Bank Zachodni WBK

Weekly economic update

6 – 12 July 2009

Ministry of Finance's inflation forecast for June released last week proved to be below range of analysts' forecasts in Parkiet's poll, which calmed down fears of some dovish MPC members and was one of factors positively affecting debt market. Nevertheless, one should remember this was just a forecast. MPC decisions about interest rates will depend on actual inflation data, which was underscored by Jan Czekaj. PMI index in manufacturing showed a rebound in June, however it was worse than expected and still remains below 50, which reflects a contraction in economic activity. Finance minister Jacek Rostowski said that an increase of budget deficit above PLN27bn is out of option, and the government has already found planned savings amounting to PLN3bn. On Tuesday the government will pass draft budget amendment, which main assumptions have been already presented, to the parliament.

Moods in the global markets were transitory improved by another increase in the Chinese PMI, but then the sentiment was deteriorated by weaker than expected data from the US labour market. The ECB left interest rates unchanged last week. President Trichet said that rates are at appropriate level, although did not exclude their lowering. He expects an economic revival in the euro zone only in mid-2010, which indicates that rates in the euro zone will remain on hold for a prolonged period of time.

Together with a rise in risk appetite the zloty appreciated during the week by over 2%, the strongest in the region, which was another factor contributing to fall in interest rates. Dollar was fluctuating in narrow range versus euro. This week, amid lack of key publications in Poland and abroad, investors will focus on domestic 5Y bonds auction, G8 meeting starting on Monday, and earning reports of international companies for Q2. The Bank of England is likely to keep main interest rates on hold this week. The zloty may appreciate further, but in next weeks we expect to see some correction. The debt market will be under influence of bond auction, international moods and next comments of MPC members.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (6 July)					
9:00	**PL**	**Auction PLN1.0-1.2bn of 52-week Treasury Bills**					
14:00	US	ISM services sector	Jun	pts	45.6	-	44.0
		TUESDAY (7 July)					
10:30	GB	Industrial production	May	%YoY	-11.2	-	-12.3
		WEDNESDAY (8 July)					
9:00	**PL**	**Auction of PLN1-2bn of PS0414 bonds**					
9:00	EZ	Revised GDP	Q1	%YoY	-4.8	-	-1.7
11:00	US	Mortgage applications index	w/e	pts		-	444.8
		THURSDAY (9 July)					
11:00	GB	BoE interest rate decision	Jul	%	0.5	-	0.5
12:30	US	New jobless claims	w/e	k	610	-	614
14:00	US	Wholesale inventories	May	%MoM	-1.1	-	-1.4
		FRIDAY (10 July)					
12:30	US	Import prices	Jun	%MoM	1.6	-	1.3
12:30	US	Trade balance	May	$ bn	-30.0	-	-29.16
13:55	US	Preliminary Michigan index	Jul	pts	71.0	-	70.8

Source: BZ WBK, Reuters;

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What's hot this week – Bond auction, budget amendment

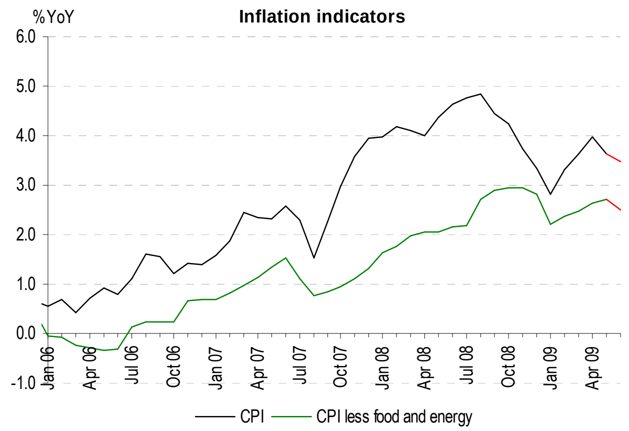
Macroeconomic assumptions from *Information on macroeconomic situation and state of the budget in 2009.*

		2008	2009 F *	2010 F *
GDP	%YoY	4.9	0.2	0.5
Private consumption	%YoY	5.4	2.1	0.8
Investment	%YoY	8.2	-1.9	0.1
Inflation	%YoY	4.2	3.0	1.0
Wage growth in corporate sector	%YoY	5.8	2.0	1.4
Unemployment rate	%	9.5	12.5	13.8
Current account to GDP	%	-5.5	-3.2	-3.2

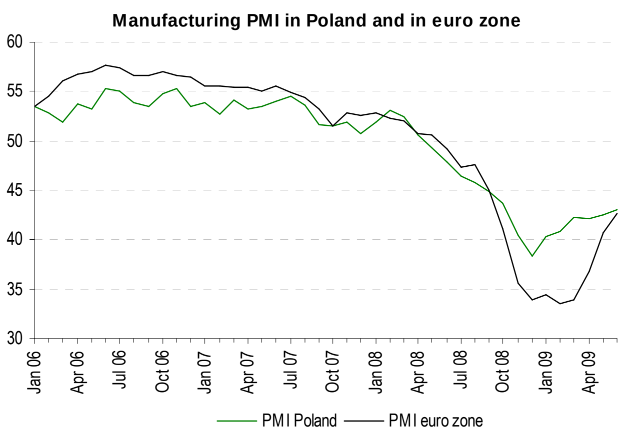
Source: FinMin, * F - forecast

- No important data releases were scheduled in Poland and few were planned abroad.
- The Ministry of Finance will try to place next portion of 52-week T-Bills and 5Y bonds. Taking into account quite good results from the last bond auction and positive moods in the debt market the FinMin should not have problems with selling the securities.
- On Tuesday the government will pass the 2009 budget amendment to Sejm. However, the most important changes in the budget were presented earlier, thus this event should not have big influence on the market.
- Abroad the G8 was scheduled for this week starting on Monday. Bank of England will make decision on interest rates. In the US we will know the data about economic activity in the services sector and preliminary index on consumer sentiment.

Economy last week – Low FinMin's inflation forecast, small increase of PMI



- The FinMin's inflation forecast for June came in at 3.4% (0.1%MoM), below the lowest market forecasts. Our estimate, at the bottom of market forecasts' range, pointed to decline in CPI inflation from to 3.5% from 3.6%YoY in May. Market consensus showed no change in inflation from 3.6%YoY.
- According to the assumptions of the Ministry of Finance, the food and non-alcoholic beverages prices in June fell by 1.5%MoM, while the fuel prices rose more than 6%MoM. Our forecast was based on assumption of much lower fall in food prices and smaller increase in fuel prices.
- Marek Rozkrut from Ministry of Finance said that inflation may fall in July below 3% and stay below this level till the year-end. In our view, CPI inflation is going to decline below 3% in September. The pace of inflation decline may be an important factor for the next moves of the MPC.



- The manufacturing PMI index for Poland slightly rose from 42.5 in May to 43.0 in June versus market consensus 43.2 and our forecast 43.5. One should remember that the indicator still points to decline of activity in manufacturing.
- According to NBP's *Financial Stability Report* released last week the financial system in Poland will be able to absorb effects of slower economic growth without significant impact on its stability. Nevertheless, the report said that in Q1, despite lower risk for financial sector concerning worsening of interbank market liquidity, conditions of financial system functioning deteriorated. A risk for financial stability may be a deeper economic slowdown, which may lead to more significant drop in profitability of banks and stronger weakening of credit activity.

Quote of the week – Inflation will be crucial for the MPC decisions

Jan Czekaj, MPC member, TVN CNBC, 2 July
I would not rule out further interest rate cuts. We will see what will be the next data on production, GDP in Q2 and inflation. (...) Inflation will be crucial.

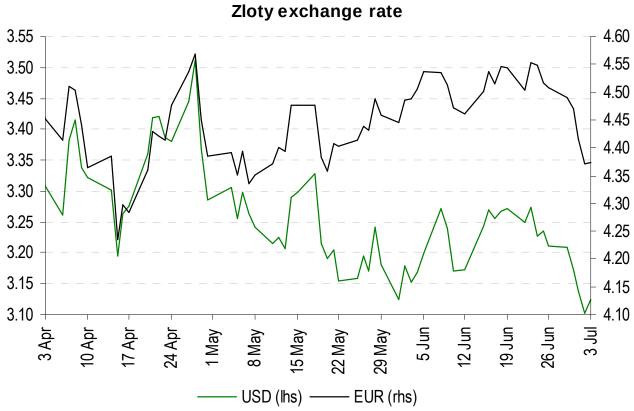
Mirosław Pietrewicz, MPC member, PAP, 1 July
Data for H1 will allow to answer the question whether further correction of interest rates is necessary or if they should remain unchanged. I do not rule out that the interest rates could stay unchanged at the current level.

Marian Noga, MPC member, Reuters, 3 July
There is no room for interest rate cuts this year.

Stanisław Nieckarz, MPC member, Bloomberg, PAP, 30 June
The moment of interest rate reduction will depend on the economic results, fiscal situation and better assessment of influence of previous interest rate cuts. Such assessment may be made only in September.

As we wrote earlier the scale and the pace of inflation decline in the coming months may be crucial for the MPC decision, which was suggested by the key swing voter in the Council Jan Czekaj. The dovish MPC members positively assessed the decline of consumer prices growth rate forecasted by the FinMin, though in our view it may be slightly too optimistic. Hawkish member of the Council Marian Noga was sceptic about the FinMin's estimate, who in contrast to the previous week, does not see room for interest rate reductions. According to the majority of the Council members better conditions for the assessment of the situation and of the need of further monetary policy easing will be after gating acquainted with full set of data for H1, which will be possible after Q2 data release at the end of August after MPC meeting.

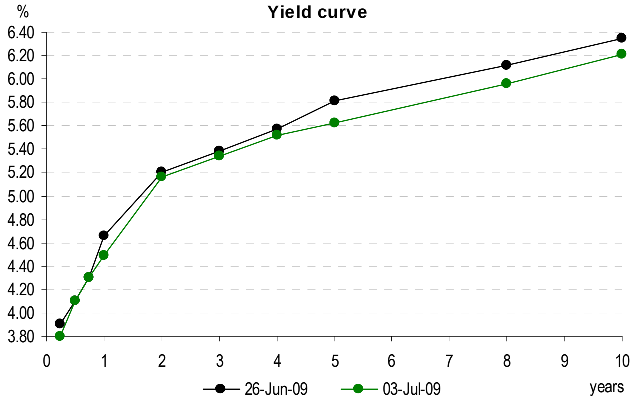
Market monitor



Zloty clearly appreciated

▪ After stabilisation in the first part of the past week, later on the zloty clearly appreciated, which was connected with improvement in moods on the global markets. EURPLN broke the support level of 4.40 indicated in our previous weekly report, fell to ca. 4.35 and stabilised around this level until the end of the week. Over the whole past week the zloty gained the strongest in the region, catching up for gains of the forint and the Czech crown in a month.

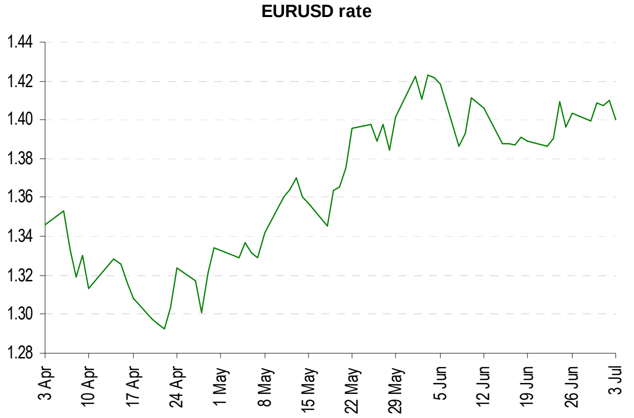
▪ Although weaker than expected labour market data from the US lowered risk appetite, we think that unless there is renewed negative newsflow from the region, e.g. from Latvia, the EURPLN may soon break a range of 4.32-4.33 and drop to 4.25. However, later on there may be a correction to resistance levels of 4.40 and 4.45.



Falling market interest rates

▪ Over the past week the Polish debt market was still under positive impact of information about no supply of long-term bonds in summer months. Additional favourable factors for local bonds were the zloty appreciation, low inflation forecast of the FinMin and successful auction of 2Y papers with sale worth PLN4bn. Over the whole week, the strongest gains were in 10Y segment. IRS curve also flattened somewhat and it lowered stronger than in case of bonds.

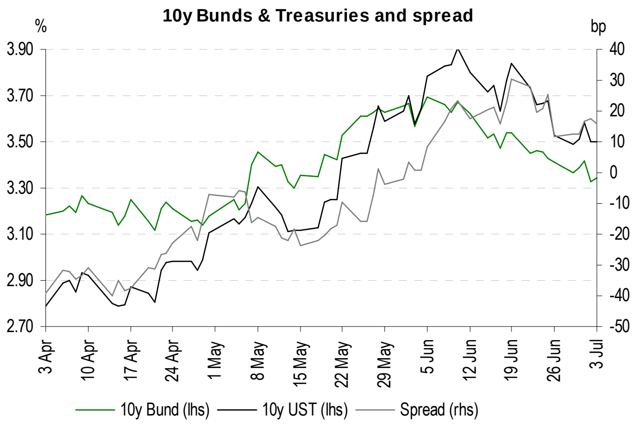
▪ This week the number of market-sensitive events is limited. In face of no major data releases domestically (the market waits for fresh CPI figures due on July 14) and abroad the key focus of attention will be auction of 5Y bonds locally and change in moods on the global markets.



EURUSD in tight range

▪ EURUSD was fluctuating in a narrow range last week and at the end of Friday's session it was at similar levels as a week earlier. The euro was appreciating at the beginning of the week, but then the dollar rebounded thanks to higher risk aversion after weak consumer confidence data in the US on Tuesday. Afterwards the euro strengthened again due to strong PMI from China. Then the dollar recovered following rise in risk aversion in reaction to weaker than expected the US non-farm payrolls report.

▪ There is a light data releases calendar this week. EURUSD may be influenced by the euro zone's revised GDP data for Q1 and among the US data by ISM services and Michigan index. Important factor for the EURUSD rate may be the G8 meeting. Q2 earnings reports to be released this week also may be important for risk appetite and for the EURUSD rate.



Slight fall in yields in the core debt markets

▪ Although lack of bond auctions in the US last week was supportive factor for Treasuries, their yields were stable in the first part of the week while Bunds gained. A weakening took place after the Chinese PMI, but the move was corrected following the weak US non-farm payrolls report. The ECB left rates unchanged and tone of comments from J.C. Trichet had little impact on the market. At the end of the week yields of 10Y Treasuries and Bunds fell to 3.50% and 3.33%, respectively, from 3.53% and 3.41% a week earlier.

▪ This week there will be next auction of bonds in the US. The core debt markets will be driven by the ISM services, the Michigan index and releases of earnings reports for Q2.

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