Bank Zachodni WBK

Weekly economic update

14 – 20 January 2008

Among numerous data releases planned for this week, the focus will be on inflation numbers, both in Poland and on major foreign markets. Domestic inflation, likewise in many other countries, still remains under pressure of rising prices on food and fuel markets, so its increase seems to be inevitable. However, in our view the CPI growth may be slightly lower than 4% predicted by the market consensus. A slowdown should take place in the case of wages in enterprises sector, which were biased up in November by a bonuses payments in mining sector. In general, such combination of data releases should favour strengthening on the interest rate market in the middle of the week. Apart from the data releases, comments of the MPC members following the publications may be very important for market sentiment. Production data due on Friday are likely to show that industrial and construction sectors sustained a rapid expansion in Q4. The financial market behaviour may be also influenced by numerous important data publications abroad. In particular, the market will focus on data concerning inflation, retail sales, and housing market performance in the US.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (14 January)					
13:00	**PL**	**Money supply**	**Dec**	**%YoY**	**13.0**	**12.8**	**13.3**
10:00	EZ	Industrial production	Nov	%YoY	2.8	-	3.8
		TUESDAY (15 January)					
13:00	**PL**	**CPI**	**Dec**	**%YoY**	**4.0**	**3.9**	**3.6**
10:00	DE	ZEW index	Jan	pts	-40.0	-	-37.2
13:30	US	New York Fed index	Jan	pts	8.25	-	10.31
13:30	US	PPI	Dec	%MoM	0.4	-	3.2
13:30	US	Retail sales	Dec	%MoM	0.1	-	1.2
		WEDNESDAY (16 January)					
10:00	**PL**	**Switching auction**					
13:00	**PL**	**Wages in enterprises sector**	**Dec**	**%YoY**	**11.0**	**10.5**	**12.0**
13:00	**PL**	**Employment in enterprises sector**	**Dec**	**%YoY**	**5.0**	**4.9**	**5.0**
10:00	EZ	Final HICP	Dec	%YoY	3.1	-	3.1
13:30	US	CPI	Dec	%MoM	0.3	-	0.8
14:15	US	Capacity use	Dec	%	81.3	-	81.5
14:15	US	Industrial production	Dec	%MoM	-0.1	-	0.3
		THURSDAY (17 January)					
13:30	US	House starts	Dec	m	1.16	-	1.19
15:00	US	Philadelphia Fed index	Jan	pts	-0.8	-	-1.6
		FRIDAY (18 January)					
13:00	**PL**	**Current account balance**	**Nov**	**€ m**	**-950**	**-1276**	**-1302**
13:00	**PL**	**Industrial production**	**Dec**	**%YoY**	**8.6**	**10.4**	**8.3**
13:00	**PL**	**PPI**	**Dec**	**%YoY**	**2.8**	**3.1**	**2.6**
15:00	US	Preliminary Michigan index	Jan	pts	75.0	-	75.5

Source: BZ WBK, Parkiet, Reuters

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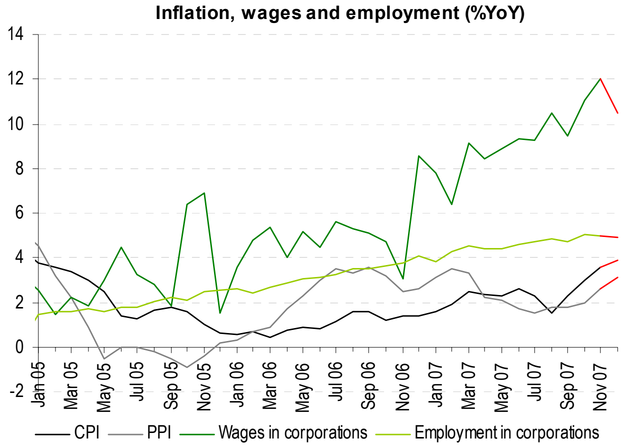
What's hot this week – New important data releases in Poland and abroad

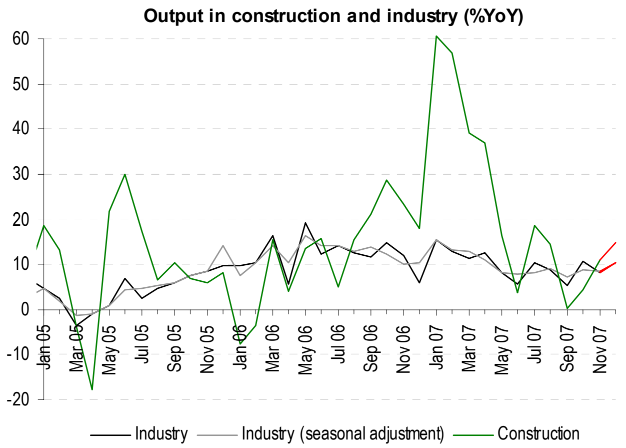


▪ The week ahead will be full of important data releases in Poland and abroad, that may have significant impact on the behaviour of financial markets.

▪ The most important for the local market will be CPI data as well as employment and wages in enterprises sector.

▪ Inflation rise to 4%YoY is to a large extent priced-in by the market, so realisation of our slightly lower forecast could result in some decline in yields on the debt market.

▪ Strengthening in interest rate market could be also caused by data about wage growth in December, likely to show a deceleration after November's figure 12%YoY was biased up temporarily by bonus payments in mining sector. In this case, our forecast of average pay rise is also below median market prediction.



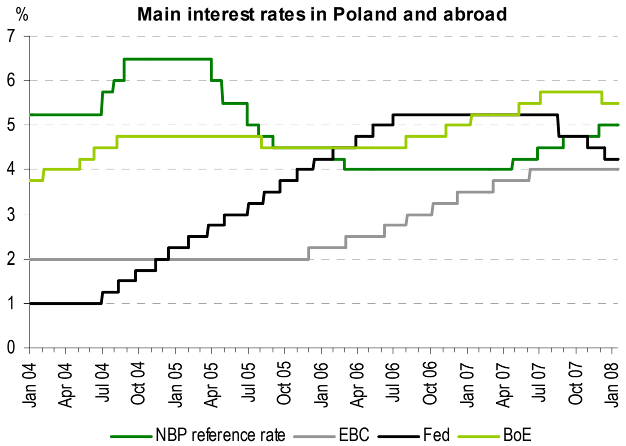
▪ Production data due for release at the end of the week, are likely to show a return of output growth in manufacturing to double digit level and further improvement in construction output growth, confirming our forecast of ca. 6% GDP growth in Q4 2007. Market consensus forecast are slightly weaker.

▪ PPI growth could accelerate in December to over 3%, mainly due to low base effect.

▪ Balance of payments data for November will show a decline in current account deficit, however its relation to GDP may increase slightly (from 3.8% to 3.9%).

▪ Among numerous publications abroad, one should pay attention to data concerning inflation rate in the US and in the euro zone, and data about American retail sales and housing market performance, as well as several leading indicators from Fed's regional branches.

Economy last week – Interest rates in the euro zone and in the UK unchanged



▪ The Bank of England kept main interest rates unchanged at the first meeting in 2008.

▪ The European Central Bank also left rates unchanged. Comments of the ECB president Jean Claude Trichet were more hawkish than the market expected. He said that inflationary pressure still persists in the short run, and that the ECB is ready to take pre-emptive measures aimed at curbing second round effects.

▪ The latest estimates of the Ministry of Finance suggest that budget deficit in 2007 reached PLN16.5-17bn. The result was much better than earlier expectations. However at this moment, the market is more focused on realisation of this year's budget and prospects of the budget draft for the next year, which will be entirely designed by the new government amid increasing risk of some slowdown in economic growth.

Quote of the week – Hawks ready to hike

Dariusz Filar, MPC member, TVN CNBC, 9 January

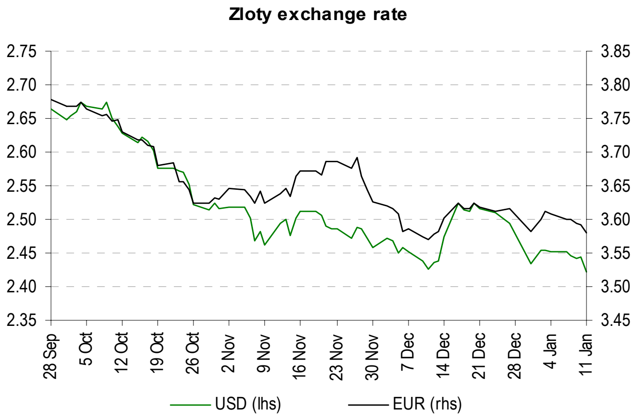
I believe we are facing a persistent shock on the markets of food and fuels. I do not believe in forecasts that assume a clear drop in inflation in second half of 2008.There may be some slowdown, but I don't think it may descend too much.

H. Wasilewska-Trenkner, MPC member, Gazeta Prawna, 9 Jan

A fast return of inflation to ca. 2.5% may be problematic. It would be good if it happens in Q1 2009. Most likely, inflation will decline below 3.5%, but it depends on development of commodities prices and effectiveness of the MPC policy. (...) I think that main rate around 6% will be necessary, but it may appear that it will be insufficient hike to bring inflation back to the target.

Representatives of "hawkish" faction within the MPC clearly suggested a need of further rate hikes in order to bring inflation back to the target. In particular, Dariusz Filar did not reject a possibility of scenario predicted by one of the commercial banks where the MPC's main interest rate goes up to 6.5% at the end of the year. In Filar's opinion inflation rate will not decline substantially in H2. Even though Halina Wasilewska-Trenkner is more optimistic as regards inflation prospects, predicting it will go down below 3.5%, she mulls a similar scale of monetary tightening – in her opinion a rate hike to 6% could be insufficient. Obviously, key for the MPC's decision will be opinions of "core" Council members. Possibly, some of their comments will appear after data releases this week.

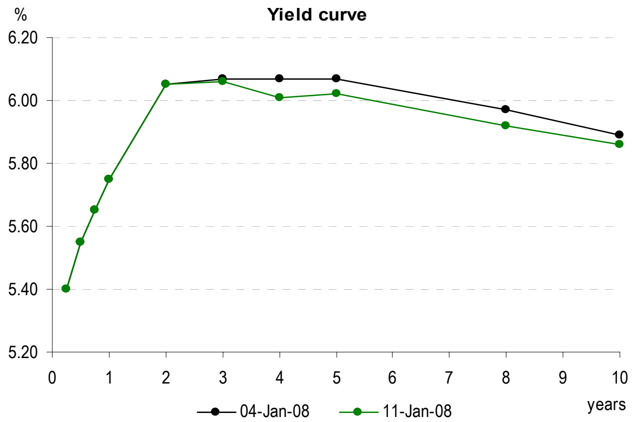
Market monitor



Zloty resilient to changing sentiment abroad

▪ In the last week, the zloty strengthened against both dollar and euro, despite quite unfavourable and volatile sentiment abroad in relation to rising concerns about possible recession in the US. Possibly, the currency was supported by foreign investors' demand for Polish bonds and news about speeding up privatisation process.

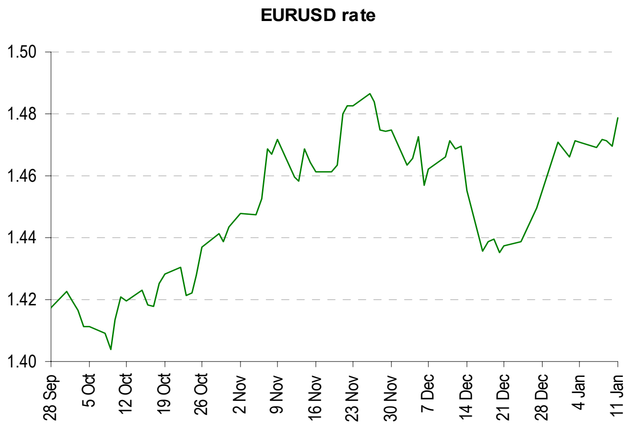
▪ The next week can be characterised by bigger volatility of the zloty due to large amount of new information and possible fluctuations of moods abroad. Reduction in rate hike expectations in Poland may slightly lessen a pressure on zloty appreciation. We predict a band of currency fluctuations at 3.55-3.65 for EURPLN and 2.38-2.48 for USDPLN.



Big appetite for Polish bonds

▪ Polish bonds enjoyed big interest of foreign investors during the week, despite quite significant risk aversion on global markets. The results of auction of 20Y bonds were very good. Comments of deputy finance minister that foresaw a gradual decline in inflationary pressure due to food prices stabilisation were helpful for bonds. On Friday, a correction erased part of earlier gains in reaction to hawkish comments of MPC members that suggested that main interest rate may go up to 6.5%.

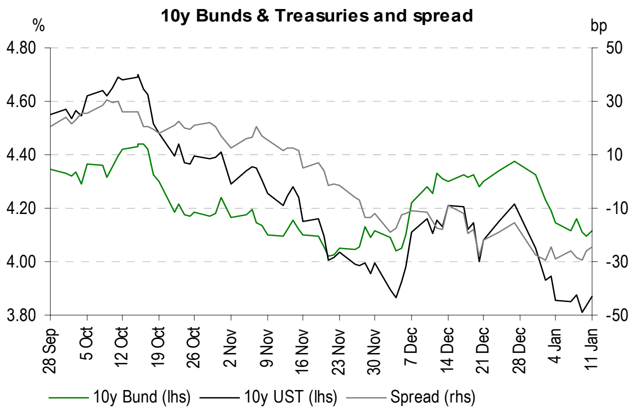
▪ In the next days, data releases concerning inflation and wages will be key for the bond market, as well as possible comments of the MPC members that will follow. We assume the data will be slightly below market consensus, which will favour further decline in yields.



Dollar more stable, but still under pressure

▪ Dollar remained quite stable against the euro for the better part of the week, fluctuating in 1.467-1.474 band. At the end of the week, the EURUSD increased to ca. 1.48, among others due to comments of ECB and Fed chairmen. While Jean Claude Trichet was more hawkish than expected, warning against further inflation increase and possible ECB action, Ben Bernanke signalled more possible rate cuts and a sharp slowdown in US economic growth ahead.

▪ We believe the dollar weakness may continue, and EURUSD rate may approach 1.50 in the nearest weeks. It will be related to persisting concerns about condition of US economy, in particular a slowdown in private consumption growth.



Recession fears strengthened core debt markets

▪ Bond yields on core debt markets were declining last week, as investors were becoming more and more concerned it may be impossible to avoid a recession in the American economy. More hawkish than expected comments of ECB president triggered a correction in European bonds at the end of week. In effect since last Friday yields of 10Y Treasuries fell by 3 bp and yields of 10Y Bunds increased by over 1 bp.

▪ Inflation data and economic activity measures for the euro zone and USA will be important for behaviour of core bond markets this week. In our view low yields in the US will be supported by expected further Fed's rate cuts to3.75% already in Q1. In turn, interest rates in the euro zone should remain unchanged until year-end.

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