Bank Zachodni WBK

Weekly economic update

20 –26 October 2008

Despite governments and central banks announced actions aimed at increasing liquidity and restoration of confidence in the banking sectors, situation in the financial markets is still far from normality and investors moods remain very vulnerable to any negative news. Attention of the markets is focusing to a growing extent on consideration of possible consequences of the current situation in the markets for the global economy and economic growth in the longer term. The key gauge of market sentiment in the global markets will remain situation on the Wall Street. Moods in the region are additionally negatively affected by news about problems of Hungary and Ukraine and concerns about contagion effect. Fundamentals of the Polish economy are stronger than in case of Hungary and economic slowdown will be much less considerable than in the euro zone. This should support the zloty in the medium term, although currently the possible next negative news from Hungary and overall pessimism in the markets are risk factors for the zloty. On the other hand, a positive factor for the Polish currency and local bonds would be official approval of the schedule of the euro zone entry. According to finance minister, approval of the schedule by the Prime Minister will take place this week and the Prime Minister is likely to decide about publication of the document in the near term. The decision would improve sentiment towards Poland and make the domestic financial market more resistant to negative moods in the region. As regards moods in the global markets, the key focus of attention will be comments from the ECB and Fed and possible indications that more rate cuts are in the pipeline. Data releases calendar abroad is light.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 October)					
09:00	**PL**	**Auction of PLN1bn of 13-week and PLN1bn of 52-week Treasury bills**					
14:00	US	Leading indicators	Sep	%	-0.3	-	-0.5
		TUESDAY (21 October)					
12:00	**PL**	**Net inflation**	**Sep**	**%YoY**	**4.0***	**4.3 (4.0*)**	**4.0**
12:00	**PL**	**CPI excl. food and energy prices**	**Sep**	**%YoY**	**-**	**3.0**	**2.7**
		WEDNESDAY (22 October)					
09:00	**PL**	**Switch tender of bonds**					
		THURSDAY (23 October)					
12:00	**PL**	**Minutes of the MPC meeting in September**	**-**	**-**	**-**	**-**	**-**
12:00	**PL**	**Retail sales**	**Sep**	**%YoY**	**11.7**	**13.5**	**7.7**
12:00	**PL**	**The registered unemployment rate**	**Sep**	**%**	**9.3**	**9.3**	**9.3**
12:00	**PL**	**Business climate indicators**	**Oct**	**-**	**-**	**-**	**-**
12:30	US	Initial jobless claims	w/e	'000	470.0	-	461.0
		FRIDAY (24 October)					
08:00	EZ	House starts	Oct	pts	44.0	-	45.0
08:00	EZ	Building permits	Oct	pts	47.0	-	48.4
14:00	US	Preliminary Michigan index	Sep	m	4.95	-	4.91

Source: BZ WBK, Reuters; * Forecasts for the net inflation before publication of the CPI data for September

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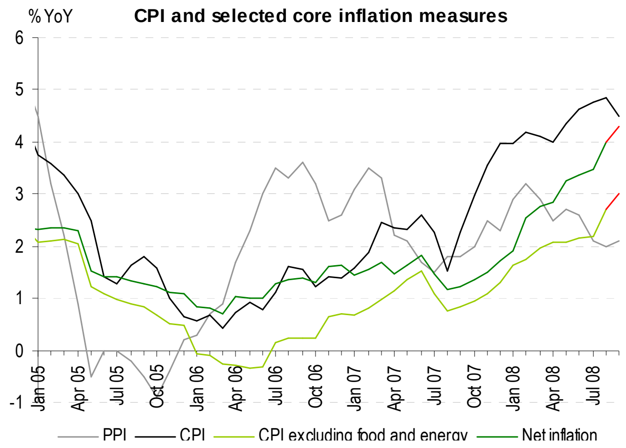
What's hot this week – Data, earnings reports and possibly schedule of euro adoption

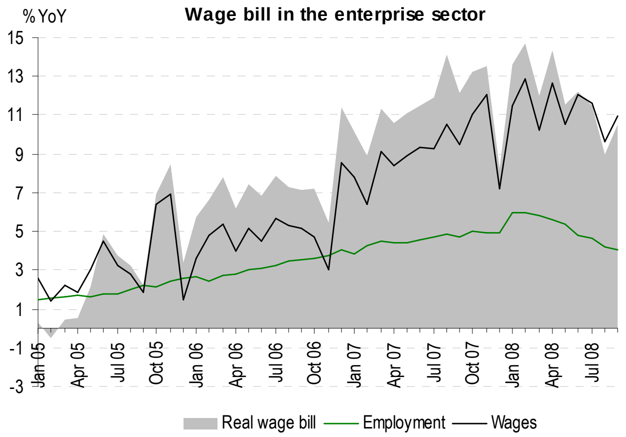


▪ This week there will be few data releases abroad. The most important will be the Friday's publication of the euro zone's PMIs and the US retail sales figures. With low number of macro data publications, market sentiment may be shaped to a large extent by earning reports for Q3.

▪ Among local data releases, the key focus of attention will be retail sales, as markets now pay more attention to economic activity indicators (amid uncertainty regarding scale of economic slowdown) than to inflation (wide consensus view that inflationary pressures are waning).

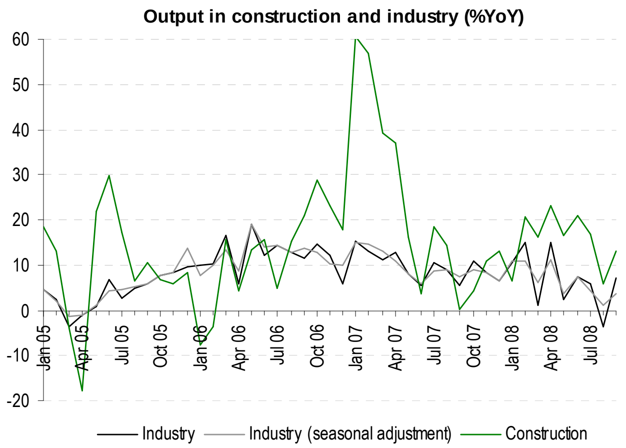
▪ Apart from data releases, a crucial event in the local market may be government's approval and possible publication of the official schedule of the euro zone entry, which was heralded by the minister of finance.

Economy last week – Data neutral for expectations regarding MPC policy



▪ CPI inflation amounted to 4.5% in September, which was in line with our forecast and above market expectations. Decrease from August's level of 4.8% resulted from lower scale of food price increase and fall in fuel prices. Prices of other goods and services were above expectations, which implies higher core inflation measures in September. The data were neutral for the MPC given the global markets turmoil and lower restrictiveness of monetary policy by main world central banks.

▪ Rise in wages and employment remained at the high level in September (10.9% and 4.1%YoY, respectively), which bodes well for fast growth in private consumption in the third quarter. However, some deceleration has been observed, which implies lower inflationary pressure from the labour market.



▪ Production data for September confirmed that significant deterioration observed in the previous month was the one-off effect connected mainly with lower number of working days. Industrial production rose by 7%YoY in September after decrease by 3.7%YoY in August. Also, construction production accelerated to 13.2%YoY from 5.9%.

▪ At the same time, the data showed some weakening in the upward trend of production in terms of seasonally adjusted data. As regards this figure, the growth in September amounted to 3.5%YoY against the average of 7% in the January-August period. According to our forecast GDP growth amounted to ca. 4.5% in 3Q08 and similar expansion should be also expected in Q4.

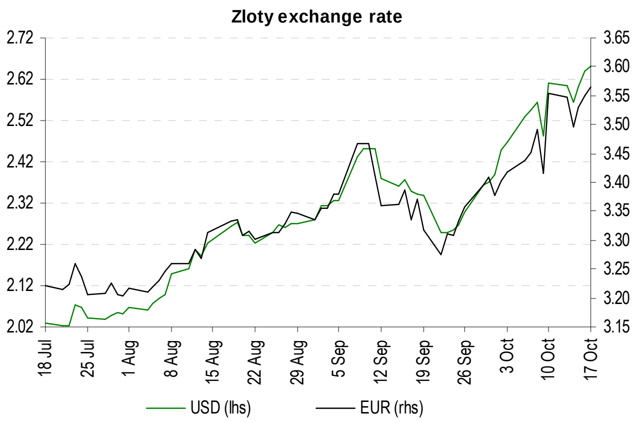
▪ PPI inflation was at 2.1% In September (2% in August), in line with expectations. Still PPI on the domestic market is much higher.

Quote of the week – Consensus that rates should be stable

Dariusz Filar, MPC member, *Rzeczpospolita* daily, 17 October
[Q: Maybe there are no hawks in the MPC anymore?] There is interesting consensus building in the Council that rates should be stable. There was rarely such unanimity. [Q: Thus, will we have stable rate until the end of this year?] Yes. I count on stabilisation in the financial markets until the end of this year. In January 2009 we will have the new inflation projection. At the beginning of the next year we will also have change of the CPI basket. [Q: And a rate cut in spring 2009?] I would not exclude it. January will be a good moment for assessment of future trends, as we will have the new NBP projection. In March, April we will have the new CPI basket and thus a possibility to better assess the inflation path.

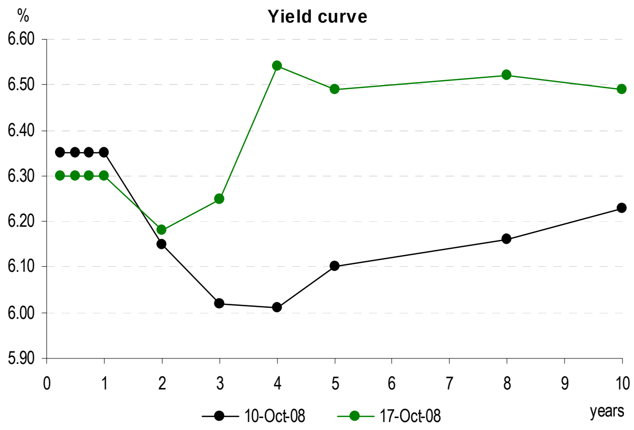
Comments from the most hawkish member of the MPC suggest that Polish central bankers are currently very unanimous in the view that interest rates should remain stable for some time. In Filar's opinion, keeping rates on hold reflects, among others, care about the zloty. Adequately high level of interest rates may help banks to offer attractive deposits. However, prof. Filar does not exclude a rate cut in spring 2009, while he expects the GDP growth to reach 3.8-4.1% in 2009 (our current forecast is 3.9%). The fact that the most hawkish rate-setter does not exclude a rate cut increase downward risk to our assumption that official rate will remain unchanged until the end of next year. Especially that similar opinion was expressed recently by other MPC's hawk, Andrzej Wojtyna.

Market monitor



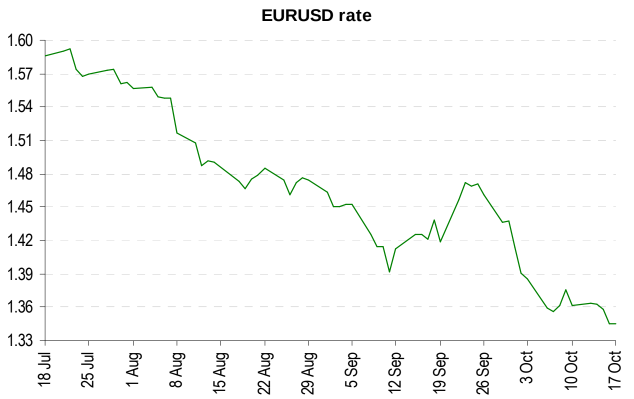
High volatility on FX market

- G7 meeting during the previous weekend and meeting of euro zone countries' leaders brought a significant moods improvement in global market and the zloty appreciated to as much as 3.43 against the euro. However, negative news from Hungary led to another wave of assets weakening in the region with EURPLN rate temporarily above 3.60.
- Fundamentals of the Polish economy are much better as compared to Hungary and economic slowdown will be less significant than in the euro zone. This should support the Polish currency in the medium run, similarly as possible dollar rebound against the euro. Nevertheless, moods in the region are the key today and zloty may be under pressure in the case of another negative information from other countries. We maintain our forecast range for the zloty – 3.48-3.60 for EURPLN and 2.58-2.70 for USDPLN.



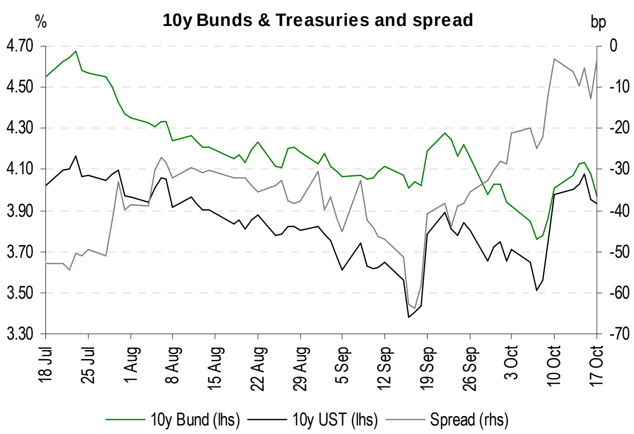
Low liquidity, sell-off following Hungarian market

- After the fixed income market showed much lower liquidity at the end of the previous week, as a result of news from Hungary, similar inactivity was also observed in the next couple of days. Clearly, investors decided to close positions in the region which led to a significant rise in yields, especially for the bonds of longer maturities. At the same time, rise in IRS and FRA rates was observed despite the set of rather dovish comments of the MPC members.
- In the near term the domestic debt market will remain under influence of higher risk aversion towards the region and data releases will recede to the background. However, taking into account fundamentals and difference between Poland and Hungary and additionally a possibility of ERM2 entry in 2009, domestic bonds may be perceived as attractive for foreign investors.



Demand for dollar still strong

- After the G7 summit and agreement assuming guarantees for interbank loans, banks' recapitalisation and taking over shares, there was a rebound in euro versus the dollar to over 1.36. Despite next weak data from the US economy, the dollar started trimming losses and strengthened to 1.34 at the end of the week amid still high demand for the US currency and poorly functioning money markets.
- If situation in financial markets stabilises somewhat, euro may trim some of recent losses against dollar. However, once investors will start taking into account economic fundamentals and relatively better perspectives of US economy amid flexible monetary and fiscal policies, dollar may start strengthening again.



Changing moods influence core debt

- In the first part of the week in the core debt markets the weakening was continued due to lower risk aversion, amid stock markets recovery and decline of money market rates. However, at the end of the week there was a significant increase in bond yields (very poor data from the US) on another wave of risk appetite drop. Yields pf 10Y Treasuries and Bunds fell since last Friday by 4-5 bp to 3.97% and 3.94%.
- The market moods, which remain sensitive to any new negative information, will still affect the prices behaviour ion the core debt markets. In the US investors will look at housing markets data and Fed chairman comments. In the EMU the PMI indices are going to be crucial. More weakening is expected regarding both data in the US and the euro zone.

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