Bank Zachodni WBK

Weekly economic update

1 – 7 September 2008

As we expected, the last week was marked by depreciation of the zloty and rise in market interest rates. The zloty weakened despite no change in EURUSD and the fact that outcome of the MPC meeting proved more hawkish than expected by the market. As it was widely predicted, the MPC left rates on hold, but tone of the post-meeting official statement and comments from rate-setter proved more hawkish than expected by the market. In fact, as we have indicated, overall message from the Council did not differ much as compared to the previous month. Door for more monetary tightening are still open. We expect that in August the CPI inflation rose to around 5%, net inflation to around 4% and the CPI less food and energy prices to above 2.5%, while wage growth remained at two-digit level, which should persuade the Council to tighten monetary policy again. An encouraging factor for some additional tightening were stronger than expected GDP numbers for Q2. However, we think that more and more numerous indications of economic slowdown in the next quarters (last week brought slightly weaker than predicted retail sales for July, fall in consumer confidence indices for August and confirmation of weakening in labour demand growth) will not enable to convince rate-setters to more than one hike this year.

This week we expect slight recovery of the zloty, although EURPLN may temporarily test again the level of 3.36, which was shortly broke on Friday. The domestic currency should be supported by upward correction in EURUSD expected by us. The local interest rate market will be influenced by release of the FinMin's inflation forecast for August and performance of the core debt markets amid many crucial events scheduled abroad.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (1 September)					
09:00	**PL**	**Tender of 26-week T-bills worth PLN0.5bn and 52-week T-bills worth PLN0.5bn**					
-	US	Market holiday					
8:00	EZ	Manufacturing PMI	Aug	pts	47.5	-	47.4
		TUESDAY (2 September)					
9:00	EZ	PPI	Jul	%YoY	9.1	-	8.0
14:00	US	Manufacturing ISM	Aug	pts	49.9	-	50.0
		WEDNESDAY (3 September)					
	PL	**Auction of 5Y bonds worth PLN1.5-3bn**					
8:00	EZ	Services PMI	Aug	pts	48.2	-	48.3
9:00	EZ	Retail sales	Jul	%YoY	-2.1	-	-3.1
14:00	US	Factory orders	Jul	%MoM	0.4	-	1.7
		THURSDAY (4 September)					
11:00	GB	BoE meeting – decision	Sep	%	5.0	5.0	5.0
11:45	EZ	ECB meeting – decision	Sep	%	4.25	4.25	4.25
12:15	US	ADP report	Aug	'000	-20.0	-	9.0
12:30	US	Jobless claims	w/e	'000	-	-	425.0
12:30	US	Labour productivity	Q2	%	2.8	-	2.2
12:30	US	Unit labour costs	Q2	%	0.8	-	1.3
14:00	US	Non-manufacturing ISM	Aug	pts	49.4	-	49.5
		FRIDAY (5 September)					
12:30	US	Non-farm payrolls	Aug	'000	-73.0	-	-51.0
12:30	US	Unemployment	Aug	%	5.7	-	5.7

Source: BZ WBK, Reuters

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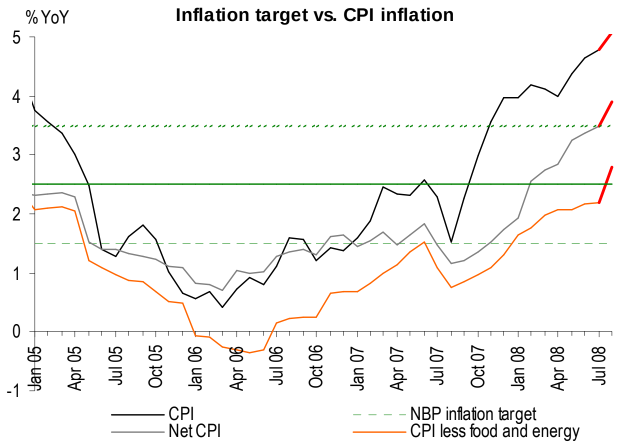
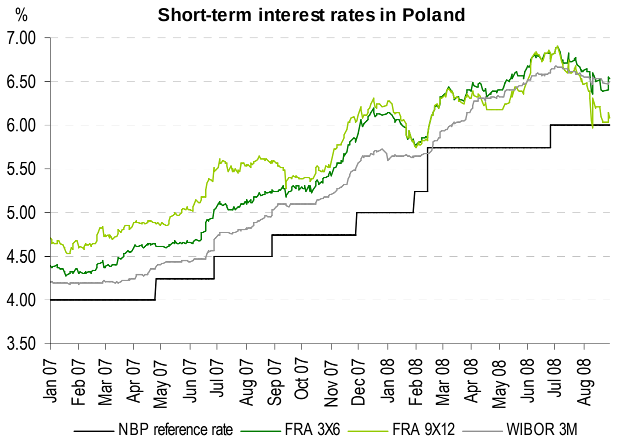
What's hot this week – FinMin's inflation estimate and events abroad



▪ This week the key event for the local market will be publication of the FinMin's inflation forecast for August due on Monday (our forecast is 5.1%YoY). At this occasion, one should expect to see new comments of the MPC members. Besides, information about next year's budget may appear (work on the draft is entering the final stage and until 30 September the government must hand the draft bill to the parliament).

▪ Despite publication of FinMin's forecast, Monday should see little activity of the financial market due to market holiday in the US. In the further part of the day, there will be plenty of important events abroad. As usually at the start of the month, market players will be waiting most of all for Friday's employment report in the US. Earlier, attention will focus on the ECB meeting (we see interest rates unchanged until year-end).

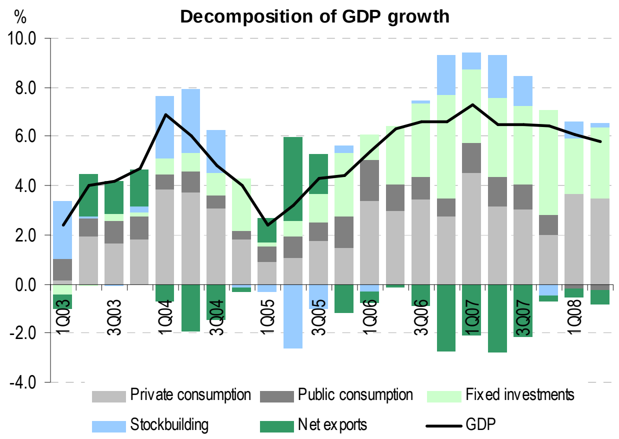
Economy last week – MPC still in tightening mode, strong GDP data



▪ The MPC kept interest rates unchanged at its meeting last week, as widely expected in the market. Tone of the post-meeting statement did not change much over the last month, which we suggested.

▪ The inflation risk remains high in the MPC's view (we expect that in August the CPI inflation rose to around 5%, the net inflation to ca. 4% and the CPI less food and energy prices to above 2.5%) and this may require further monetary tightening.

▪ However, on the other hand, deeper economic slowdown abroad will persuade the Council to be cautious. Overall, we expect that the next interest rate hike of 25bp will only be delivered in October when the new projection of inflation and GDP will confirm that economic slowdown will be moderate and return of inflation to the target quite slow.



▪ Slowdown in economic growth in 2Q08 proved weaker than expected. GDP growth reached 5.8% (against 6.1% in 1Q08) and it was driven by continuously robust growth in private consumption (5.6%) and fixed investment (15.2%).

▪ Still strong growth in domestic demand (above 6%) and the fact that data for 2Q08 are much better than in the last projection of the NBP mean that the data should be treated as hawkish argument. However, the data are historical and much more important will be next information from the economy (wages, retail sales, output figures), which will show what scale of economic slowdown should be expected in the next quarters. In our view, the slowdown will be moderate, which supports our expectations for further monetary policy tightening.

▪ Retail sales data for July proved slightly weaker than expected (14.3%YoY rise vs. market consensus of 14.6%).

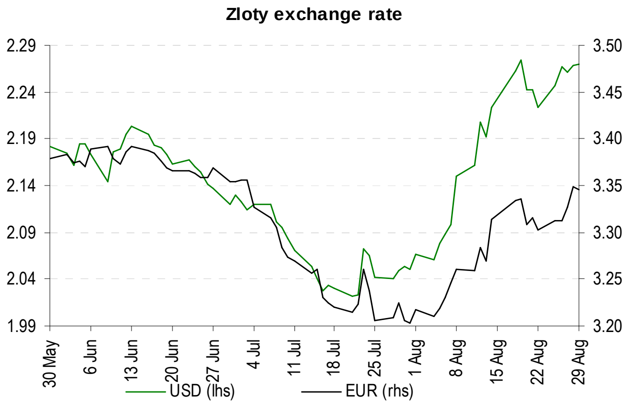
Quote of the week – Further tightening may take place

Andrzej Sławiński, MPC member, PAP, 28 August

Further tightening may take place. This will depend on developments in the euro zone's economy. We do not know to what extent the slowdown in the European economy will sill over to the Polish economy. An optimistic thing is that the economic growth remains high. In GDP data for Q2 the breakdown of economic growth will be important. If consumption growth is as strong as in previous quarters, this will be favourable situation from the central bank's point of view. As for now, we think more of rate hikes than of rate cuts. The economic of every country is a quite capricious lady and it is hard to predict what will happen. An example is the Bank of England where recently we had motions to hike rates, lower them and leave on hold.

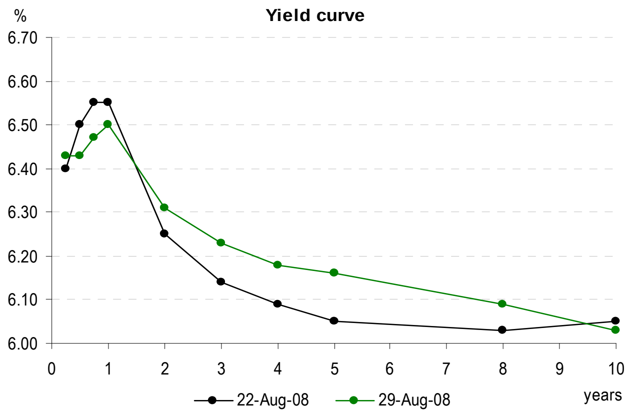
After no change in rates at the MPC meeting in August, hawks from the Council decisively confirmed their opinion about the need for further monetary tightening. Meanwhile, although moderate rate-setter Jan Czekaj stressed, in line with official pose-meeting statement, that tightening cycle had not ended, he said that slowdown in GDP growth to 4-4.5% in 2008 may weaken pressure on price growth. However, he does not see a possibility of a rate cut this year, but not exclude such an option the next year. Balanced view on monetary policy, although with an indication that a rate hike is still possible, was presented by Andrzej Sławiński. Overall, recent comments from MPC members confirm the view that there should be one more rate hike this year, most likely in October when the new inflation projection is revealed.

Market monitor



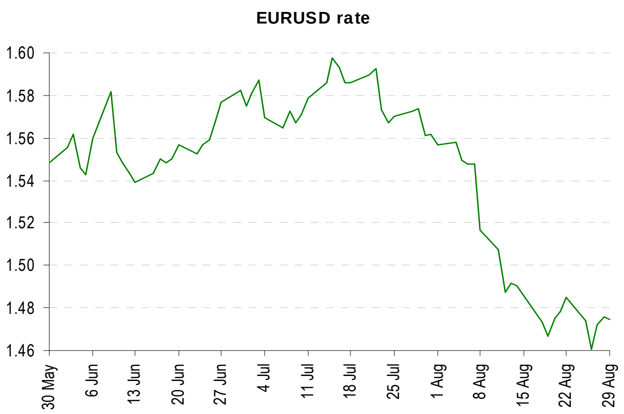
The zloty weaker

- Last week, the zloty weakened against the euro and the dollar while there was no major changes in EURUSD. Upper end of the expected range for EURPLN last week, i.e. 3.36 was broken only temporarily at the beginning of the Friday's session. Afterwards the zloty erased losses and ended the week at 3.33 versus the euro and 2.26 against the dollar.
- This week, the zloty's rate will be mainly driven by moves in EURUSD. However, FinMin's inflation forecast may be important as well, though its impact on the market may be reduced due to small activity of the markets on Monday due to market holiday in the US. For this week we keep range for EURPLN at 3.26-3.36 and for USDPLN increase to 2.18-2.28.



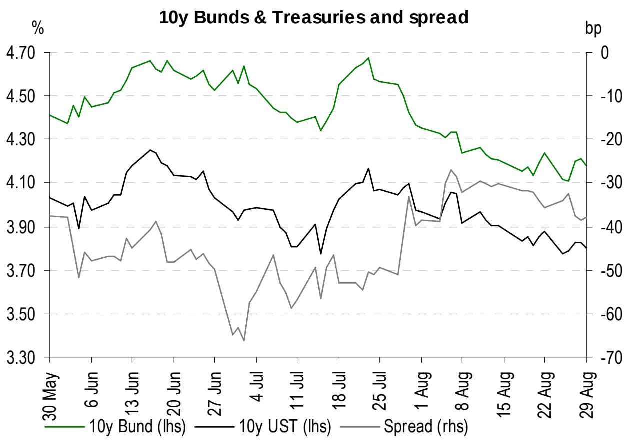
Domestic yields curve up

- Last week events confirmed our opinion that drop in market interest rates in the local market came to an end (at least so far). It was due to the statement of MPC, which was similarly hawkish as a month ago, while the previous strengthening in the interest rate market suggested that investors expected more dovish comment signalling that rate cut could be the next move of the MPC. Higher than expected GDP data resulted in increase in rates as well, despite yields dropped in the core debt markets.
- This week, the FinMin's forecast of inflation in August will be important for the local interest rate market. Auction of 5Y bonds will also be significant test for the market. Moreover, indirect influence of important foreign events will be crucial.



EURUSD little changed

- Even though variation of EURUSD during the week was quite substantial, in sum in the last two weeks there was a stabilisation of this exchange rate around 1.47, after a strong slump in several previous weeks. Recently, a fall in EURUSD was supported by weaker than predicted data in Germany and lower HICP inflation in the euro zone, as well as better than forecast GDP data from the US. On the other hand, strengthening fears about US financial sector condition worked against the dollar.
- We still believe that one should expect upward move in EURUSD, which should be supported this wee by expected "hawkish" tone of the ECB statement and data showing continuing employment fall in the US.



Yields down on the core debt markets

- Lower than predicted data from the euro zone (mainly German Ifo and euro zone's HICP) and increase in risk aversion after resurgence of fears about US financial sector resulted in strengthening of core bond markets. However, the move was reduced by better than predicted data about consumer sentiment, durable goods orders and GDP from the US. At the end of the week, yields of 10Y Treasuries and Bunds were at 3.80% and 4.18%, i.e. 8 and 6 bp lower than a week earlier.
- This week, core debt markets will receive several key information. After sluggish start of the week (US market holiday on Monday), next days will bring many news that may have significant impact on the assessment prospects for monetary policy of the ECB and Fed.

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