

# Weekly economic update

16 – 22 February 2009

The last week was marked in all markets by dominant influence of increase in risk aversion. The zloty weakened significantly, domestic bond yields went up (with widening of asset swap spread and rise in CDS rates reflecting increase in the country's credit risk premium), EURUSD fell and core bond market gained. This week we assume some improvement in moods, which would change tendencies in the markets. Local data released last week (slump in foreign trade turnover and fall in inflation) had no major impact on markets. As regards domestic data due for release this week, we think they will confirm clear contraction in economic activity and thus will be positive for the interest rate market, increasing expectations for next rate cut by the MPC this month, despite the zloty weakness.

## Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (16 February)</b>							
10:00	PL	Auction of 52-week Treasury Bills (PLN1.3-1.8bn)					
-	US	Market holiday					
<b>TUESDAY (17 February)</b>							
10:00	DE	ZEW index	Feb	pts	4.8	4.8	5.4
13:00	PL	Average wage	Jan	%YoY	0.4	0.5	2.3
13:00	PL	Employment in enterprises	Jan	%YoY	-28.0	-	-31.0
13:30	US	NY Fed index	Feb	pts	-21.25	-	-22.2
14:00	US	Capital flows	Dec	\$bn	-	-	-21.7
<b>WEDNESDAY (18 February)</b>							
10:00	PL	Switch auction of bonds					
13:30	US	House starts	Jan	m	0.53	-	0.55
13:30	US	Building permits	Jan	m	0.54	-	0.547
13:30	US	Import prices	Jan	%MoM	-1.4	-	-4.2
14:15	US	Industrial output	Jan	%MoM	-1.3	-	-2.0
14:15	US	Capacity utilisation	Jan	%	72.6	-	73.6
19:00	US	Minutes of FOMC meeting in January					
<b>THURSDAY (19 February)</b>							
13:00	PL	Industrial putput	Jan	%YoY	-12.4	-15.1	-4.4
13:00	PL	PPI	Jan	%YoY	2.3	2.0	2.6
13:00	PL	Minutes of MPC meeting in January					
-	JP	Bank of Japan – decision					
13:30	US	PPI	Jan	%MoM	0.2	-	-1.9
13:30	US	Initial jobless claims	w/e	'000	-	-	623.0
15:00	US	Leading indicators	Jan	pts	-0.2	-	0.3
15:00	US	Philly Fed index	Feb	pts	-23.0	-	-24.3
<b>FRIDAY (20 February)</b>							
08:58	EZ	Flash PMI manufacturing	Feb	pts	35.0	-	34.4
08:58	EZ	Flash PMI services	Feb	pts	42.4	-	42.2
13:00	PL	Business climate indicators	Feb	-	-	-	-
13:30	US	CPI	Jan	%MoM	0.1	-	-0.7

Source: BZ WBK, Parkiet daily, Reuters

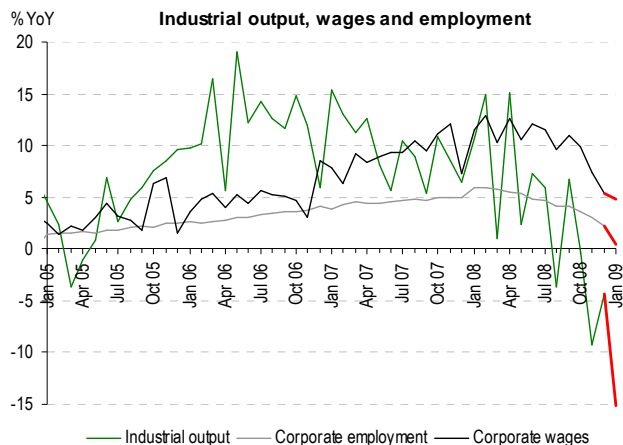
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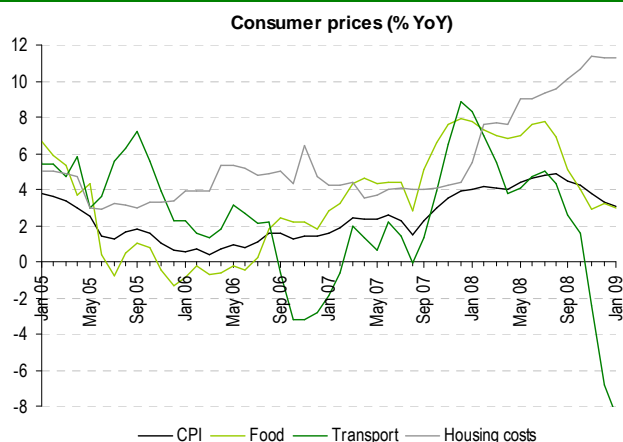
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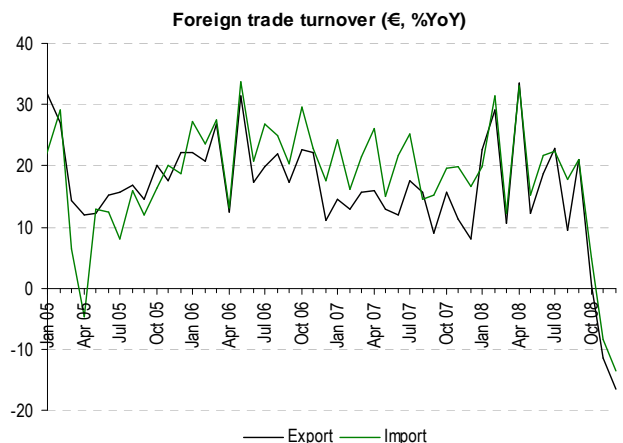
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**What's hot this week** – NBP report on euro adoption and many data locally and abroad

- This week will start in calmly amid market holiday in the US on Monday, but the same day the NBP will release a delayed report about costs and benefits of Poland's euro zone entry. Earlier comments of the NBP vice-president W. Koziański suggested that it will show greater benefits than costs. However, we do not know what will be potential proposals in the report concerning optimal date of euro adoption.
- Information of Labour Ministry about stronger than predicted unemployment rise in January (please see below for details) creates a downward risk for labour market data, especially for employment growth, however in this case there is huge uncertainty about effect of change in CSO sample of firms.
- For Polish market key will be data about industrial output due on Thursday, as well as changes in sentiment in the

**Economy last week** – Inflation fall and slump in foreign trade turnover

- CPI inflation in January was 3.1%YoY (against 3.3%YoY in December), in line with our forecast, below the estimate of the Ministry of Finance (3.2%YoY) and above market consensus. CSO information on particular price categories was not too precise, as January's inflation data are provisional. Full information will be released in March after recalculation of CPI according to new basket of weights. Thus, the NBP will not publish data on core inflation this month. However, according to our estimate, CPI inflation excluding prices of food and energy (using current system of weights) fell significantly, below 2.5%YoY in January against 2.8% in December.
- Monetary statistics for January confirmed our expectations of a slowdown in loans growth, especially after elimination of the FX effect. At the same time, growth in total deposits and money supply also lowered.



- Much deeper than predicted fall in exports (-16.4%YoY) and imports (-13.5%) in December increases downward risk for GDP forecasts, showing that influence of global recession on the Polish economy is stronger than expected. In our view this is another argument for the MPC to continue interest rates cuts. Current account in December was close to market forecasts and topped €1.9bn, which means that cumulative 12-month deficit reached 5.4% of GDP (coverage by FDI and EU funds fell to 67% from 74%). FDI inflow in December was negative, however it should be a temporary effect, although we still expect a fall in FDI inflow this year by ca. 50% (to ca. €6bn).
- Ministry of Labour said that registered unemployment rate rose to 10.5% in January (10% expected) from 9.5% in December, much stronger than in corresponding period of economic slowdown in 2000-2003.

**Quote of the week** – Hawks do not exclude rate cut in February**Halina Wasilewska-Trenkner, MPC member, PAP, 11 February**

*On the basis of what we know today, I think we should wait peacefully. I see no need to cut interest rates at all cost in February. (...) Credit is not cheap and will not be, even if we cut rates, because other factors will not disappear quickly. (...) Level of reference rate at 4.25% may be too high, but it does not mean that there will be another 75 bp rate cut, and another one, and the Council will stop cutting rates only at 2%. I see no reasons to proceed with large moves.*

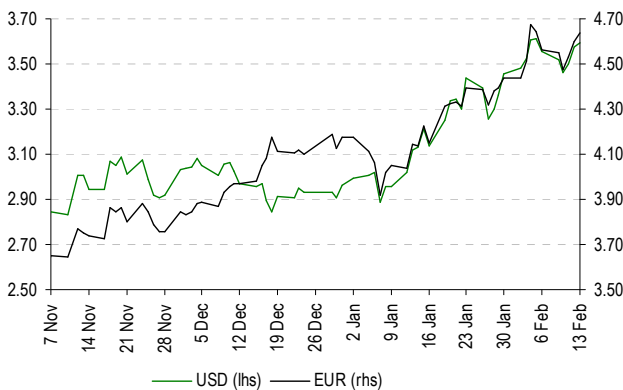
**Marian Noga, MPC member, PAP, 12 February**

*We have not concluded a monetary easing cycle yet. I cannot rule out that rates will go down again in February. I am advocate of small reductions, by 25 bp.*

According to "hawkish" Halina Wasilewska-Trenkner, further reduction in interest rates will not cause a fall in credit costs and higher availability of loans, as bank margins and requirements will remain unchanged. In our view, one should not forget about fall in costs of debt servicing for already granted loans, and improvement in pricing of investment projects. In sum, it seems that views of Halina Wasilewska-Trenkner are more and more isolated in the MPC. This is indicated, among others, by comments from hawkish Marian Noga that the Council has not abandoned the easing cycle yet and one cannot exclude another cut in February (although on lower scale, possibly by 25bps). Stance of MPC members may further soften after output figures due for release this week, which in our view will be really weak, below market consensus.

**Market monitor**

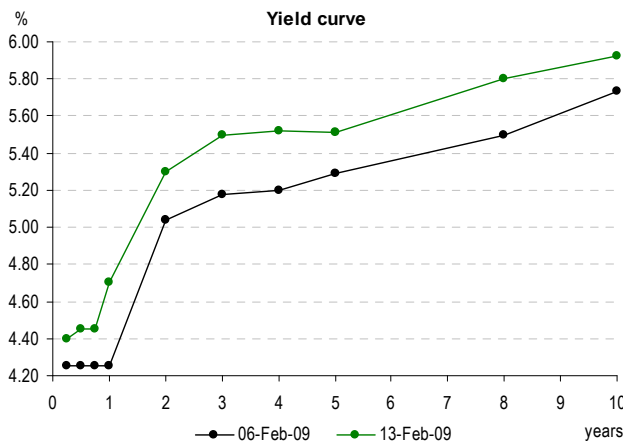
**Zloty exchange rate**



**Weaker zloty - risk aversion and poor moods in region**

- Though the first day of the week brought a continuation of the positive trend observed in the previous week, the next couple of days showed depreciation trend for the zloty. This was connected with higher risk aversion in global markets, as well as negative investors' moods towards emerging markets. During the week the zloty lost 2.3% similarly as the Czech crown (2.5%) and less than the forint (3.3%).
- This week may bring some positive sentiment for the zloty, as we can see some profit taking after the significant move last week. However, rather weak data on the Polish economy may work in the opposite direction. Similarly as in the previous months global sentiment will be very important. We assume that risk aversion will not be as high as recently and thus we do not assume that the level of 4.70 for EURPLN rate will be broken.

**Yield curve**



**Domestic yield curve sharply up**

- Weak zloty was accompanied by a similar sentiment on the interest rate market. Bond yields rose across the curve by more than 30-40bp and ten-year papers' yields exceeded 6%. Rise in IRS rates was less significant, by 10-20bp. As a result asset swap spread rose showing that weakening in the interest rate market is connected not only with lower expectations for interest rate cuts by the MPC amid zloty weakening, but is also (or above all) the result of higher risk premium connected with higher credit risk of the country. This was also visible in another increase in credit default swap (CDS) for Polish bonds. CDS for five-year bond temporarily reached a new record-high level of 363bp.
- This week we expect the domestic interest rate market to strengthen amid weak economic data and possible rebound in global moods, which would result in higher appetite for assets in the region.

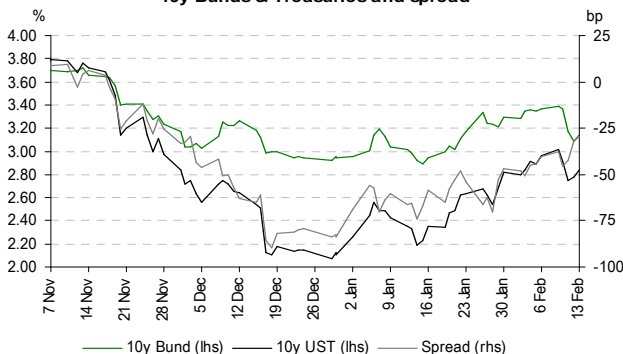
**EURUSD rate**



**Dollar gained versus euro**

- Increase in risk aversion in the global markets led to fall in EURUSD. This was also influenced by weaker data from the euro zone (among others on industrial output for December and GDP for Q4) as well as concerns about impact on the euro zone from deepening slowdown in Central and Eastern European economies and dangers to financial stability of some countries in the region (some new negative news from Russia). At the end of the week EURUSD was 1.285 versus nearly 1.30 at the end of the previous week.
- This week we expect a risk in EURUSD with the above-mentioned assumption that risk aversion will ease to some extent. Much will also depend on the data from the US and the euro zone and assessment of relative strength of the two economies.

**10y Bunds & Treasuries and spread**



**Core bond market much stronger**

- Heightened risk aversion translated into increased interest in Treasuries and Bunds and 10Y yields significantly fell. At the end of the week they were at 2.84% and 3.13%, respectively, versus 2.97% and 3.37% a week earlier. Bunds were also positively affected by indirect suggestion from ECB President that although he does not imagine fall in the euro zone's rates to zero in the near term, one cannot exclude it in future.
- In our view this week will bring correction in the core debt market along with some improvement in moods on the global markets. Monday will be calm with lower investors activity due to market holiday in the US.

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