Bank Zachodni WBK

Weekly economic update

26 November – 2 December 2007

Last week brought moderate depreciation of the zloty and clear weakening in the fixed income market. The domestic currency has been negatively affected by higher risk aversion in the global markets, but at the same time it has been supported by expectations for further rate hikes by the MPC. The latter is very negative for the local fixed income market and it is not offset by falling yields in the core debt markets. Lower-than-expected PPI data brought about only a temporary rebound. Other data published this week, the same as exposé of the new Prime Minister, had no impact on the market, as they have not changed assessment of the economic situation, medium-term inflation prospects and expected scenario of monetary policy.

While there are growing expectations for more aggressive actions of the MPC (rate hike of 50bps in November or more frequent hikes of 25bps, higher maximum level of interest rates in the tightening cycle), we think that the Council will consistently continue the measured pace of rate hikes. We predict that after 25bps move in November the MPC will deliver two next hikes of 25bps in January and March. An outcome of the MPC meeting in November will be the key factor for the Polish financial market this week, but quarterly data on labour market and GDP will also be important.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (26 November)					
09:00	**PL**	**Retail sales**	**Oct**	**%YoY**	**16.3**	**16.7**	**14.2**
09:00	**PL**	**Registered unemployment rate**	**Oct**	**%**	**11.3**	**11.3**	**11.6**
		TUESDAY (27 November)					
09:00	GER	Ifo index	Nov	pts	109.1	-	109.6
15:00	US	Consumer confidence	Nov	pts	91.6	-	95.6
		WEDNESDAY (28 November)					
-	**PL**	**MPC meeting – decision**	**-**	**%**	**5.0**	**5.0**	**4.75**
09:00	EMU	Money supply M3	Oct	%YoY	11.5	-	11.3
13:30	US	Durable goods orders	Oct	%	0.0	-	-1.7
15:00	US	Existing home sales	Oct	m	5.0	-	5.04
		THURSDAY (29 November)					
10:00	**PL**	**Switch auction**					
13:30	US	Preliminary GDP	Q3	%	4.8	-	3.9
13:30	US	Core PCE	Q3	%	1.8	-	1.8
13:30	US	GDP deflator	Q3	%	0.8	-	0.7
15:00	US	New home sales	Oct	m	0.75	-	0.77
		FRIDAY (30 November)					
09:00	**PL**	**GDP**	**Q3**	**%YoY**	**5.8**	**5.8**	**6.4**
09:00	**PL**	**Private consumption**	**Q3**	**%YoY**	**5.5**	**5.5**	**5.1**
09:00	**PL**	**Fixed investment**	**Q3**	**%YoY**	**18.2**	**16.0**	**20.8**
10:00	EMU	Economic sentiment	Nov	pts	105.0	-	105.9
10:00	EMU	Flash HICP	Nov	%YoY	2.7	-	2.6
10:00	EMU	Preliminary GDP	Q3	%YoY	2.6	-	2.5
13:30	US	Core PCE	Oct	%MoM	0.2	-	0.2
14:45	US	Chicago PMI	Nov	pts	50.3	-	49.7

Source: BZ WBK, Parkiet, Reuters

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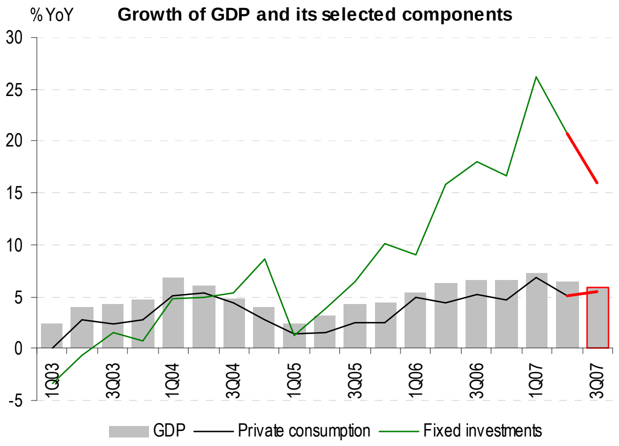
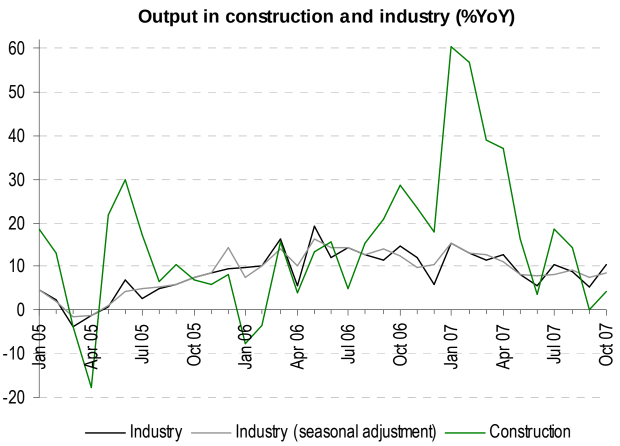
What's hot this week – MPC meeting and GDP data

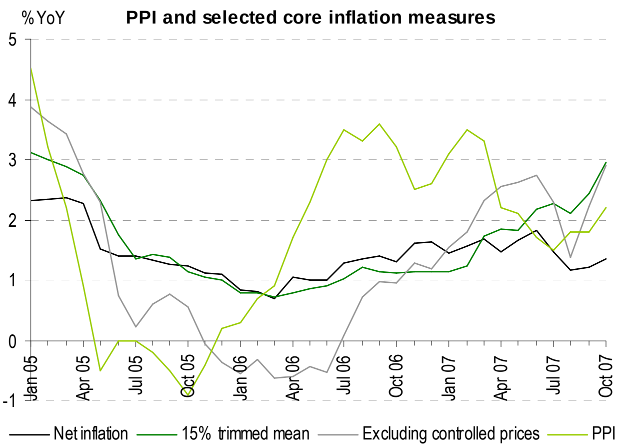


- This week the key event in the Polish financial market will be the MPC meeting. Rate hike of 25bps seems sure. However, there is uncertainty in the market whether the MPC will not deliver 50bps hike and if not whether the Council will not suggest higher frequency of hikes.
- Before announcement of the MPC decision we will get not only retail sales and unemployment figures for October, which should confirm that firming labour market conditions translate into solid rise in consumption demand, but also data on employment in the whole economy in Q3. The latter will enable, together with GDP figures and earlier released data on wages in the whole economy in Q3, to estimate growth in unit labour costs.
- Data on GPD for Q3 will be revealed after the MPC meeting and they will influence expectations regarding further moves of the central bank.

Economy last week – Moderate output growth, moderate price increase



- Industrial output in October grew over 10%YoY, stronger than expected. Seasoanlly adjusted growth reached 8.6%YoY, which was the similar level as on average in two previous quarters of the year. Breakdown of the output growth suggest that export sector still perform quite well, despite the zloty appreciation this year.
- Good condition of exporters was confirmed by data on financial results of enterprises after Q3, although one should note faster rise in costs than in revenues and slower pace of profit increase.
- The negative surprise was weaker than expected rise in construction output, slightly higher than 4%YoY. However, in our opinion this does not mean a major slowdown in investment activity, yet is related to high base effect and a phase of investment cycle, which is suggested by breakdown of construction output growth.



- Data on PPI inflation proved lower than expected. PPI inflation reached 2.2%YoY against market consensus of 2.5%YoY. What is important, for the first time this year there was monthly drop in producer prices (of 0.2%). This suggests that enterprises do not pass through higher costs into prices of produced goods.
- Although one should expect that due to low base effect the PPI inflation will accelerate in the next months, its scale will be smaller than it was earlier predicted. We forecast that PPI inflation will reach 3.4%YoY in December.
- Net inflation in October proved in line with our estimates and reached 1.4%YoY. The remaining measures of core inflation are higher than net inflation, but one should remember that they are to some extent affected by surging food prices and do not reflect intensification of the underlying inflationary pressures.

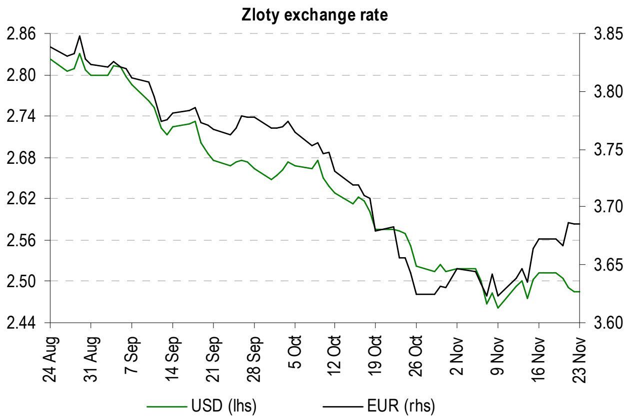
Quote of the week – The situation requires decisive actions

Dariusz Filar, MPC member, PAP, 21 Nov

We are not any more in the period when we could have made pre-emptive hikes of 25bps every two months. Now the situation is completely different and requires decisive actions in short time. (…) Considering whether we need hikes of 50bps each should be connected with considering whether there will be hike in December.(…) The MPC should act in the near time, as inflation expectations may strengthen and this could couple with increase in wages which traditionally take place in Q1. (…) As for now, I have not changed my view on the maximum level of interest rates we should aim at, but I am convinced we should reach it faster.

Comments from one of the hawks indicate that some MPC members would like more decisive rate hikes, although Filar said that maximum level in the tightening cycle had not changed in his opinion. He just only believes that rate hikes should be delivered faster either through their higher frequency or by larger size of a single hike. Given that other MPC members have different opinion than Filar on relative risks to economic growth and inflation (they put more relatively more emphasis on risks to growth than inflation), we think that in the next months the Council will continue rate hikes at measured pace, i.e. after 25bps rate hike in November we should see the next two moves of the same size in January and March.

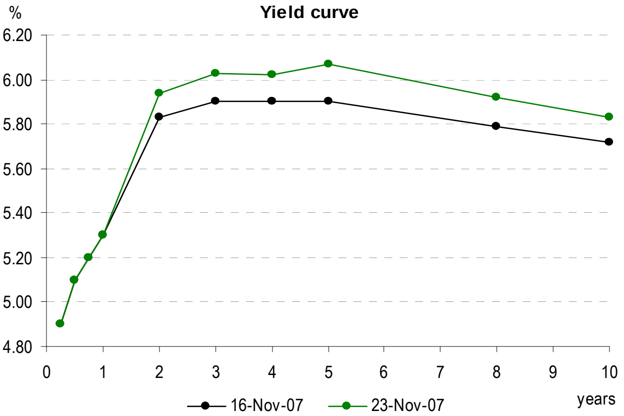
Market monitor



Zloty slightly weaker

▪ In line with our expectations, changes of the zloty exchange rate last week were limited, among others due to limited activity in the global markets. On Monday the zloty weakened on the wave of rising risk aversion in the global markets and though it temporarily recovered on Tuesday, close to 3.67, later on the EURPLN rate remained close to 3.69, and temporarily it was getting close to 3.70. The range of 3.70-3.74 seems to be strong resistance for the EURPLN rate.

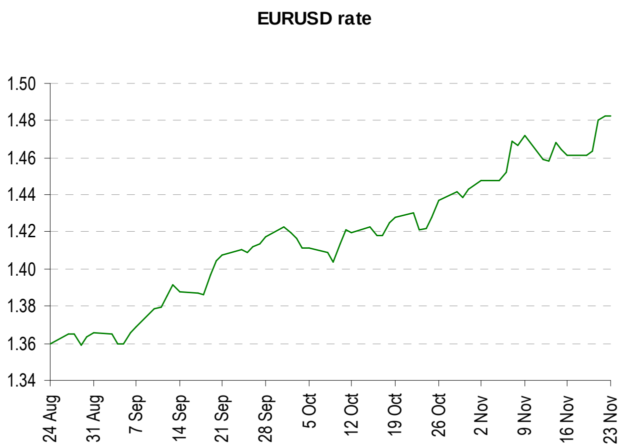
▪ This week the zloty rate will be under influence of the MPC meeting and the level of the risk appetite in the global markets. In our view the overall effect of the two factors should be slightly negative for the zloty. Thus, we move expected range of the EURPLN rate up to 3.64-3.74 and maintain range for the USDPLN rate at 2.45-2.55.



Domestic yield curve clearly up

▪ Last week, similar as the previous one, brought a clear weakening in the local debt market. The yield curve went up by more than 10bps. Lower than expected PPI data was positive news for the debt market (one of few recently), but they allowed only for a temporary strengthening in the fixed income market. There were other factors which worked in the opposite way, among others comments of MPC's Filar, which fueled expectations for further rate hikes.

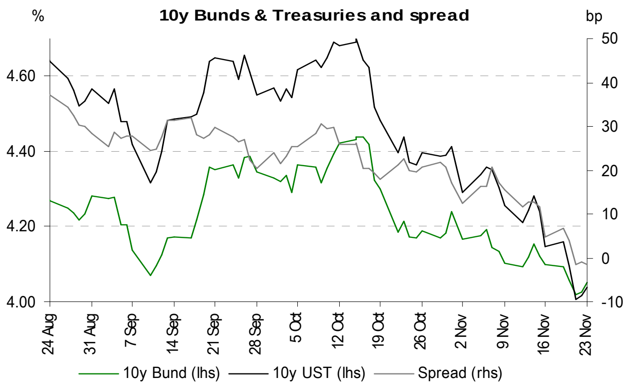
▪ This week an outcome of the MPC meeting and as well GDP data will be key factors for the fixed income market. If the Council raises rates by 25 bp, and the tone of the Council communiqué is not clearly hawkish and GDP data shows some slowdown in economic growth, there should be some recovery in the local fixed income market.



Dollar reaches new lows

▪ The last week brought further dollar weakening. On Friday morning, amid low liquidity, the EURUSD rate reached historical maximum at 1.495. In the later part of the Friday session the dollar managed to recover, though at the end of the day it was weaker by 1.5% vs. the previous week, reaching 1.48. The dollar's depreciation is a result of mounting expectations of interest rate cuts in the US, despite the recent comments of Fed officials. The greenback was hurt among others by the release of the downwardly revised Fed's forecasts of the US GDP in 2008 and new information on the problems of the financial institutions with regard to the crisis in the credit market.

▪ This week the EURUSD rate is going to be under influence of the release of many important data, which may show the direction of further moves of the dollar. After the end of the long weekend in the US the market activity should revive.



Significant fall in yields on the core debt markets

▪ Persistence of higher risk aversion and concerns about a slowdown of the US economy and the weakening of the euro zone's economy supported bond prices in the core debt markets. At the end of the week yields of 10Y Treasuries and Bunds reached 4.03% and 4.04%, respectively, against 4.15% and 4.10% in the previous week. During the week yields of Treasuries fell below 4% for the first time since mid-2005 and below Bunds yields for the first time since April 2004.

▪ This week, the core debt markets will be under influence of many data releases in the US and the euro zone. It is not very likely so that the new data significantly weakened expectations of further rate cuts by Fed. Therefore, bonds yields will remain close to a few years lows.

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