Bank Zachodni WBK

Weekly economic update

9 – 15 February 2009

The last week was the period of significant worsening of moods in the Polish financial market, which caused zloty depreciation and weakening in the bond market. Among market participants some doubts appeared whether the scale of domestic currency depreciation would lead to limiting moves of the Monetary Policy Council in the cycle of monetary expansion, which was reflected in higher FRA and IRS rates. However, in our opinion, arguments in favour of further rate cuts are still valid, and this will be supported by the next series of weak economic data releases in the reminder of the month. This week we will know only a few pieces of information, including balance of payments statistics as well as CPI inflation and money supply. Data crucial for the outcome of MPC meeting (labour market figures and industrial production) will be released in the following week and fixed income market may stay on relatively weak levels until then. As regards this week's data, we forecast a continuation of significant exports decrease (-11.6%YoY in December), though even more significant fall (more than 20%) will probably be visible only in the data for January. In our opinion, January's CPI inflation figure will be higher than suggested market consensus, but in the following months inflation is likely to fall to the level of NBP inflation target (2.5%), or even below despite zloty weakening. Also, it is worth to notice that according to NBP survey released last week situation in credit markets is difficult with a dramatic constraint in loans supply in all segments of the market. In spite of this factor, January's data on money supply will show only moderate deceleration in broad money (to 18.4%YoY) and total credits (to 35.9%YoY), which is connected with higher value in zloty terms of foreign exchange denominated loans and deposits. For the Polish foreign exchange market, other factors than domestic data will be important (global markets moods, level of risk appetite and trends of other currencies in the region).

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (9 February)					
10:00	**PL**	**Auction of 52-week Treasury Bills (PLN1.5-2.0bn)**					
		TUESDAY (10 February)					
15:00	US	Wholesale inventories	Dec	%MoM	-0.9	-	-0.6
		WEDNESDAY (11 February)					
13:30	US	Trade balance	Dec	$bn	-35.5	-	-40.44
19:00	US	Fed budget	Jan	$ bn	-77.0	-	17.84
		THURSDAY (12 February)					
10:00	EZ	Industrial production	Dec	%YoY	-8.9	-	-7.7
13:00	**PL**	**Current account balance**	**Dec**	**€ bn**	**-2.00**	**-1.40**	**-1.75**
13:00	**PL**	**Exports**	**Dec**	**%YoY**	**-10.8**	**-11.6**	**-11.9**
13:00	**PL**	**Imports**	**Dec**	**%YoY**	**-8.9**	**-14.5**	**-8.2**
13:30	US	Jobless claims	w/e	k	610.0	-	626.0
13:30	US	Retail sales	Jan	%MoM	-0.8	-	-2.7
15:00	US	Business inventories	Dec	%MoM	-0.8	-	-0.7
		FRIDAY (13 February)					
7:00	DE	GDP flash	Q4	%YoY	-1.3	-	1.3
10:00	EZ	GDP flash	Q4	%YoY	-1.1	-	0.6
13:00	**PL**	**Money supply**	**Jan**	**%YoY**	**18.8**	**18.4**	**18.8**
13:00	**PL**	**CPI**	**Jan**	**%YoY**	**2.9**	**3.1**	**3.3**
14:55	US	Michigan index preliminary	Feb	pts.	60.6	-	61.2

Source: BZ WBK, *Parkiet* daily, Reuters

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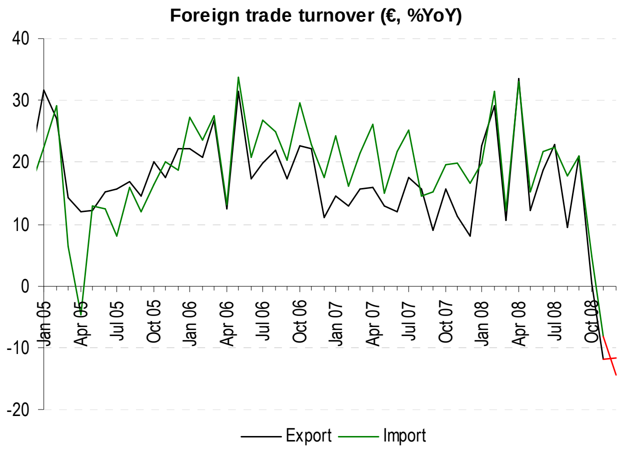
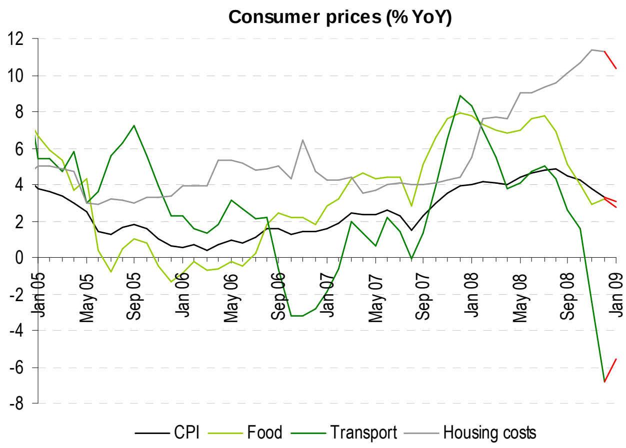
What's hot this week – First pack of new weak data



▪ Balance of payments data for December will be the first set of bad news that we are expecting to see this month, and that should in our view persuade the MPC to continue monetary easing. We predict a strong drop in exports (-11.6%YoY) amid quite small trade deficit and current account gap (5.3% of GDP) thanks to even stronger collapse in imports (-14.5%YoY). Market consensus shows smaller import drop and thus higher deficit.

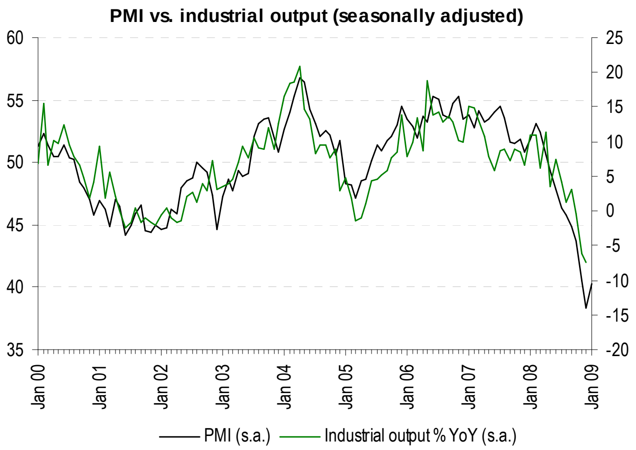
▪ Data about money supply, usually not very important for the market, are currently gaining relevance when main concerns about economic growth relate to credit market freeze. Alas, value of loans and deposits is still biased by rapid zloty slump, which makes it difficult to extract real trends in the market. Predicted small deceleration in M3 and credit growth reflects a quite severe slowdown if we take into account impact of exchange rates fluctuation.



▪ CPI data on due Friday will show a drop in inflation. Opinions about scale of this drop are divided – market consensus is at 2.9% (minimum 2.8%), our forecast points to 3.1%, while Ministry of Finance's estimate is even higher, at 3.2%YoY. Factors limiting inflation fall in January will be hikes in fuel prices and some housing-related costs. However, in the further part of the year inflation is going to continue falling and even though zloty depreciation may decelerate pace of decline, a fall to 2.5% inflation target does not seem to be endangered.

▪ Apart from domestic publications, next data abroad about economic activity will be important, as they will impact moods in international markets. Particularly important may be data about retail sales and consumer sentiment in the US and industrial production and GDP in the euro zone.

Economy last week – Slight rebound in PMI, savings in 2009 budget



▪ Polish manufacturing PMI increased in January to 40.3 from 38.3 in December. Four of five components improved, except for employment index that fell the most since 1999. Also PMI in the euro zone, German Ifo index, and US ISM recorded an increase in January. Slight improvement in moods does not change our assessment that situation in Polish economy is still deteriorating, and data for January will show a significant drop in industrial output (fewer working days, high base).

▪ The government approved budget savings totaling PLN19.7bn. Spending cut of PLN10bn was applied in ministries and Social Security Fund, while PLN9.7bn savings result from a change in financing of infrastructure projects – Domestic Road Fund will take over entire costs related to road investment with a use of EU funds. The latter shift will not decrease a general government deficit though.

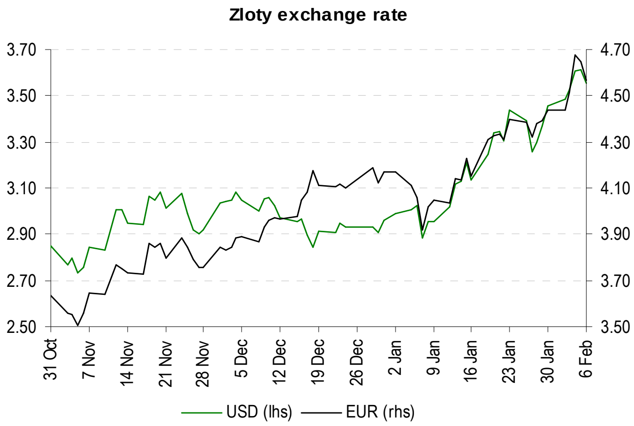
Quote of the week – Will zloty depreciation limit rate cuts?

Sławomir Skrzypek, NBP president, PAP, 6 February
Ths year I do not expect the exchange rate to impact inflation. Inflation will be gradually marching towards the inflation target, which will be reached this year. We may be even below the target. (...) Interest rate cuts are likely.

Jan Czekaj, MPC member, PAP, 5 February
There is a room for interest rate cuts. (...) I do not rule out a cut in February. I think this level (of interest rates) here is still high, looking at other countries, thus we may apply next interest rate cuts relatively quickly. (...) Probably during the next MPC meeting (exchange rate) will be one of the most important topics of discussion.

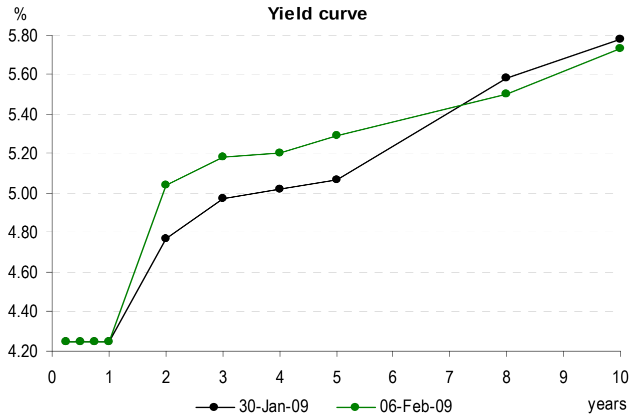
Zloty weakening in recent weeks brought market uncertainty as regards future decisions of the MPC. Though a few members of the Council admitted that foreign exchange market development will be a subject of discussion during the next meeting, we still expect that majority of the members will support the rate cut, especially given our forecasts of the next data releases. MPC's Andrzej Sławiński said that zloty weakening does not have to lead to higher inflation amid much lower demand in the economy and given quite high margins of importers. Jan Czekaj, whose vote is important for the decision said recently that "interest rates influence on the zloty level is not currently the same as described in economic textbooks". In his view the MPC may cut rates further to 3.0-3.5% (in the moves not bigger than 75bp) and he did not exclude a possibility of reference rate falling below 3% level if the economic slowdown is really significant.

Market monitor



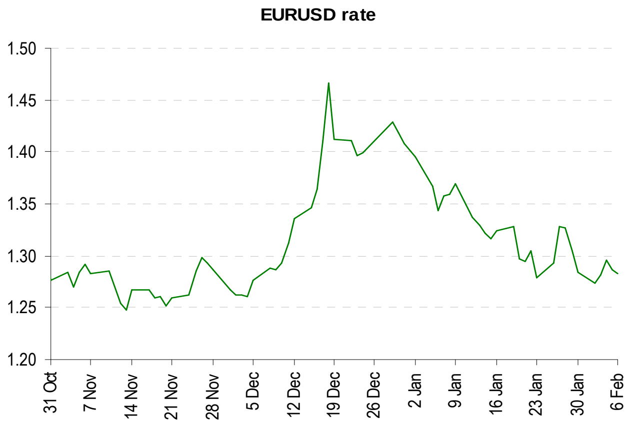
The zloty was breaking several key levels

- A week ago we forecasted the zloty may soon break 4.50 level against the euro, with decreasing potential for further depreciation. On the wave of sell-off in the region it reached even 4.70, though the end of the week brought recovery to 4.55. Over the past week Polish currency depreciated by ca. 2.2%, much more than the Czech crown (-0,3%), while the Hungarian forint strengthened (+2.7%).
- We can not state whether this is the end of bad times for the zloty, however we sustain our assessment that the scale of the weakening is already limited. The zloty is going to remain sensitive to changes of investors' moods and risk aversion, which may be more important than the domestic releases (poor data abroad may deteriorate sentiment again). The predicted small current account deficit will be offset by deep drop in exports.



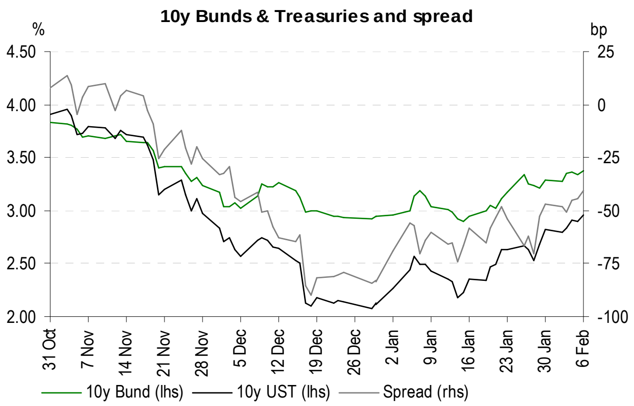
The weakening also in the interest rate markets

- The scale of zloty depreciation decreased market expectations regarding the scale of interest rate reductions, which resulted in substantial increase of market FRA and IRS rates (30-40 bp!). Rising bonds yields were additionally supported by the weakening in the core debt markets as well as rising fears regarding the situation of Polish budget amid substantial economic slowdown. The spending savings presented by the government did not significantly change these concerns. The strengthening of the zloty at the end of the week contributed to a recovery in the interest rate market.
- Slightly higher inflation than market consensus, weak FX market and still high risk aversion may hold weakness of bonds this week. However, we expect rebound later this month after a series of weak data and rate cut by the MPC.



Relatively stable week for the dollar

- Dollar exchange rate against euro was fluctuating in range 1.27-1.30 last week. Initially, euro strengthening was favoured by better than expected business climate indices and a fall in risk aversion. Later on, there was a rebound and in sum the EURUSD rate remained virtually unchanged versus last Friday. After US non-farm payrolls data (598,000 drop in January, jobless rate up to 7.6%) dollar gained slightly.
- A number of Fed members are scheduled to speak this week, including Bernanke who is due to give testimony before the House Finance Committee. Any comment regarding economic outlook or ways to cope with financial crisis may be crucial for currency markets. Also, new data publications will be important, including GDP in the euro zone, trade balance, retail sales and consumer confidence in the US.



Yields abroad are rising

- Core bond markets are witnessing an upward trend in yields for some time. It seems that the main reason for that is growing concern about huge supply of government bonds around the globe this year, however some also ascribe this to growing inflationary fears and expectation for gradual economic revival in major economies (some of recently released data were better than predicted).
- We would like to see some signs of economic recovery very much, however we are not expecting a lot of good news in the near term. Main central banks' interest rates will remain low for a long time (in the euro zone, a rate cut to 1% is possible in Q2) and next data may be again more pessimistic. US labour market figures for January confirmed that it is still a long way to go until the recovery comes.

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