Bank Zachodni WBK

Weekly economic update

13 –19 October 2008

Improvement in market sentiment after approval of the rescue package for the financial sector by the US Congress was very short-lived and the last week began again with increased risk aversion, among others due to news about problems of next financial institutions in Europe. Temporary improvement in moods took place also after rate cut by the Bank of Australia and then after coordinated rate cut by the world's major central banks. Risk aversion and unwinding of carry trade positions as well as negative news from Hungary led to substantial weakening of the zloty. The situation in Hungary also contributed to large jump in Polish bond yields. There was also increase in expectations of rate cuts, in our view not justified in face of the prospects for swift euro adoption. Incoming data from the economy (against the market consensus we expect weaker fall in inflation and slightly higher wage and industrial production growth) should have lower importance for the market in face of the current turmoil. The key factor for market sentiment will be outcome of the G7 meeting over the weekend, where solutions for the crisis will be discussed.

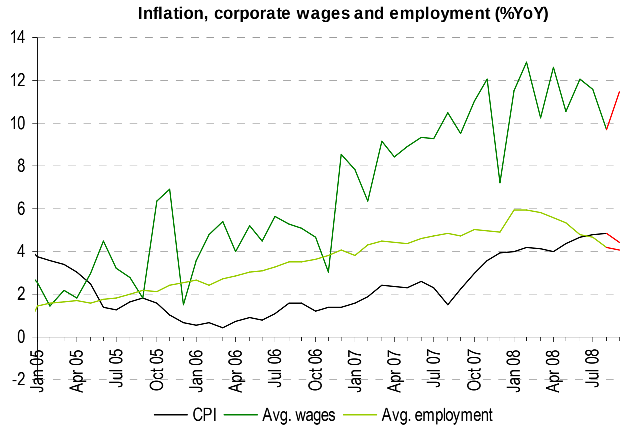
Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (13 October)					
9:00	**PL**	**Auction of PLN800m of 13-week and 52-week Treasury bills**					
12:00	**PL**	**Current account deficit**	**Sep**	**€ m**	**-1481**	**-1481**	**-1222**
		TUESDAY (14 October)					
12:00	**PL**	**CPI**	**Sep**	**%YoY**	**4.4**	**4.5**	**4.8**
12:00	**PL**	**Money supply**	**Sep**	**%YoY**	**17.1**	**16.7**	**16.6**
9:00	DE	ZEW index	Oct	pts	-51.1	-	-41.1
9:00	EZ	Industrial production	Aug	%YoY	-1.6	-	-1.7
		WEDNESDAY (15 October)					
12:00	**PL**	**Wages**	**Sep**	**%YoY**	**10.8**	**11.4**	**9.7**
12:00	**PL**	**Employment**	**Sep**	**%YoY**	**4.0**	**4.0**	**4.2**
8:00	EZ	Final HICP	Sep	%YoY	3.6	-	3.8
12:30	US	PPI	Sep	%MoM	-0.3	-	-0.9
12:30	US	NY Fed index	Oct	pts	-7.5	-	-7.41
12:30	US	Retail sales	Sep	%MoM	-0.6	-	-0.3
		THURSDAY (16 October)					
12:30	US	CPI	Sep	%MoM	0.0	-	-0.1
13:00	US	Capital flows report	Aug				
13:15	US	Capacity utilisation	Sep	%	78.3	-	78.7
13:15	US	Industrial production	Sep	%Mom	-0.5	-	-1.1
14:00	US	Philadelphia Fed index	Oct	pts	-2.0	-	3.8
		FRIDAY (17 October)					
12:00	**PL**	**Industrial production**	**Sep**	**%YoY**	**5.6**	**6.0**	**-3.7**
12:00	**PL**	**PPI**	**Sep**	**%YoY**	**2.1**	**2.1**	**2.0**
12:30	US	House starts	Sep	m	0.88	-	0.895
12:30	US	Building permits	Sep	m	0.85	-	0.857
13:55	US	Preliminary Michigan index	Oct	pts	68	-	70.3

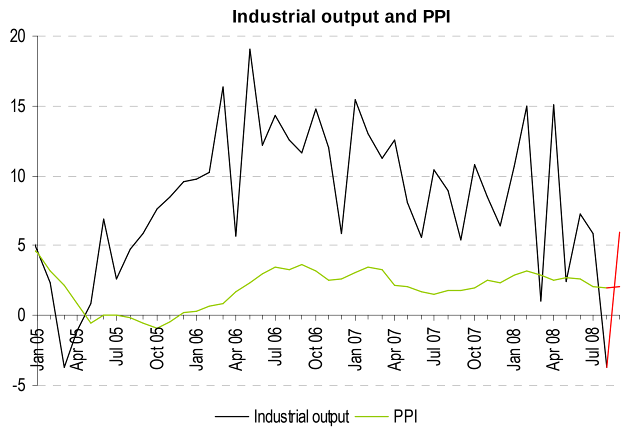
Source: BZ WBK, Reuters

Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – What will data from local economy show?

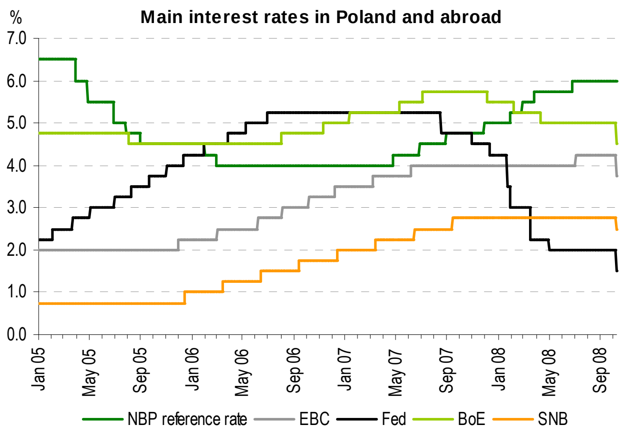


- We expect that inflation fell in September to 4.5% from 4.8% in August amid monthly increase in prices of 0.3%. We assumed that food prices rose 0.7%MoM and transport prices declined 0.2%MoM. FinMin's inflation forecast shows inflation slowdown to 4.4%YoY (0.3%MoM), which is in line with market consensus.
- We predict acceleration in PPI growth in September to 2.1%YoY from 2.0% in the previous month.
- In our view, industrial output increased 6.0%YoY in September, after falling 3.7%YoY in August, amid two working days more than in the corresponding year of last year. In monthly terms, production soared 16% (two more working days as well versus August). We also expect a rise in construction output to 18.3%YoY and 16.3%MoM.



- According to our estimate, average pay rise accelerated to 11.4%YoY in September. Although this is still a double digit increase, we expect that in the next months it will decelerate and will remain in 7-10%YoY, which may be still unsatisfactory level from the MPC point of view.
- We also expect a decline in employment growth to 4.0%YoY in September.
- We forecast that money supply growth remained at 16.7%YoY, close to August level, amid slight decrease in deposit growth (ca. 18%YoY). According to our estimates, loan growth fell slightly again to 25%YoY. In the next months we expect continuation of slowdown in money and credit growth.

Economy last week – Coordinated rate cut by main central banks



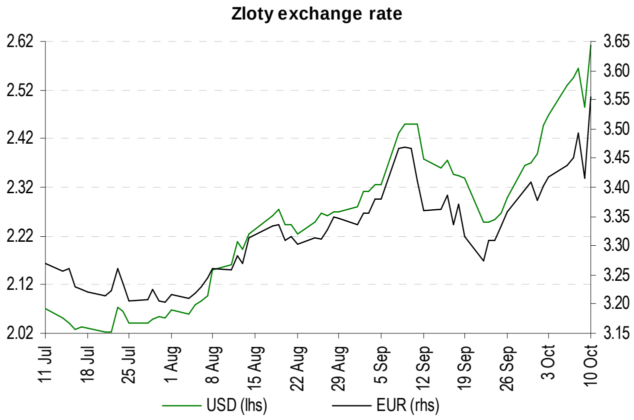
- World's main central banks cut official interest rates on Wednesday in order to revive confidence on credit markets. In a common statement central banks justified decision by deterioration in perspectives of economic growth amid decreasing inflation.
- The Monetary Policy Council has called a special meeting after the central banks' action. Local rates were kept on hold and the Council said in a statement that effect of world central banks' action will be taken into account when analysing inflation and GDP growth prospects at the end of month.
- Finance Minister confirmed that there are no reasons to change GDP forecasts for 2009 (4.8%) and that the best moment of ERM-2 entry is the first part of 2009.

Quote of the week – Situation abroad changed interest rate perspectives in Poland

Sławomir Skrzypek, NBP president, Reuters, 7 October
Undoubtedly situation in the global market will have impact on our decisions.
Jan Czekaj, MPC member, Reuters, 8 October
In a sense, those decisions are limiting room for interest rate hikes in Poland.
Andrzej Sławiński, MPC member, TVN CNBC, 9 October
We are a part of international economy, and thus effects of those recession periods unfortunately predicted in some countries will affect our economy, so this will have impact on monetary policy.

Amid mounting uncertainty in international financial markets, frozen credit markets, continuing slump in stock markets, weakening forecasts of economic growth and central banks' decision to cut rates, perspectives of monetary policy in Poland have changed as well. Such opinion was shared by MPC members who are crucial for the potential decision about rate hike. Even "hawkish" Marian Noga said that leaving interest rates unchanged in October would be appropriate action. In our view, interest rate hike in October is unlikely, however we maintain opinion that interest rates will not be reduced in 2009 due to perspective of ERM2 entry and necessity to meet inflation criteria as well as moderate economic slowdown.

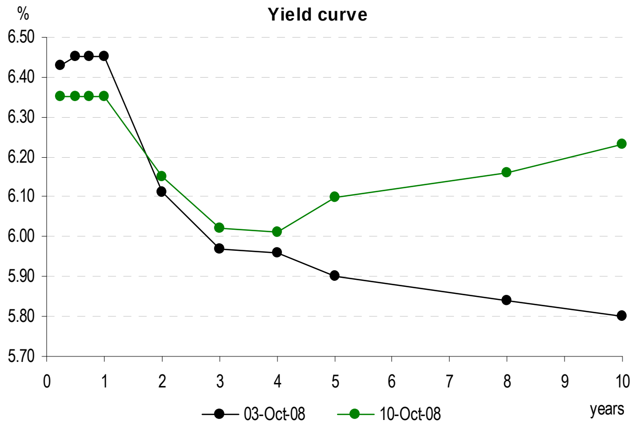
Market monitor



Risk aversion weakens the zloty

▪ The local FX market was very volatile for the whole last week. EURPLN already on Monday approached the upper end of our expectations range and on Tuesday broke 3.50. Then, after significant rebound, the end of the week was marked by rapid zloty depreciation (EURPLN above 3.60 and USDPLN above 2.60) mainly due to weakening of the Hungarian forint (rumors about problems of the country's financial sector).

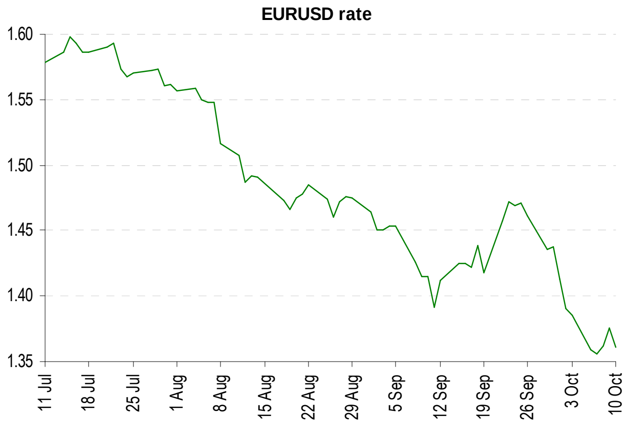
▪ Until situation in the global markets does not stabilize, the zloty will be vulnerable to negative news from abroad. Fundamentals of the Polish economy are relatively favourable (expected less significant economic slowdown and no rate cuts soon), which should support the zloty. We lift up range for EURPLN to 3.48-3.60 and for USDPLN to 2.55-2.67.



Instable debt market

▪ Last week there was considerable drop in yields at the short-end of the swap curve (2Y IRS was 5.78%, FRA9x12 was 5.36%). The main part of the move took place in reaction to rate cut by the central bank, which lowered probability of rate hikes and increased expectations of rate cuts. Purchases of bonds were limited due to preference of liquidity, which led to widening of asset swap spreads. After negative news from Hungary, there was rapid increase in bonds yields and the market became illiquid.

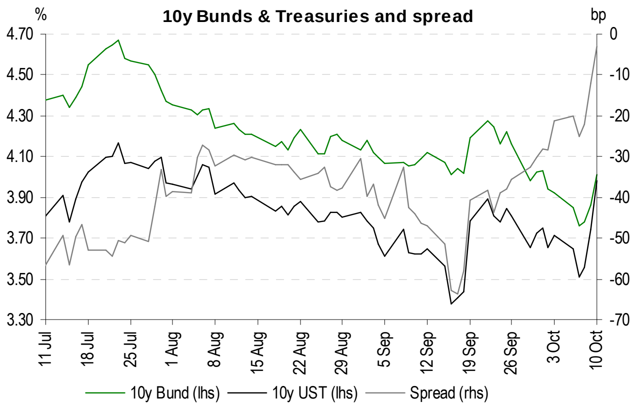
▪ In our view, the scale of rate cuts in Poland expected by the market is not justified. However, turmoil in the global markets is likely to intensify speculation on lowering of borrowing costs by the central bank. Negative news from the region may lead to temporary fall in demand for Polish bonds.



Dollar gains resume after correction

▪ Following rapid gains of the dollar over the last weeks on the wave of worsening prospects for the euro zone's economy and negative news from the European financial sector, there was some rebound of the euro last week. It took place amid information about guarantees for deposits by several European countries and announcement of partial nationalisation of the UK financial sector. The end of the week again was marked by gains of the dollar amid another wave of increased risk aversion.

▪ Demand for the dollar due to liquidity issues may support the US currency. We predict that with an improvement in moods in the euro zone should help the single currency to erase a part of losses versus the dollar. However, later in the year the dollar may gain further to ca. 1.35 at year-end.



Fear of higher supply weakening core debt markets

▪ After stronger opening at the start of the week and stabilisation of long-term yields in US and German debt markets later on, there was a significant weakening due to predicted higher supply of Treasuries needed to finance rescue of the world financial sector. Yields of 10Y Treasuries and Bunds increased by 3 bp and 11 bp versus last Friday and spread between them narrowed to 13 bp.

▪ We predict that a scale of rate cuts in the nearest quarters will be higher in the euro zone (to 3.0%) than in the US (to 1%). Apart from risk aversion, core debt markets will be under influence of next data releases (German ZEW, set of publications in the US that is likely to show risk for economic growth and inflation).

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl