Bank Zachodni WBK

Weekly economic update

19 – 25 January 2009

Last week the zloty remained highly volatile with EURPLN and USDPLN breaking important resistance levels while clear risk in risk appetite towards the end of the week brought about only a temporary and partly recovery of the domestic currency. What is important, the zloty performance was weaker than other currencies in the region, which suggests that the problem of option, specific for the Polish market, still plays a negative role. This indicates, along with deteriorating picture of prospects for the Polish economy, that the zloty will remain under pressure and next week one cannot exclude EURPLN will test 4.30, although unsuccessfully in our view. The local interest rate market clearly strengthened last week due to mounting expectations for a decisive rate cuts by the MPC after last bunch of domestic macro data and more and more dovish comments from rate-setters. In case of bonds, a positive role was also played by lowered credit risk, reflected in narrowing of asset swap spread.

With large dynamics of event in the markets and economy, the minutes of MPC meeting in December due for publication this week are not likely to alter assessment of monetary policy prospects. Numerous data releases this week are likely to be more important. Particular attention should be paid to labour market statistics on Monday and output figures on Tuesday (the importance of the latter numbers was explicitly stressed by prof. Jan Czekaj, one of rate-setters, apart from NBP governor, who are key for outcome of MPC votes). Of course, there will be also crucial events abroad.

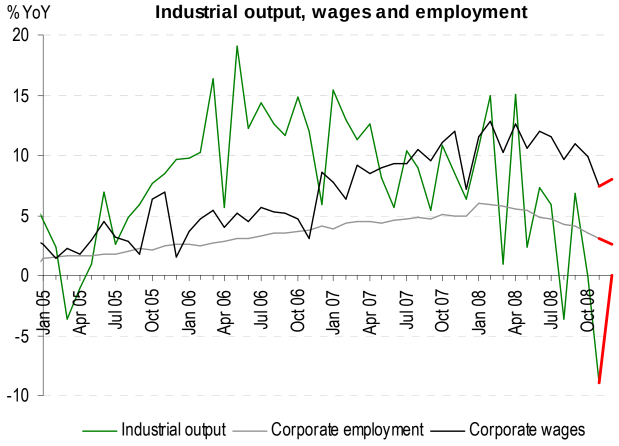
Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (19 January)					
09:00	**PL**	**Auction of 52-week Treasury Bills (PLN0.5-1bn)**					
13:00	**PL**	**Average wage in enterprises**	**Dec**	**%YoY**	**7.4**	**8.0**	**7.4**
13:00	**PL**	**Employment in enterprises**	**Dec**	**%YoY**	**2.7**	**2.5**	**3.1**
-	US	Market holiday (Martin Luther King Day)	-	-	-	-	-
		TUESDAY (20 January)					
10:00	DE	ZEW index	Jan	pts	-44.0	-	-45.2
13:00	**PL**	**Industrial output**	**Dec**	**%YoY**	**-0.7**	**0.0**	**-8.9**
13:00	**PL**	**Construction output**	**Dec**	**%YoY**	**5.7**	**10.4**	**5.5**
13:00	**PL**	**PPI**	**Dec**	**%YoY**	**2.0**	**2.6**	**2.2**
		WEDNESDAY (21 January)					
09:00	**PL**	**Switch tender of bonds**					
13:00	**PL**	**Core inflation (CPI less ford and energy prices)**	**Dec**	**%YoY**	**2.8**	**2.7**	**2.9**
		THURSDAY (22 January)					
-	JP	Bank of Japan – decision	-	%	0.1	-	0.1
13:00	**PL**	**Minutes of the MPC meeting in December**	**-**	**-**	**-**	**-**	**-**
13:00	**PL**	**Business climate indicators**	**Jan**	**-**	**-**	**-**	**-**
13:30	US	Initial jobless claims	Jan	'000	-	-	524.0
13:30	US	House starts	Dec	m	0.61	-	0.625
13:30	US	Building permits	Dec	m	0.61	-	0.615
		FRIDAY (23 January)					
09:00	EZ	Flash PMI manufacturing	Jan	pts	33.2	-	33.9
09:00	EZ	Flash PMI services	Jan	pts	41.5	-	42.1

Source: BZ WBK, *Parkiet* daily, 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 – Next dose of important data

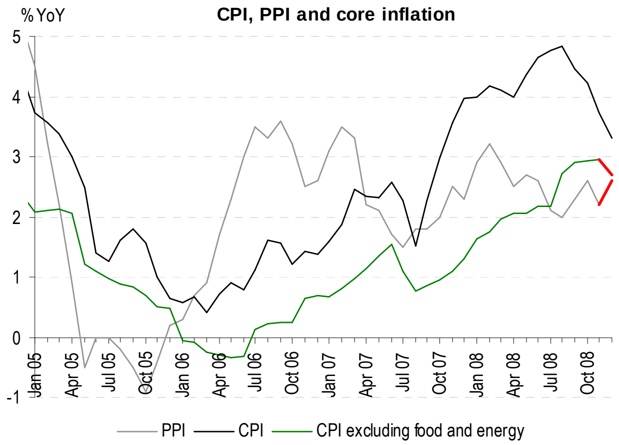


▪ In case of local data from the labour market, we predict significant weakening of labour demand (much lower employment growth) and further deceleration in wage pressure (small increase in annual wage growth is a result of higher number of working days, excluding this factor wage growth will decelerate).

▪ In case of industrial production, our forecast has been revised down (from 0.6%YoY when market consensus was established, to 0%) after the release of lower than predicted PMI index. Construction output data will be important for assessment of scale and pace of investment weakening.

▪ Although rise in zloty-denominated export prices after zloty depreciation calls for a rise in PPI in December, a deep fall in fuel prices in CPI data creates risk for our PPI forecast. At the same time, after CPI data we maintained our estimates of core inflation.

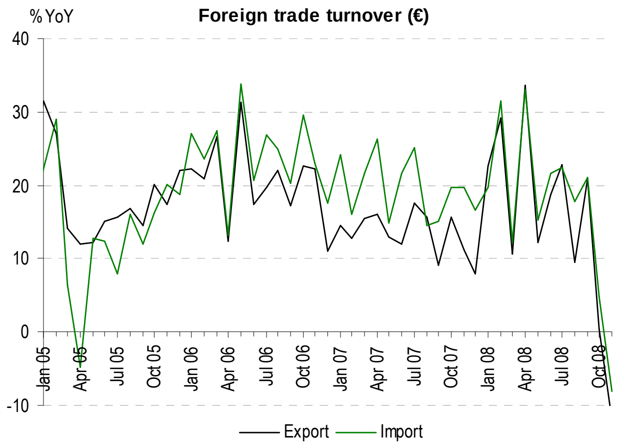
Economy last week – Inflation and foreign trade turnover sharply down



▪ The annual inflation rate fell to 3.3%YoY in December after a decline in prices of consumer goods and services by 0.1% against November. The result was in line with the market consensus, though higher than FinMin's estimate of 3.4%YoY and our forecast of 3.5%YoY.

▪ The most important factor, which contributed to deeper than we expected inflation decline was a large scale of fuel prices reduction (-9%MoM and -15%YoY). The drop in clothing and footwear prices was also larger than expected (-0.6%MoM against our forecast of -0.2%MoM). On the other hand, increase in food prices appeared slightly higher than our forecast (0.8%MoM instead of 0.5%MoM). The strongest pro-inflationary factor are still housing and energy costs (annual growth down only slightly to 11.3% from 11.4%).

▪ Now we expect that CPI inflation will return to target of 2.5% in May (against earlier expected June).



▪ Balance of payments data for November are not optimistic as regards condition of the Polish economy. Although we had expected two-digit export drop in annual terms, its scale proved even larger. At the same time, a clear drop in imports shows the domestic demand, probably mainly investment growth, is weakening. The only positive element is inflow of foreign direct investment amounting to €1bn. If we look at the foreign trade data from the monetary policy perspective (see comments from D. Filar below), they are argument in favour of interest rate cut deeper than 50bps, however a scale of decision will be probably be determined by output figures (see comments from J. Czekaj below).

▪ Monetary statistics for December showed acceleration in annual growth rate of credit, deposits and money supply, but this was an effect of FX changes on loans and deposits, and high interest rates on deposits before cuts by the MPC.

Quote of the week – Room for rate cuts is now open (wider)

Jan Czekaj, MPC member, PAP, 14 January

The decisive factor for decision whether there will be a rate cut and on what scale will depend industrial output data as they will shed much light on what may be the scale of economic slowdown. If the numbers are very weak, it would undoubtedly have substantial influence on MPC decision in January.

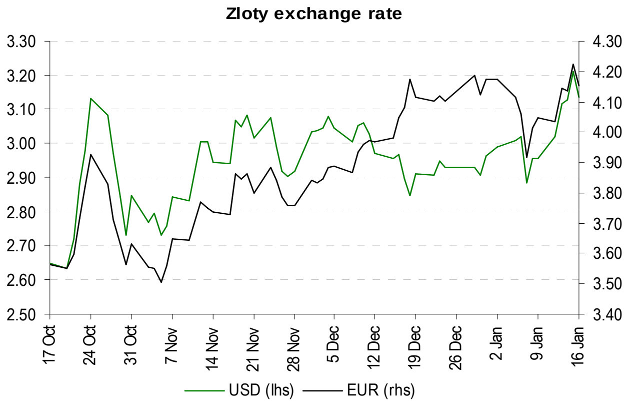
Dariusz Filar, MPC member, Reuters, 15 January

I have no doubt that room for rate cuts is now open. I would use this room in a cautious way – rather more small cuts within relatively short period than aggressive reduction in one month.

Rzeczpospolita, 16 stycznia: [After balance of payments data] This is very negative signal for the economy. I had expected that Poland's exports would be more resistance to the crisis.

Recent comments from MPC members indicate that macro data released last week increased their willingness to cut rates. Hawkish prof. D. Filar said he had been surprised with scale of exports slump and CPI figures made them believe that inflation return to the target will be sooner. Thus, currently even hawks (M. Noga broadly shares Filar's view while only H. Wasilewska-Trenkner still opposes to cuts) see room for rate cuts already at the beginning of this year, although it should take place in small steps. In case of doves and moderate rate-setters one may talk of strengthening of belief that decisive actions are needed already in first months of the year. In Czekaj's opinion (he is one of crucial voters) the key factor for scale of a rate cuts will be output data. We expect 50bps reduction, although one cannot exclude move by 75bps.

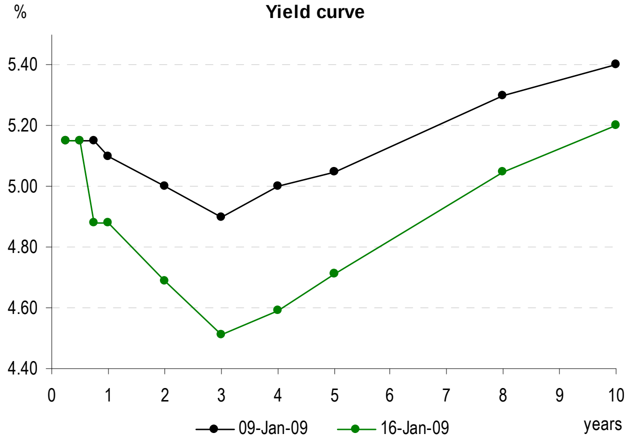
Market monitor



Polish zloty under pressure

▪ The Polish currency depreciated against major currencies again last week. What is more, zloty weakened more than other currencies in the region – 2.6% vs. 2% loss of the Czech crown and 0.2% of the Hungarian forint. This suggests that not only higher level of global risk aversion, but also the domestic specific problems (e.g. foreign exchange options) influence the market.

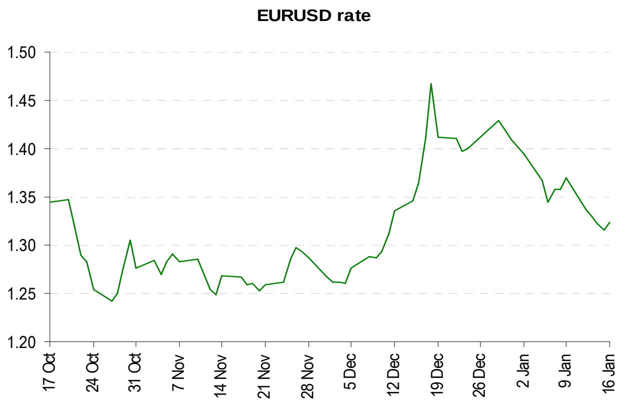
▪ The EURPLN rate broke the upper band of the range we suggested in the previous report and we think that the zloty will still remain under pressure with high volatility, though the first day of the week may be relatively calm amid market holiday in the US. We assume the zloty trading range for this week of 4.10-4.30 against the euro and 3.05-3.25 against the dollar.



Polish yields sharply down

▪ Despite a significant weakening of the zloty the domestic fixed income market showed a sharp strengthening during the week. This was mainly driven by stronger expectations for swift interest rate cuts by the MPC, which was influenced by both economic data and Council's members comments. At the same time spread between bonds and IRS (asset swap spread) tightened (the short-end of the curve fell less than the bond curve, while long end of the IRS curve moved up with falling bond yields). This may show a fall in assessment of credit risk (of the country) for the Polish bonds.

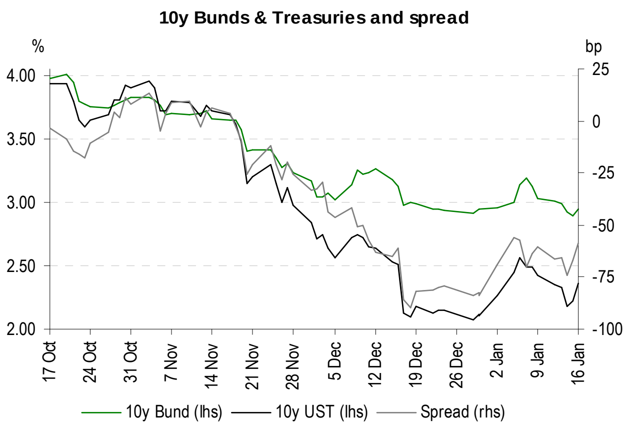
▪ The next couple of days may show a correction on the Polish bond market on profit-taking after large gains last week. Especially as economic data releases may support it - we have higher forecast of production and wages as compared to the market consensus.



Amid increased risk appetite the EURUSD lower ...

▪ In the last week the tendency of dollar appreciation against the euro was dominating amid environment of increase risk aversion in the global markets. The dollar was supported by expectations for interest rate cuts by the ECB at the Thursday meeting. On Friday the single European currency recovered losses from the first part of the week due to increase in risk appetite and economic data, which shoed that in November there was outflow of long-term capital from the US instead of expected inflow.

▪ This week the changes in EURUSD rate will be relatively small amid long weekend in the US and relatively small number of data releases both in the euro zone and the US. The release of Q4 financial results by further listed companies may be more important.



... and core debt markets stronger

▪ The core debt market's behaviour in the past week was correlated with EURUSD rate movements, i.e. till Thursday the tendency of falling yields was dominating along the intensification of risk aversion, while on Friday there was a change in this tendency amid improved risk appetite (after successful works in the US Congress on further elements of packages supporting the financial sector and the economy and granting help to Bank of America). Overall, at the end of the week yields of 10Y Treasuries and Bunds were at 2.37% and 2.94% against 2.43% and 3.03% a week earlier.

▪ We think that this week the core markets bond yields, similar to EURUSD rate, will experience rather narrow fluctuations without specific direction.

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