Bank Zachodni WBK

Weekly economic update

10 – 16 November 2008

The beginning of the past week was marked by increase in risk appetite. After news about Barack Obama's win in US presidential election, there was a short-lived positive reaction of the market. However, much weaker than expected macro data and weak earnings reports from some companies in the euro zone and the US increased concerns about conditions of the major economies and negatively affected the stock markets. At the same, the dollar gained in the international markets and the zloty weakened. Investors' moods were not comforted by decisions of several central banks in Europe to lower interest rates. With aggressive rate cuts by the Bank of England and the SNB, the ECB move by 50bp was disappointing and led to weakening of the euro versus the dollar. The FinMin's inflation forecast for October was consistent with market forecasts and did not influence the local interest rate market. Domestic bond yields dropped with limited liquidity in the market and FRA and IRS rates fell amid dovish comments from the MPC. The NBP carried out the first repo operation in PLN with maturity of 3 months and announced an agreement with the SNB enabling to provide Polish banks with liquidity in CHF. The actions should lead to gradual improvement in conditions on the domestic money market. The positive impact of the news about the NBP agreement with the SNB on the zloty was offset by news about downgrade in Moody's rating for Hungary to A3 with negative outlook.

The beginning of this week in the Polish markets should be calm due to market holiday in the US and Poland on Tuesday. Later in the week, we will get the first domestic macro figures due for release in November. We expect the figures will show deeper fall in the headline inflation rate for October than the market expects and rise in the 12M cumulated C/A gap in relation to 5.2% of GDP after September. The data may have negative impact on the zloty and positive for the interest rate market. However, the main driver for the Polish market will remain developments in the global market, which will depend on next macro data releases and a number of comments from the ECB and Fed officials.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (11 November)					
	PL	**Independence Day**					
	US	Veteran's Day – partial market holiday					
10:00	DE	ZEW index	Nov		-63.0	-	-63.0
		WEDNESDAY (12 November)					
13:00	**PL**	**Current account deficit**	**Sep**	**€ m**	**1950**	**2024**	**1736**
13:00	**PL**	**Trade deficit**	**Sep**	**€ m**		**1400**	**1503**
10:00	EZ	Industrial production	Sep	%YoY	-0.9	-	-0.7
		THURSDAY (13 November)					
13:00	**PL**	**CPI**	**Oct**	**%YoY**	**4.2**	**3.9**	**4.5**
7:00	DE	Preliminary GDP	Q3	%YoY	1.6	-	3.1
13:30	US	New jobless claims	w/e	'000		-	481
13:30	US	Trade balance	Sep	$ bn	-57.9	-	-59.14
		FRIDAY (14 November)					
13:00	**PL**	**Money supply**	**Oct**	**%YoY**	**17.8**	**18.7**	**17.1**
10:00	EZ	Flash GDP	Q3	%YoY	0.7	-	1.4
10:00	EZ	Final HICP	Oct	%YoY	3.2	-	3.6
13:30	US	Import prices	Oct	%MoM	-3.0	-	-3.0
13:30	US	Retail sales	Oct	%MoM	-1.0	-	-1.2
14:55	US	Preliminary Michigan	Nov	pts	55.5	-	57.6

Source: BZ WBK, Parkiet Reuters;

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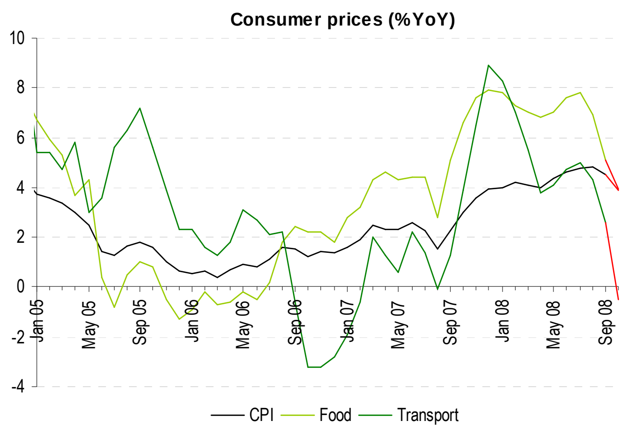
What's hot this week – Peaceful start of the week, new domestic data

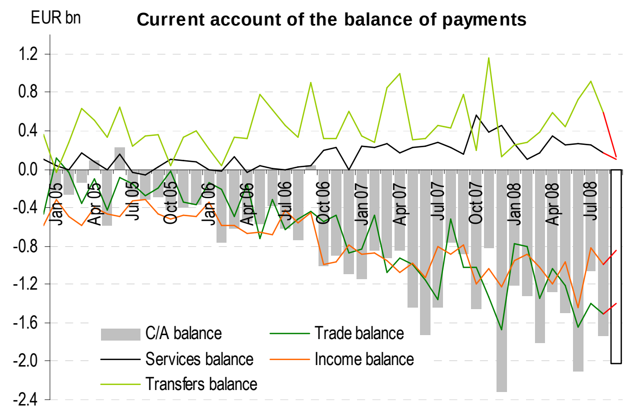


▪ Start of the week should be quite peaceful amid no important data releases in Poland and abroad, Polish Independence Day and US Veteran's Day on Tuesday.

▪ This week, the main local data release will be inflation data for October. In our view, CPI price growth decelerated to 3.9%YoY (0.1%MoM) from 4.5% in September.

▪ Ministry of Finance predicts that inflation fell to 4.2%YoY (0.4%MoM), which is consistent with median market forecast.

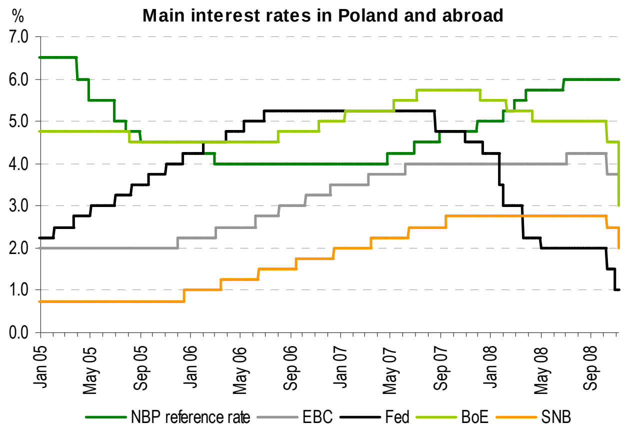
▪ According to ministry's assumptions, transport prices declined 0.8%MoM, fuel prices fell 1.8%MoM, and prices of food increased 0.9%MoM. Our inflation forecast assumes a deeper fall in transport prices (3%MoM) and smaller rise in food prices (0.5%MoM).



▪ Earlier, we will see balance of payments data for September. We predict a rise in current account deficit to slightly above €2bn. At the same time, we expect a small decline in trade deficit to €1.4bn amid rebound in export and import growth rates to ca. 25%YoY. Moreover, we assume a slight decrease in services surplus and significant drop in transfers surplus (due to lower transfers from EU).

▪ At the end of the week, we will see money supply data for October. We predict acceleration in money supply growth to 18.7%YoY, mainly as a result of low statistical base. In the following years, we predict a gradual reduction in money growth rate. At the same time, we forecast deposit growth in October at ca. 20%YoY and slight acceleration in loan growth (ca 29%YoY) due to impact of significant zloty depreciation on the value of FX loans portfolio.

Economy last week – Central banks cutting rates, PMI at record lows



▪ Poland's manufacturing PMI fell in October to 43.7, the lowest level in the survey's history. The price component recorded the deepest fall in three years.

▪ NBP held liquidity providing 3-month repo operation injecting PLN4.75bn into the market amid average yield 6.25%. NBP's fine-tuning operations should support a decline in 3M WIBOR. Moreover, NBP signed agreement with SNB concerning FX swaps in EURCHF.

▪ Bank of England trimmed main interest rates by as much as 150 bp, Swiss National Bank cut rates by 50 bp, while Czech National Bank cut by 75 bp. EBC reduction was consistent with expectations and amounted to 50 bp. J.C Trichet did not rule out further rate cuts. In our view, both the ECB and BoE will cut main interest rates next year at least to 2%.

Quote of the week – Start of monetary easing cycle next year

Jan Czekaj, MPC member, TVN CNBC, 7 November

It seems that probability or even a need of rate cuts is getting more and more obvious.(...) We have to observe (...) and try to implement such policy that would be reasonably consistent with actions of other central banks.

Stanisław Nieckarz, MPC member, PAP, 6 November

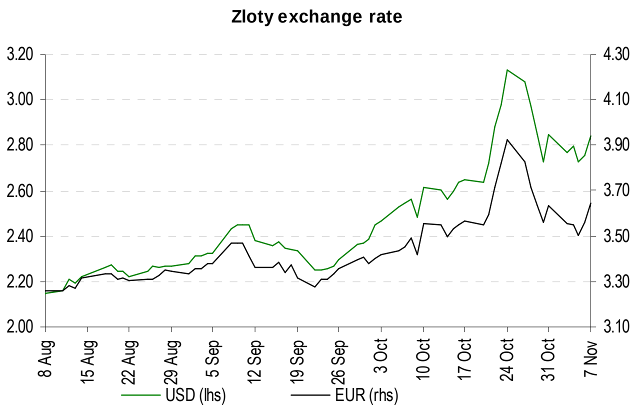
Rate cuts of ECB and other central banks, decreasing economic growth in 2009 to 3.5-4%, much below potential, amid weakening inflationary pressure from demand side, will determine a direction of interest rate movements in Poland. Future balance of risks for inflation shows that conditions of start of monetary easing cycle and reduction in intrest rate disparity will show up at the start of 2009.

Sławomir Skrzypek, NBP governor, PAP, 6 November

There are many arguments in favour of beginning of interest rate cuts cycle.

Hawkish MPC members are not convinced about a need to cut interest rates. According to H. Wasilewska-Trenkner there is no sense in making such decisions as long as situation in financial markets abroad does not settle down. In D. Filar's opinion, change in monetary policy parameters should wait until new inflation projection in February and revision in CPI basket in March, taking into account that a fall in inflation in Poland will be slower than in countries threatened by recession. Moreover, A. Sławiński said that domestic monetary policy should be relatively more restrictive due to need to meet inflation criterion, while a scale of slowdown is difficult to assess right now. However, decisions about rate cuts will dement more on dovish MPC members that suggested that they are needed. This need is justified by growing interest rate disparity, economic slowdown and fall in inflationary pressure.

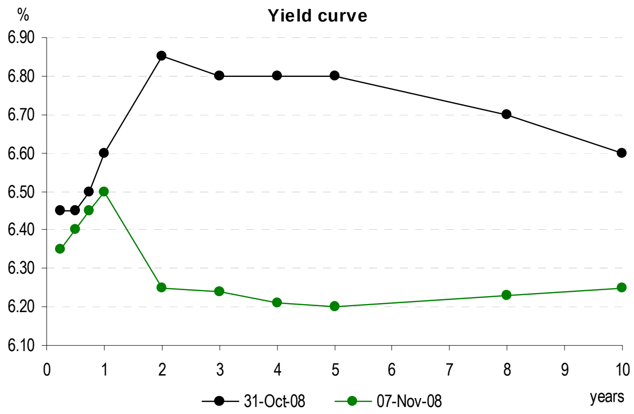
Market monitor



Zloty weaker though lower volatility

▪ In the first part of the week the volatility fell it the option market while the zloty was relatively stable as compared to the October sessions. The zloty depreciated again at the end of the week amid deteriorating moods in the global markets, lower risk appetite and interest rate cut by ECB and CNB, which strengthened market expectations for interest rate cuts in Poland and increased investors' doubts regarding the term of euro convergence. After the news on agreement with SNB the zloty recovered.

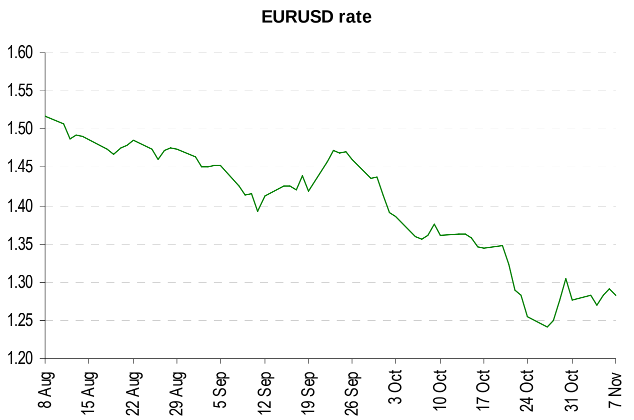
▪ In our view the zloty weakening trend may hold in the nearest time. This week the CPI and C/A data will be against the zloty. Moreover the domestic currency will still be strongly influenced by risk appetite and information from the region. The support and resistance levels for the EURPLN are at 3.58 and 3.75.



Significant drop in market rates

▪ The prices increase in the bond market continued in the past week, though the market liquidity was still marginal. Quite dovish MPC comments including the NBP president contributed to fall of FRA and IRS rates. At the same time the difference between bond yields and IRS rates stayed at similar levels as in the previous week (ca. 65 bp for 5Y term). The news on CHF swaps was also positive for bonds.

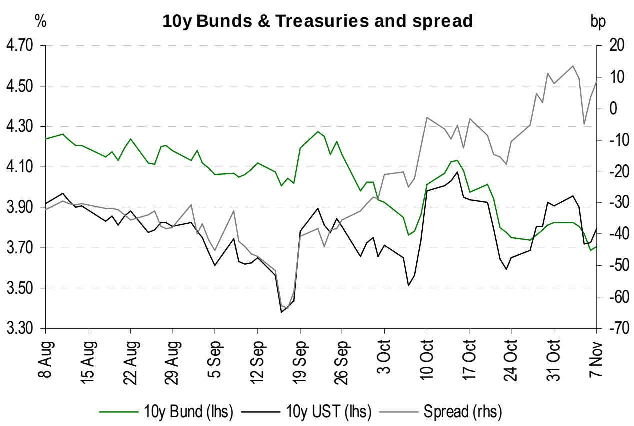
▪ In our view there is still some space for strengthening in the bond market as well as FRA and IRS rates due to expected monetary policy easing in the first months of the next year. The liquidity in the bond market may still be limited until the risk aversion significantly and permanently declines.



EURUSD relatively stable

▪ After initial strengthening of the dollar on Monday there was a significant rebound of the euro to 1.31 amid improvement of market moods and fall in risk aversion, among others in expectation for results of US presidential election and decisions of central banks in Europe. Interest rate cut in the euro zone only by 50 bp could have disappointed some investors, while weaker companies' results and data from US and euro zone brought concerns about world economic growth to the forefront again, leading to dollar strengthening to 1.28 close to Monday's levels.

▪ We maintain expectations for gradual strengthening of the dollar amid predicted euro zone's slowdown and fall in disparity versus US. EURUSD may fall to ca. 1.25 at the end of the year.



Strengthening in core debt markets

▪ Interest rate cuts in Europe and expected further easing, as well as much weaker than predicted economic data from the euro zone (PMI) and US (ISM, non-farm payrolls) contributed to significant strengthening in core debt markets. Yields of 10Y Treasuries and Bunds fell during the week to 3.77% and 3.68% from 3.91% and 3.82% on previous Friday.

▪ Core debt markets may strengthen further if there will be more weak data from the economy, which will support chances for rate cuts. Data about inflation in the euro zone will probably confirm its significant decline. Also ZEW index and euro zone's Q3 GDP will be important. In the US, Friday's reports about retail sales and Michigan index will be the most important.

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