

Weekly economic update

30 June – 6 July 2008

The MPC raised interest rates by 25bp at its meeting last week. The decision was widely expected and has not triggered any reaction of the market, the post-meeting statement proved surprising, as the Council dropped sentence used for many months that indicated informal restrictive bias in monetary policy. As usual, there were both dovish and hawkish comments in the MPC statement and we have an impression that the document was written in a way so that it could be consistent with possible further hikes (if they prove necessary) or with an end in the tightening cycle at 6% with the last week's move. Despite the phrase indicating the informal restrictive bias was dropped from the statement, we still think that the Council may deliver more tightening later in the year. This should not take place in July and August, given comments by MPC's Jan Czekaj. However, when CPI inflation reaches the peak at around 5% in August, then at the turn of the third and fourth quarter we may see further rate hike(s) to 6.25-6.50%. Retail sales figures released before the MPC meeting were in line with expectations and had no impact on the market.

This week the key event for the Polish market will be publication of the FinMin's inflation forecast for June. Besides, there will be many crucial events abroad with key focus of attention on the ECB meeting and the US non-farm payrolls report, both scheduled on Thursday.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (30 June)							
09:00	EZ	Preliminary HICP	Jun	%YoY	3.8	-	3.7
12:00	PL	Balance of payments	Q1	-	-	-	-
13:45	US	Chicago PMI	Jun	pts	48.0	-	49.1
TUESDAY (1 June)							
08:00	EZ	PMI manufacturing	Jun	pts	49.1	-	50.6
09:00	EZ	Unemployment	May	%	7.1	-	7.1
14:00	US	ISM manufacturing	Jun	pts	48.6	-	49.6
WEDNESDAY (2 June)							
Auction of 2Y bonds							
09:00	EZ	PPI	May	%YoY	6.7	-	6.1
12:15	US	ADP Report	Jun	'000	-20.0	-	40.0
14:00	US	Factory orders	May	%	0.4	-	1.1
THURSDAY (3 June)							
08:00	EZ	PMI services	Jun	pts	49.5	-	50.6
09:00	EZ	Retail sales	May	%YoY	-0.8	-	-2.9
11:45	EZ	ECB decision announcement	-	%	4.25	4.25	4.0
12:30	US	Initial jobless claims	w/e	'000	385.0	-	384.0
12:30	US	Non-farm payrolls	Jun	'000	-60.0	-	-49.0
12:30	US	Unemployment	Jun	%	5.4	-	5.5
14:00	US	ISM services	Jun	pts	51.0	-	51.7
FRIDAY (4 June)							
-	US	Market holiday	-	-	-	-	-

Source: BZ WBK, Parkiet, Reuters

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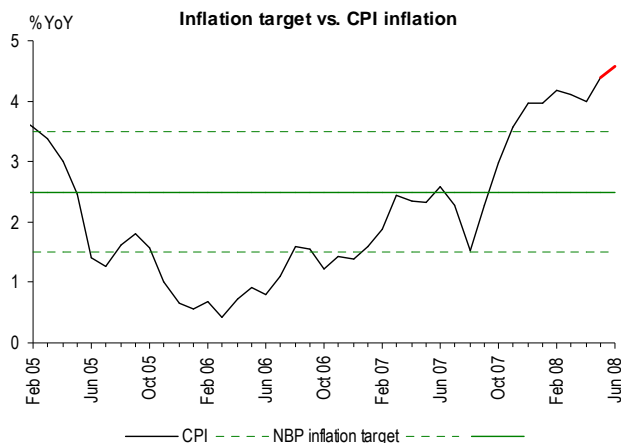
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What's hot this week – FinMin's inflation forecast and events abroad



- The key domestic event this week will be publication of the FinMin's estimate of CPI inflation in June.
- Recently observed rise in fuel prices led to deterioration in the short term inflation outlook and according to our forecasts CPI inflation accelerated to 4.6%YoY in June. If the FinMin's estimate also points to inflation increase, one should expect a correction in the interest rate market, following the strengthening that was seen after the MPC meeting last week. In this context, auction of 2Y bonds scheduled on Wednesday will be an important test for the local debt market.
- Besides, there is heavy events calendar abroad for this week. The key day of the week will be Thursday with the ECB decision announcement and release of the US non-farm payrolls report (one day earlier than usual due to market holiday in the US on Friday). However, there are many major data releases due earlier in the week.

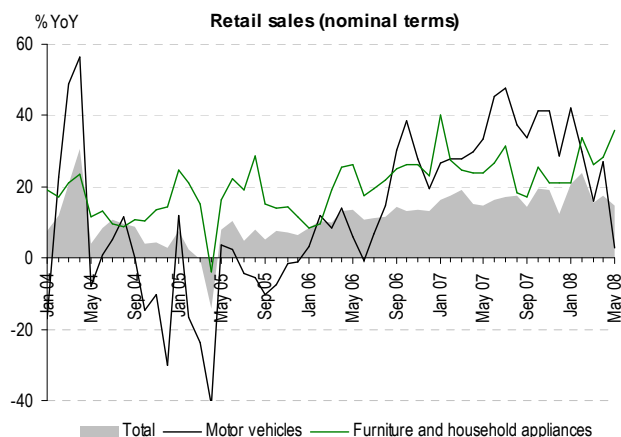
Economy last week – MPC not in rush with further tightening

Inflation projections in consecutive Inflation

CPI inflation			
Jul 07	Oct 07	Feb 08	Jun 08
2.2-2.5	2.2-2.3	-	-
2.1-3.8	2.2-3.5	3.6-4.7	3.8-4.7
2.1-4.3	2.5-4.6	2.6-4.9	2.5-5.8
-	-	2.1-4.8	0.1-5.7

Note: according to NBP projection the CPI inflation will stay within the indicated ranges with probability of 50%

- After two-months break in tightening cycle, the MPC decided last week to hike rates again by 25 bp. Increasing rates fourth time this year the Council equalised the last year's result. There are six more meetings in 2008 and thus the question arises whether we should expect further moves (and when)?
- The question is so important, as the MPC, quite unexpectedly, dropped the sentence in the statement, which indicated informal restrictive bias in monetary policy. This was not clarified during the press conference, though MPC members suggested a few months pause in tightening.
- In our opinion, the risk of further hikes is still relatively high, which is related, among others, to changing expectations as regards monetary policy actions by the ECB and Fed. We think that likely months for next rate hikes are September (following CPI inflation peak at ca. 5% in August) or/and October (when the next inflation projection is published).



- Nominal growth in retail sales was 14.9%YoY in May versus the market consensus and our forecast of 15%YoY. The result mean a deceleration as compared to previous months, but one should remember that sales growth in May this year was negatively affected by two long weekends (against one long weekend in May last year) and the new law which forces shops to be closed during holidays (there were 4 such days in May this year).
- Real growth in retail sales was 11.2%YoY, which means that sales deflator (an indicator of inflationary pressure in retail trade) reached 3.7%YoY and has not changed much against 36%YoY in April.
- All in all, retail sales figures for May suggest that consumption remains strong and its source is improvement in labour market conditions. The registered unemployment rate in May dropped to 10%, by 2.9 pp YoY.

Quote of the week – One cannot exclude that there will be no more hikes

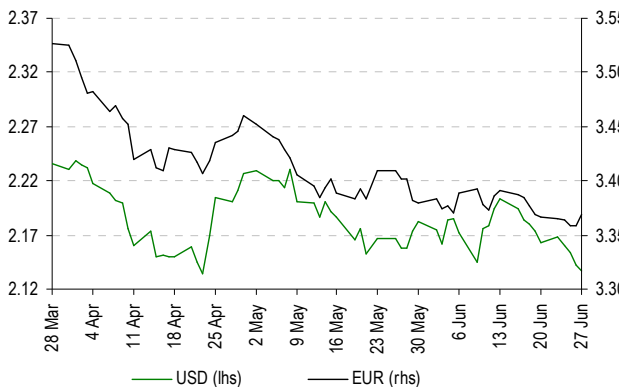
Jan Czekaj, MPC, Reuters, 26 June

We'll get a more complete picture of the future inflation and the situation in the economy only after the release of the October inflation projection and thanks to data that will come from the economy in the following months. It cannot be ruled out today that the MPC won't have to hike rates any more. But this cannot be predetermined today. This is under condition that nothing happen which would require decisive actions of the MPC – for instance that wage growth does not accelerate or the ECB and the Fed significantly raise interest rates. However, this is hard to imagine. (...) Inflation in the coming months will still be on the rise. It seems, however, that it would not be good if our decisions depended on the current inflation figures. We now know that inflation will reach a peak, probably in August, and we also know, that after this peak inflation will start to go down.

In Jan Czekaj's opinion, information to be received in the next 2-3 months will not differ much from information currently possessed to an extent that would require decisive MPC action. In his opinion, a decisive MPC action would be required in case of strong acceleration in wage growth or significant moves by the ECB and the Fed. Widely expected rate hike of 25bps at the ECB meeting this week is not likely to be considered as "significant move" and it seems the MPC has already taken it into account in June. Czekaj added that the MPC would not act under influence of current inflation, which suggests that inflation peak in August is unlikely to trigger a rate hike. However, we think that it will probably depend on a scale of CPI rise, as exceeding 5% may have some impact on the MPC.

Market monitor

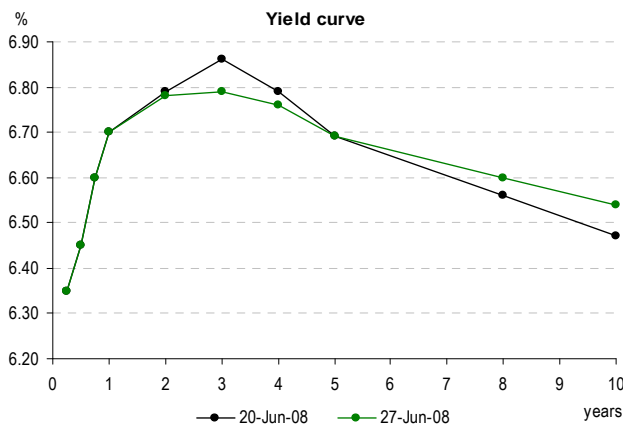
Zloty exchange rate



Zloty stable to the euro, stronger to the dollar

- In the first part of last week, the zloty strengthened both against the euro and the dollar. The second part of the week brought correction of the zloty versus the single currency and continuation of appreciation against the dollar with the latter's weakening in the international markets. The negative factor for the zloty in the second part of the week was a message from the MPC (suggested a few months pause in hikes) and strong rise in risk aversion in the global markets.
- This week the positive factor for the zloty should be the FinMin's CPI forecast that is likely to show inflation acceleration, which could reinforce expectations for rate hikes. Besides, the ECB meeting and many major data from abroad will be important. We predict EURPLN will remain in a range of 3.34-3.44 and we lower range for USDPLN to 2.10-2.20.

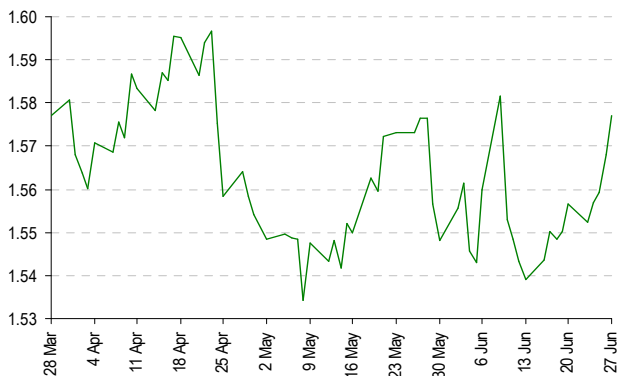
Yield curve



Flattening of the domestic yield curve

- Last week saw a strengthening in the local debt market, but only at the short end of the curve. This was brought about by less hawkish than expected message from the MPC (notably comments from moderate rate-setter Jan Czekaj). Loner dated bonds weakened, even despite fall in yields on the core debt markets. As a result, the domestic yield curve flattened.
- This week the key factor for the Polish interest rate market will be the FinMin's inflation estimate. If it shows an inflation acceleration (similar to our forecast), one may expect rise in market interest rates. Auction of 2Y bonds will also be important factor for the debt market and already Monday's information on the supply at the auction may have some impact on the market. Of course, the local market will be also driven by many crucial events abroad due this week.

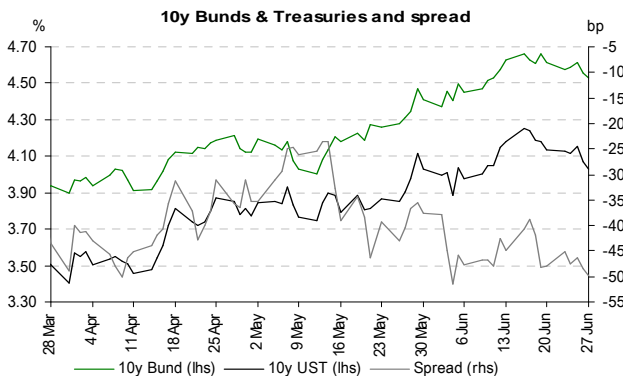
EURUSD rate



EURUSD up following FOMC announcement

- Although on Monday the dollar erased a part of losses seen the previous week, later on the US currency was gradually weakening. The most significant move took place after the FOMC meeting, as the tone of the post-meeting statement proved less hawkish than expected by some market participants. At the same time, hawkish comments from ECB President, indicating growing inflation risks and cementing market expectations for a rate hike in the euro zone this week, were positive for the euro. At the end of the week EURUSD stabilised around 1,575.
- If there is actually hike by the ECB this week (followed by a hawkish comments at the press conference), the dollar may weaken further. However, EURUSD movements will also depend on many important data releases this week.

10y Bunds & Treasuries and spread



Fall in yields on the core debt markets

- Last week saw a decline in yields on core debt markets. It resulted partly from waning expectations for rate hikes in the US, but mostly from a rise in risk aversion on global markets (strong slump in stock markets in the US, Europe and Asia). Investors' worries about financial sector condition increased again. In effect, interest in safe assets increased. At the end of last week, yields of 10Y Treasuries and Bunds reached 4.03% and 4.53%, respectively, versus 4.14% and 4.62% at the end of the previous week.
- This week, core debt markets should stabilise in expectation for the result of the ECB meeting and the US non-farm payrolls report.

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