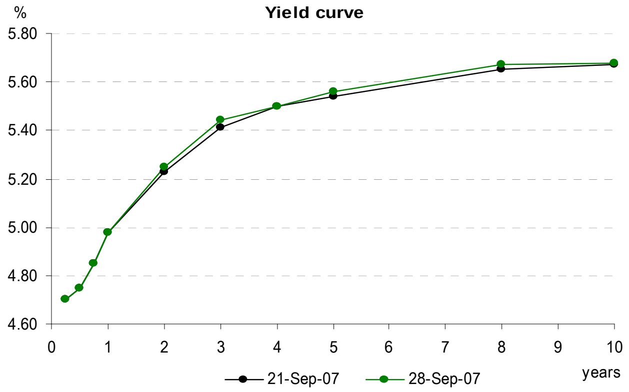
Quoted comments from hawkish MPC members weakened market expectations of further rate hikes (fall in FRA rates by a few basis points). Looking at them, one may actually conclude that even conservative rate-setters has become less prone to further hikes. Both for Wasilewska-Trenkner and Filar the new inflation projection due in October will be of high importance, but according to Filar the Council may not be convinced about a need for next hike even in November, when labour market data for Q2 are available, nor in December, when GDP figures for Q3 will be published. In our opinion new labour market data may be a signal significant enough to persuade the MPC to hike rates again.

Market monitor



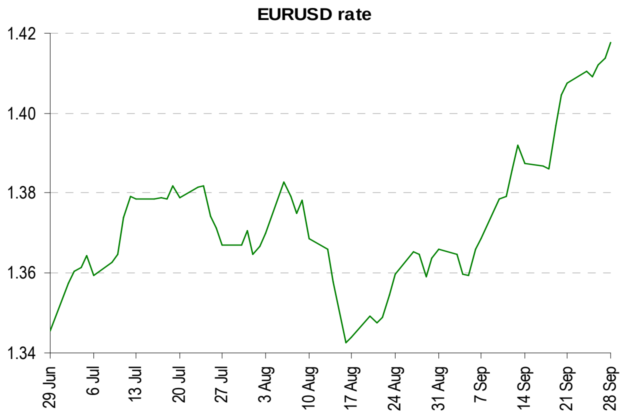
Zloty stronger to the dollar, weaker to the euro

- Last week the zloty weakened versus the euro and strengthened against the dollar, as the latter was loosing throughout the week in the international markets. The strength of the domestic currency versus the basket of two currencies did not change significantly. MPC comments were not good information for the zloty, as they weakened expectations of interest rate hikes in Poland. However, these were the moods in the world markets that were the most important for the zloty, but they were changing without clear direction.
- This week the zloty is still going to be under influence of international sentiment, as there will be no major data releases in Poland. We keep the expected range for the EURPLN rate at 3.73-3.83 and we slightly lower the USDPLN rate range to 2.62-2.72.



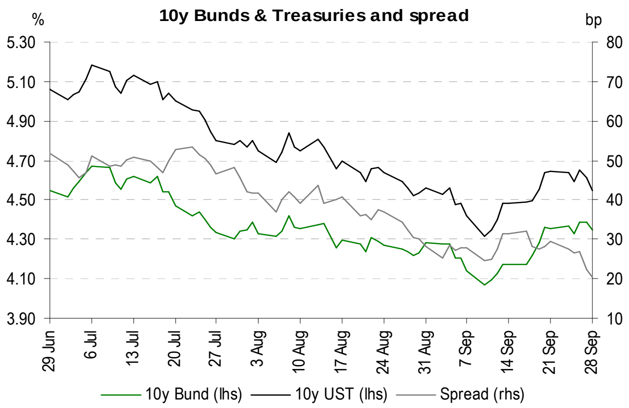
No clear direction in local debt market

- The past week did not bring much changes in the domestic debt market. The domestic data released during the week were mostly in line with expectations, thus they did not influence the fixed income market. The comments of the "hawkish" members of the Council, suggesting the weakening willingness to raise rates further, did not significantly affect bonds, though they resulted in a drop of FRA rates.
- There should be no major changes in the local market also this week amid lack of important data releases in Poland. There is only a 2Y bond auction in the agenda. The Polish market is going to follow the core debt markets with the last days of the week will be crucial for them.



Dollar reaches new lows

- Last week was not a good one for the US dollar. The US currency was harmed mainly by cementing, under influence of recently published data, expectations of next rate cuts by the Fed. As a result, the EURUSD rate reached record high levels during the week. On Friday, it even broke 1.42. It seems that after breaking the level the greenback may slip further, unless the forthcoming data, e.g. the non-farm payrolls, change the situation.
- This week will bring many important for the dollar data releases in the US. The EURUSD rate will also be affected by information from the euro zone, especially an outcome of the ECB meeting. It is widely expected that rates will be kept on hold, but markets will wait what the ECB president will say at the press conference.



Changing moods in the core debt markets

- Last week the shorter dated bonds still benefited from high interest f investors amid expectations of continuation of rate cuts by the Fed and prolongation of pause in rate hikes by the ECB. However, longer dated bonds were negatively affected by rising concerns about possible inflation acceleration due to less conservative stance of major central banks. After rise during the week, towards the end of the week yields of 10-year Treasuries fell and reached 4.55% and 4.34%, respectively, against 4.65% and 4.35% a week earlier.
- The core debt market performance this week will depend, similar to the EURUSD rate market, on both the US data, especially the key US non-farm payrolls report, and the ECB meeting.

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