# Weekly economic update

4 – 10 February 2008

**The previous week was well stocked with significant information, which in most cases matched the market expectations. The GDP growth in 2007 amounted to 6.5%. The growth structure was surprisingly beneficial considering the inflation perspectives, implying a clear slowdown in the fourth quarter's consumption growth, a high growth in investment and only slightly negative impact of net exports. Nevertheless it seems unlikely that the slowdown in consumption has a long lasting character, therefore from our point of view a GDP growth of 5.5% in 2008 is still realistic. The MPC decided to raise the main interest rates with a 25 bp move. One of the new elements in the communiqué released after the meeting was a growing risk of slowdown of the world economies. Nevertheless the MPC didn't give a clear comment to a possible influence on Poland's economy. On the other hand the Council emphasized that the risk of wage growth in the public sector is a possible inflationary factor. We keep our forecast of one more hike in key interest rates this year, which will probably take place in March. The same day as the MPC, the Fed cut key interest rates once more, this time with a 50 bp move. In their publication they pointed out that the rate cuts should help the economy but suggesting at the same time a readiness for further rate cuts if needed. At the end of the week the Ministry of Finance published the January's inflation forecast amounting to 4.0%, which matched our prediction. We can expect a higher growth in prices (CPI approx. 4.3%YoY) in February after an increase in controlled prices.**

**This week's economic calendar doesn't bring any domestic key events or publications and the list of foreign information is as well briefer than usual. The meetings of the ECB and the BoE on Thursday will be in the focus of attention. Whereas the interest rates in the euro zone are likely to stay unchanged, the market expects an interest rate cut in the UK with a 25bp move.**

## Economic calendar

| Time GMT | COUNTRY | INDICATOR | PERIOD | | FORECAST | | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | | | | MARKET | BZWBK | |
| | | **MONDAY (4 February)** | | | | | |
| 10:00 | EZ | PPI | Dec | %YoY | 4.3 | - | 4.1 |
| 15:00 | US | Factory orders | Dec | % | 2.4 | - | 1.5 |
| | | **TUESDAY(5 February)** | | | | | |
| 9:00 | EZ | PMI services | Jan | pts | 52.0 | - | 53.1 |
| 10:00 | EZ | Retail sales | Dec | %YoY | -0.6 | - | -1.4 |
| 15:00 | US | ISM services | Jan | pts | 53.0 | - | 54.4 |
| | | **WEDNESDAY (6 February)** | | | | | |
| **10:00** | **PL** | **5-year treasury bond auction** | | | | | |
| 13:30 | US | Labour cost | Q4 | % | 3.4 | - | -2.0 |
| | | **THURSDAY (7 February)** | | | | | |
| 12:30 | GB | Bank of England monthly meeting – decision | | % | 5.25 | 5.25 | 5.5 |
| 12:45 | EZ | ECB monthly meeting – decision | | % | 4.0 | 4.0 | 4.0 |
| 13:30 | US | Jobless claims | week | k | 345.0 | - | 375.0 |
| 15:00 | US | Pending home sales | Dec | % | -1.0 | - | -2.6 |
| | | **FRIDAY (8 February)** | | | | | |
| 15:00 | US | Wholesale inventories | Dec | % | 0.3 | - | 0.6 |

Source: BZ WBK, PAP, Parkiet, Reuters

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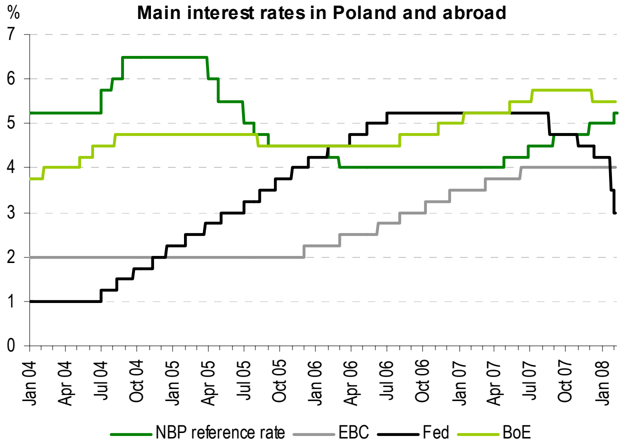
## **What's hot this week** – Fewer data releases, central banks' decisions




▪ This week we will recover from domestic publications and the calendar for foreign information will be briefer as well.

▪ This week's key day will be Thursday, the day when the European Central Bank and the Bank of England will announce their interest rate decisions after monthly meetings. The market expects a rate cut of 25 bp in the UK, whereas the interest rates in the euro zone should stay unchanged.

▪ Out of the published indicators the most interesting will be those from the US market, among others the factory orders, ISM services, wholesale inventories and pending home sales. Except the ECB decision in the euro zone the PMI for the service sector and the retail sales growth will be worth attention.

## **Economy last week** – Rate hike in Poland, next cut in the US

**Selected fragments of the MPC's communiqué after January meeting**

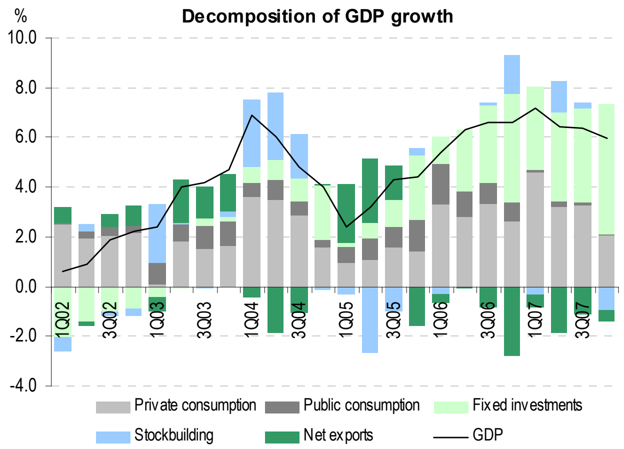
Since the last meeting of the Council the risk of a substantial slowdown in the world economy increased, though it is currently difficult to assess this risk or its impact on economic growth in Poland. An additional factor increasing the uncertainty as to the prospects of the global and consequently Polish economy growth is the increased volatility in the financial markets that has been observed over the recent period.

In the Council's assessment, in the near future inflation will remain above the upper limit for deviations from the inflation target, which may also, to a large extent, be the result of the expected increased growth of regulated prices.

The information on labour market developments in December 2007 points to a decline in the strong wage growth and an improvement in unfavourable relation between wage and labour productivity growth. However, a further build-up in wage pressure, particularly in the public finance sector and, consequently, inflationary pressure is quite probable. (...) Moreover, in line with the 2008 Budget Act passed by the Parliament, a procyclical impact of fiscal policy on the economy can be expected this year

▪ In line with the expectations, the MPC raised interest rates by 25 bp (reference rate to 5.25%). The MPC pointed out in their communiqué that the rise in uncertainty concerning the situation of the world economy. On the other hand they mentioned a risk deriving from the wage pressure in the public sector. We keep our view that the interest rates will go up by another 25 bp, most likely in March, and this will be the last hike this year.

▪ The same day the FOMC cut interest rates by 50 bps (key interest rate to 3.0%). In their publication they pointed out that the rate cuts should help the economy but suggesting at the same time a readiness for further rate cuts if needed despite the risk of higher inflation. Further interest rate cuts in the USA, even to 2.25%, can be expected later this year.




▪ According to the tentative estimation, the GDP growth amounted to 6.5% in 2007, investment growth reached 20.4%, and private consumption growth was 5.2%.

▪ Whereas such a GDP growth was expected, its structure was a surprise. There was a clear weakening in the consumption growth (according to our estimations it slowed down to 3.8% in Q4) and a higher than estimated growth in investments (18.5% in Q4). A negative contribution of net exports decreased (-0.4 pp), while change in inventories reduced GDP growth by ca. 1 pp.

▪ Right now it is hard to identify reasons for the weakening consumption, but it doesn't seem to be long lasting. Fast growing earnings of the households will support the consumption and sales growth this year.

▪ According to FinMin's forecast inflation rate in January remained at 4.0%YoY which matched our forecasts.

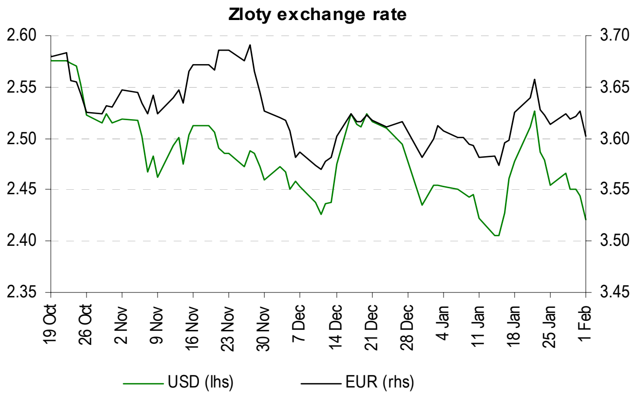
## **Quote of the week** – MPC may be less willing to hike rates

**Jan Czekaj, MPC member, Gazeta Prawna, 31 January**

*The situation is not as clear as several weeks ago. On one hand we have unexpected rate cuts in the US that may cause also a rate cut in the euro zone. On the other hand we have also weaker than predicted data concerning economy in December 2007. We do not know whether it is a start of some trend. The assessment must wait. Future MPC decisions could be affected by strengthening signs of economic slowdown in Poland. And then it would not be certain whether further rate hikes are needed. If the ECB cuts interest rates, then in my opinion the MPC's inclination to hike rates would diminish, despite elevated inflation.*

Comments of the MPC members in the previous week did suggest that their worries about impact of world economic slowdown on Polish economy have strengthened, and this was reflected in the MPC statement released after the meeting. Also, a rising interest rate disparity between Poland and core markets may be an important factor for the MPC, among others due to its impact on foreign exchange market (potential zloty strengthening). Jan Czekaj said directly that a rate cut in the euro zone will trim the Council's willingness to raise rates. Even hawkish Halina Wasilewska-Trenkner admitted that one more rate hike may prove to be enough.

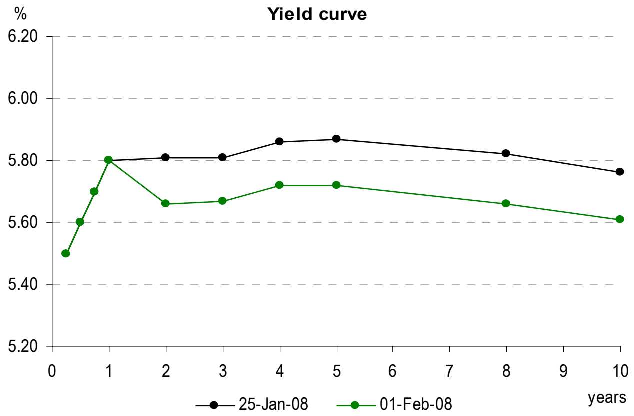
## Market monitor




### Stronger zloty, resistant to changing global moods

▪ For the majority of the week the zloty exchange rate has been changing only in moderate range, despite quite high volatility in the global foreign exchange markets. On Friday the Polish currency appreciated significantly, which was connected with US dollar's weakening internationally. The EURPLN rate finished the week at the level of 3.59 against 3.61 a week ago, while the USDPLN fell from 2.45 to 2.41.

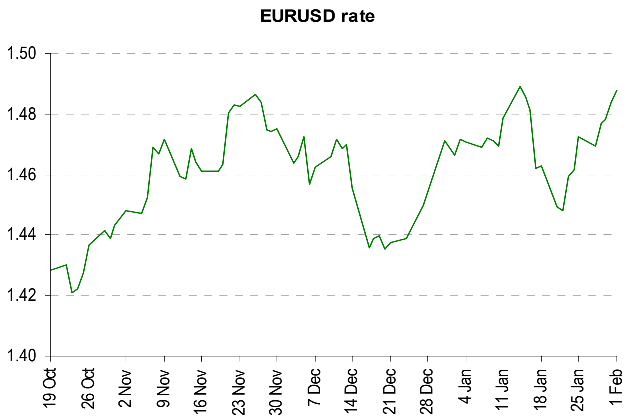
▪ This week neither data releases nor major economic events are planned in Poland and the zloty rate will be driven mainly by global factors. The outcome of the ECB meeting, especially as regards the statement, may be important for the ERUUSD rate and thus for the zloty. We see this week's the trading range for the zloty at 3.54-3.64 against the euro and 2.38-2.48 against the dollar.




### Domestic yields in downward trend

▪ The downward trend in yields on Polish fixed income market has been maintained in recent days, despite no clear-cut tendency on core bond markets. At the beginning of the week debt strengthening was connected with lowered expectations as regards the overall scale of monetary tightening, which was driven, among others, by MPC members comments and fears of recession in the US. At the end of the week the tendency has strengthened after the relatively low CPI inflation forecast for January released by the Ministry of Finance.

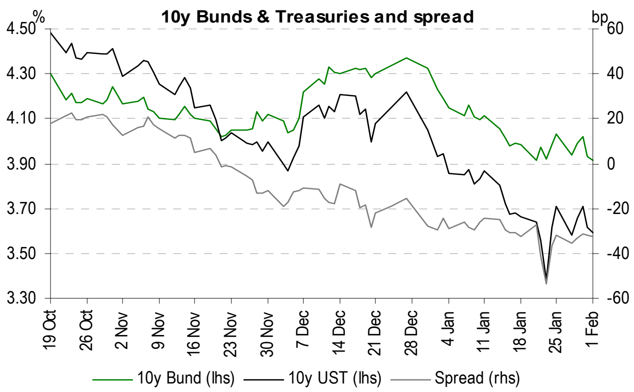
▪ In our opinion the trend of decreasing yields may be coming to an end in the prospects of the next several weeks (amid higher CPI in February). However, in the next couple of days demand for Polish bonds may remain quite high. A lot will depend on further comments by MPC members.




### Dollar loosing ground due to Fed decision and US data

▪ During the week, the US currency was depreciating against euro, initially in anticipation of Fed decision, later on in reaction to another rate cut and banks' signal that a way for further policy easing is still open. Economic data released during the week had mixed impact on the market, however Friday's weak data about non-farm payrolls in January strengthened the dollar sale-off and the EURUSD approached 1.49 in the afternoon. In the last hour of Polish session the move was partly reversed (to ca. 1.48) after the release of better than forecasted manufacturing PMI.

▪ This week, investors will be closely following comments of the ECB president, looking for any indication of a softening in his tone. ISM services index may be also important for the dollar.




### Volatile moods on core debt markets

▪ Sentiment on core bond markets were fluctuating last week along with jumps in investors' optimism on stock markets and yields were going up (to 3.75% on Wednesday) and down in reaction to flowing news. In the horizon of entire week, there was a strengthening and on Friday in the afternoon yields of 10Y Treasuries reached 3.59% and 10Y Bunds 3.93%, against 3.72% and 4.03% on Friday last week.

▪ This week, fluctuations of yields should not be dramatic due to lower number of data releases. Fro the European bond market, the tone of the ECM communiqué will be crucial and any suggestions concerning monetary policy prospects. US debt market will be awaiting the release of services ISM data.

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