

Weekly economic update

10 – 16 December 2007

This week's calendar is quite heavy with a number of data publications and the decision of FOMC as regards interest rates in the US. While the latter will be undoubtedly the most important factor for international markets, domestic market will focus on CPI inflation release for November. The rate cut by Fed should be supporting factor for the markets, which has been recently in positive pre-Christmas mood, which was reflected in rising equities and strengthening currencies in our region. However, not only the decision itself but also the communiqué released by Fed will be important for the market as it may include some hints how the central banks see the prospects of the US economy. As regards Polish inflation, we think that its increase may be slightly lower than predicted by the Ministry of Finance and this will be connected with smaller increase in food prices as compared to the previous months. If our forecast materialises, there should be a positive impact on the bond market, which has priced-in the forecast of the Ministry of Finance. Data on balance of payments should be also positive, as foreign trade turnovers will see strong growth in exports and imports. The current account deficit will be probably slightly higher than in September, though lower as compared to the analogues period of last year. Data on money supply will be neutral for the market, as usual, while among international data publication the focus will be on inflation figures in the euro zone and US.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (10 December)							
15:00	USA	Pending home sales	Oct	%	-1.0	-	0.2
TUESDAY (11 December)							
10:00	GER	ZEW index	Dec		-33.0	-	-32.5
15:00	USA	Wholesale inventories	Oct	%	0.5	-	0.8
19:15	USA	FOMC meeting – decision		%	4.25	-	4.50
WEDNESDAY (12 December)							
10:00	POL	Switch auction					
13:00	POL	Current account balance	Oct	€ m	-957	-726	-681
10:00	EMU	Industrial production	Oct	% yoy	-	-	3.5
13:30	USA	Foreign trade prices	Nov	%	1.4	-	1.8
13:30	USA	Foreign trade balance	Oct	\$ bn	-57.0	-	-56.45
THURSDAY (13 November)							
13:00	POL	MPC minutes	Nov	-	-	-	-
13:00	POL	CPI	Nov	% yoy	3.4	3.3	3.0
8:30	CH	Bank of Switzerland meeting – decision		%	2.75	-	2.75
13:30	USA	PPI	Nov	% mom	0.9	-	0.1
13:30	USA	Retail sales	Nov	% mom	0.5	-	0.2
FRIDAY (14 November)							
13:00	POL	Money supply	Nov	% yoy	13.2	13.6	13.6
10:00	EMU	Final HICP	Nov	% yoy	3.0	-	2.6
13:30	USA	CPI	Nov	% mom	0.5	-	0.3
14:15	USA	Capacity use	Nov	%	81.7	-	81.7
14:15	USA	Industrial output	Nov	% mom	0.1	-	-0.5

Source: BZ WBK, Reuters

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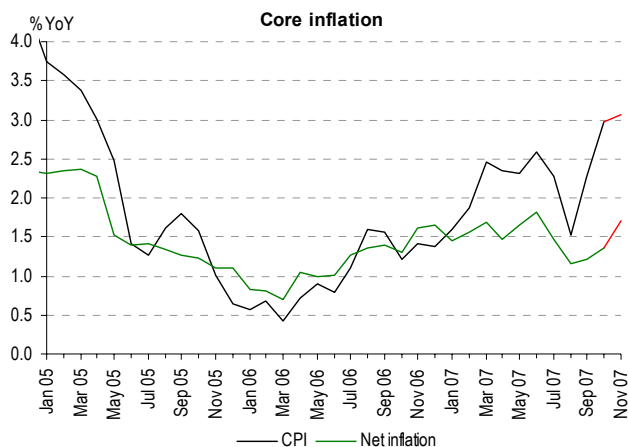
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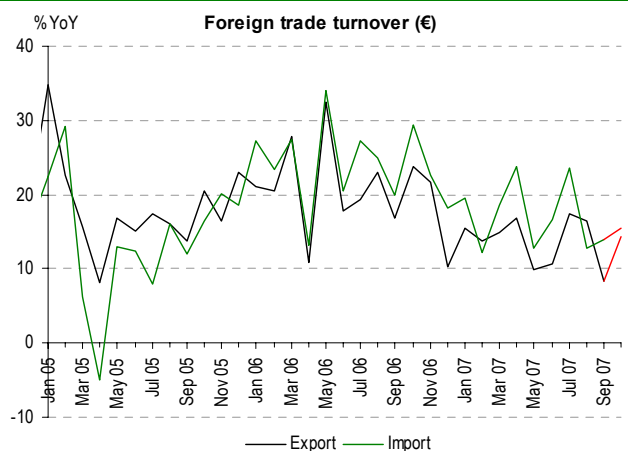
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What's hot this week – FOMC decision, local CPI, and numerous data abroad

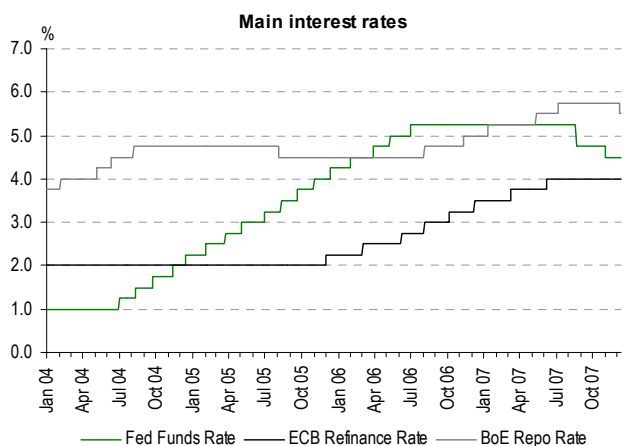


- This week the main event in the financial markets will be the FOMC meeting with decision announcement due on Tuesday in the evening.
- Majority of analysts predict a rate cut by 25bps and expectations of 50bps move diminished after publication of the better-than-expected ADP report.
- However, concerns about consequences of the credit crunch remain strong and market sentiment is vulnerable to any negative news. Therefore, the markets are going to keep a close eye on the Fed statement, searching for hints on prospects for the US economy and further monetary policy actions.
- On Thursday, the Swiss National Bank will announce its decision on interest rates. The markets expect the benchmark rate will remain at 2.75%.



- Among domestic events, the key one will be publication of the CPI figures for November. There is no doubt the headline inflation rate have risen, the question is by how much. The FinMin's estimate pointing to 3.5%YoY seems quite pessimistic. In November there was further rise in food prices, but in our opinion it was weaker growth than in previous months. On the other hand, there was stronger rise in fuel prices. Our forecast CPI inflation at 3.3%YoY and net inflation at 1.7%YoY.
- The NBP data should show increase in the C/A deficit in October to €726m (but some drop in 12-month C/A gap in relation to GDP), narrower trade gap (€578m) and acceleration in exports and imports growth.
- Increase in money supply should stabilize in November at 13.6%YoY with slight deceleration in deposits and loans growth. The data should be neutral for the market.

Economy last week – Bank of England cut interest rates, ECB on hold



- In line with expectations, the ECB maintained interest rates unchanged with the main rate at 4.0%. The ECB President emphasised risk factors for inflation saying the ECB will be ready to act against them. In our opinion, despite much hawkish talk from the ECB, the likelihood is that if there is any change in policy near term, it will be a rate cut.
- The Bank of England decided to lower interest rates by 25 bp in reaction to signs of economic slowdown, which were recently strengthened by tightening credit conditions. According to UK central bankers, higher energy and food prices are expected to keep inflation above the target in the short term, though slowing demand growth should ease the pressures on supply capacity, bringing inflation back to target in the medium term. A cut was necessary to meet the 2% target for CPI inflation in the medium term.

Quote of the week – The MPC has no reasons for nervousness

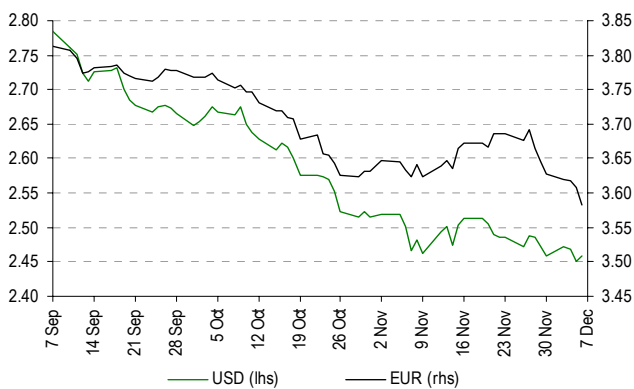
Andrzej Wojtyna, MPC member, Reuters, 6 December

Time schedule [of the next rate hikes] is difficult to predict right now. [...] but the recent cut was probably not the last one. [...] There was a shift towards higher likelihood of rate hikes as compared to last month. [...] Temporary rise in food prices is not worrying by itself, but because of its possible pass through on wage growth. [...] I do not share a view of some analysts that monetary tightening should be deeper. [...] The GDP data, as regards its structure, are comforting. There is no reason for nervousness. I believe the Council is not late with decisions. There are strong arguments [...] that from the long-term perspective, gradual rate hikes are better than more decisive movements.

One should pay attention to comments of Andrzej Wojtyna who has recently moved on the scale of MPC restrictiveness index to the highest position among hawks. As in his opinion there are no reasons for nervousness (e.g. to hike interest rate by 50 bp to increase frequency of hikes), such motion is not likely to find a support of the majority of the Council. This confirms our opinion, that a significant negative surprise in upcoming economic data releases would be necessary to cause the MPC to act during the December's meeting. On the other hand, further tightening in monetary policy seems a deal done. This was suggested by Wojtyna and this view is shared by majority of Council members.

Market monitor

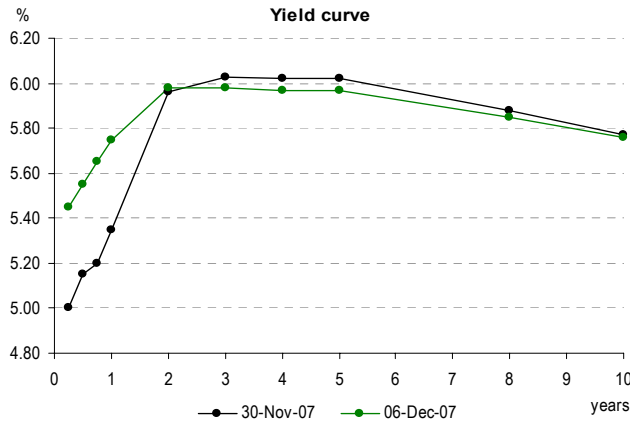
Zloty exchange rate



Zloty keeps gaining before Christmas

- Last week the zloty maintained appreciation trend against main currencies, amid improving sentiment and falling risk aversion. EURUSD rate fell below 3.60 and USDPLN approached 2.45. GBPPLN exchange rate declined below 5.00 due to the Bank of England's decision to cut main interest rate.
- If neither the Fed's communiqué nor the US data releases (particularly non-farm payrolls) will worsen the assessment of US economy's prospects, the pre-Christmas rally may persist. On the other hand, slowly some signs of technical correction are also appearing. We reduce the currency fluctuations range for the EURUSD to 3.55-3.65, while for USDPLN the range is maintained at 2.40-2.50.

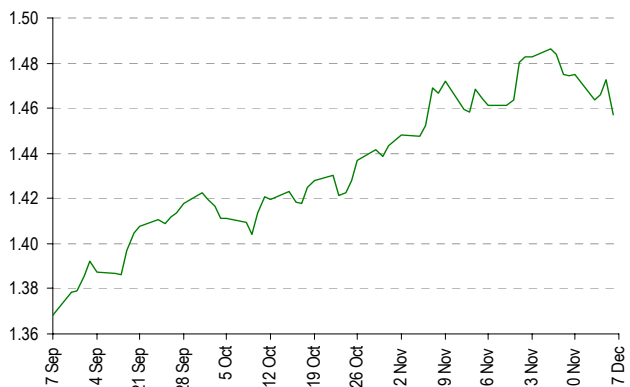
Yield curve



Inflation and liquidity issues weakened debt market

- Last week the domestic bond market saw a weakening. This was driven by the publication of high inflation forecast by the Ministry of Finance, which reinforced market expectations on further interest rate hikes. The negative mood (especially at the short-end of the curve and in the money market) was also connected with liquidity problems towards the year-end.
- This week the inflation data release will be most important for the domestic market. Taking into account that the market priced-in the MinFin forecast of 3.5%, and in our opinion there is a downward risk for this forecast, the publication may be positive for bonds. Change in global risk aversion after the Fed decision will be also important driver for the Polish fixed income market

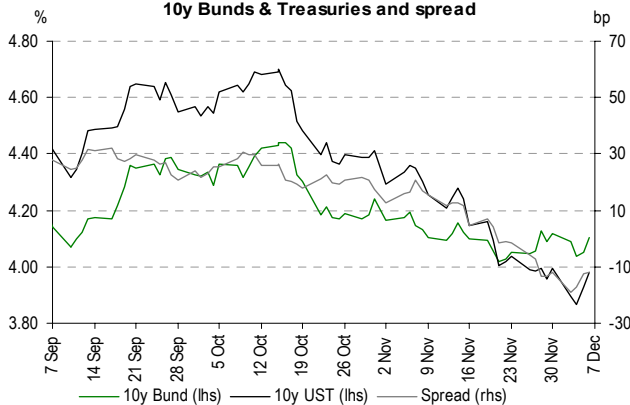
EURUSD rate



Dollar regained some ground against euro

- The dollar has been appreciating against the euro for the second week in a row. This was connected with information limiting investors' concerns regarding problems on the housing and credit markets, as well as slowdown in US economy. As a result of lower risk aversion globally, the market saw the weakening of low interest rates currencies (JPY, CHF) and rise in equity indices
- The result of Fed meeting and publication of economic data in the US and in the euro zone will be important factors for the dollar strength in the week ahead. If there are no surprises that could revive investors' concerns, the EURUSD may remain quite strong, which would also have positive impact on the currencies in our region.

10y Bunds & Treasuries and spread



Larger risk appetite hurts bonds

- While at the beginning of the week yields of 10-year Treasuries continued falling, widening spread against the Bunds, along with return of optimism to the stock markets and larger risk appetite there was weakening in demand for safe assets, which led to correction in the core debt markets and rise in bonds yields. Towards the end of the week the European debt market was negatively affected by quite hawkish comments from the ECB President Jean Claude Trichet.
- Both Fed decision as well as data releases (especially on inflation in the US and in the EMU) will influence the behaviour of the core debt markets this week. Maintaining of positive moods and low risk aversion may contribute to further rise of the yields.

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