Bank Zachodni WBK

Weekly economic update

17 – 23 April 2006

Last week, the main focus of attention on the Polish financial market were CPI figures. They showed that the headline inflation rate fell to 0.4%YoY in March from 0.7%YoY in April. Recently, almost all MPC members declared lack of motivation for further rate cuts, and it will be interesting to see whether they will confirm such view after CPI figures proved much lower than expected again. We still predict that interest rates will remain unchanged until the end of this year. In the nearest week, a large dose of important statistics – labour market data, output figures and PPI figures – will be published. We predict labour market conditions firmed again in March which may be seen as a potential source of inflationary pressure in future. Output data should confirm that the economy gains strength and thus, likewise labour market data, would be an argument against further rate cuts. On the other hand, low PPI inflation may fuel hopes that the MPC has not done the whole job yet.

PiS and Samoobrona officially confirmed a coalition agreement, but still look for a third partner. Talks with potential candidates (PSL or LPR) will be conducted after Easter. PM Kazimierz Marcinkiewicz ensured he was not going to quit after the coalition is formed, and another news that dispels some market concerns is that Samoobrona has abandoned some of their costly proposals, like social minimum for all unemployed or introduction of turnover tax. However, entry of populist Samoobrona to the government pose some danger to macroeconomic policy in future.

FinMin is not going to place new foreign debt in near term, and also no FX sales on the market are likely, so the zloty should not expect any support from ministry's operations.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MAREKT	BZWBK	
		MONDAY (17 April)					
	POL	**Easter Monday**					
13:00	USA	Net capital flows (H)	Feb	$ bn	62.8	-	66.0
		TUESDAY (18 April)					
12:00	**POL**	**Wage (H)**	**Mar**	**%YoY**	**4.1**	**4.4**	**4.8**
12:00	**POL**	**Employment (H)**	**Mar**	**%YoY**	**2.5**	**2.4**	**2.4**
12:30	USA	Houses starts (H)	Mar	m	2.03	-	2.12
12:30	USA	Build permits (H)	Mar	m	2.1	-	2.179
12:30	USA	PPI (H)	Mar	%MoM	0.4	-	-1.4
19:00	USA	FOMC meeting (H)	Mar				
		WEDNESDAY (19 April)					
9:00	**POL**	**Auction of PLN2.0bn 5Y PS0511 bonds (H)**					
9:00	EMU	Industrial production (M)	Feb	%YoY	3.1	-	2.5
12:30	USA	CPI (H)	Mar	%MoM	0.4	-	0.1
		THURSDAY (20 April)					
12:00	**POL**	**PPI (H)**	**Mar**	**%YoY**	**0.4**	**0.3**	**0.7**
12:00	**POL**	**Industrial production (H)**	**Mar**	**%YoY**	**13.6**	**13.9**	**10.1**
9:00	EMU	Final HICP (H)	Mar	%YoY	2.2	-	2.3
		FRIDAY (21 April)					
9:00	EMU	Trade balance (M)	Feb	€ bn	-4.0	-	-10.8

* Importance level: (H)igh, (M)oderate; Source: Parkiet Reuters, BZ WBK

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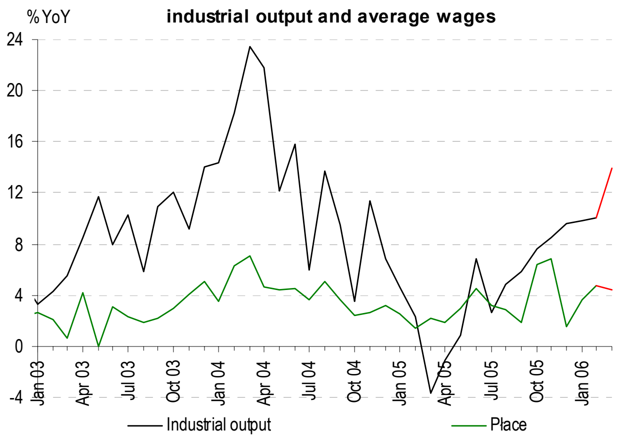
What's hot this week – Portion of fresh data



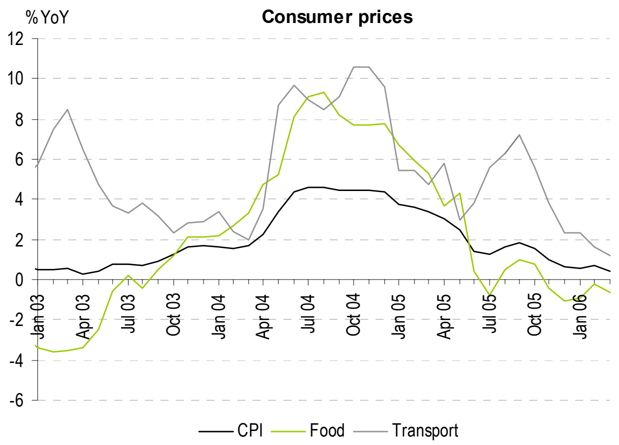
▪ After tasting of Easter specialties, participants of the Polish financial market will be able to fully mull over inflation data released last Friday. Besides, a portion of fresh data will be served.

▪ Already on the first day after holidays, the stats office will release data on average wage and employment in the enterprise sector, which are closely watched by the MPC in search of hints about medium-term inflation prospects.

▪ Another does of macro data will appear on Thursday in the form of output and PPI figures. They should confirm, likewise labour market data, that the economy gains strength and thus be an argument against further rate cuts.

▪ In the international markets, the main focus of attention will be data on net capital flows, inflation figures and the minutes of the FOMC meeting in March, the first one with Ben Bernanke at the helm.

Economy last week – Inflation fell again

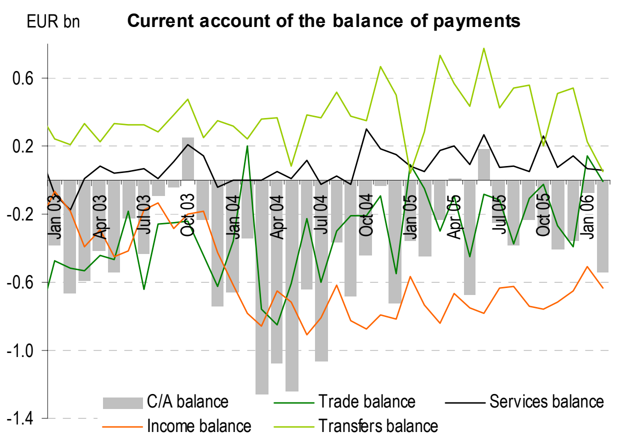


▪ CPI inflation in March was much lower than market expectations. Meanwhile, FinMin's predictions based on information about low food prices proved right and the headline inflation rate fell to a mere 0.4%YoY from 0.7% in February.

▪ The main reason for deceleration in price growth were low food prices. They fell by 0.2% on the month and their annual decrease deepened to 0.7%.

▪ However, these were not only food prices that were responsible for another fall in inflation and its continuously low level. Annual growth rate of almost all categories of prices declined in March. As a result, according to our estimates, net inflation fell to 0.7%YoY from 0.8% in February.

▪ We predict CPI inflation will fall further to 0.3%YoY in April and will not exceed 0.5% until October.



▪ Balance of payments statistics for February were quite good, despite disappointing headline figure. C/A deficit proved higher than expected, but this was a result of transitory low surplus on transfers account while other elements of C/A performed very well.

▪ Narrowing trade gap (a mere €8m in February) is a result of continued expansion of Polish exporters. What is important, exports rose at two-digit pace also in zlotys which shows that not only the volume of goods sold abroad is growing, but so are Polish entrepreneurs' proceeds from foreign trade. Imports growth was also decent, confirming that domestic demand is also an important component of GDP growth.

▪ Monetary statistics for March (M3 up 9.7%YoY, total deposits up 9.0%YoY and total loans up 13.5%YoY) also indicated the economy is gaining strength.

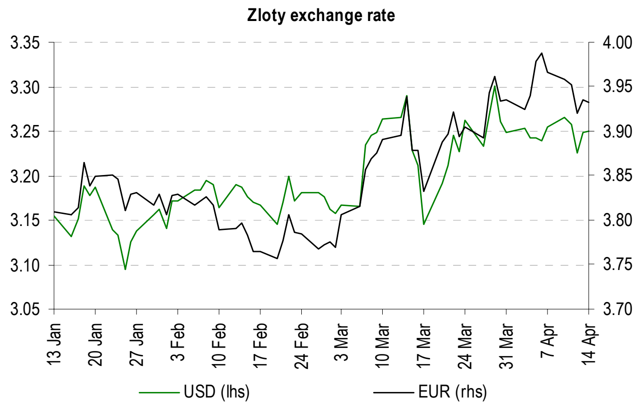
Quote of the week – Interest rate will be stable at least for a year

Stanisław Owsiak, MPC member
Reuters, 12 April

Taking into account of what is happening with rates in the euro zone and the United States, as well as our economic situation and its mid-term prospects, the room for a change in monetary policy parameters in the nearest term is small. It looks as if... interest rates will be stable, at least for a year.

Our conviction that interest rates in Poland are going to stay unchanged at least until the end of this year received more support last week, as MPC member representing "dove-ish" faction in the rate-setting panel, Stanisław Owsiak, declared he saw no need to change monetary policy stance, given current situation of the Polish economy and inflation prospects. Recently, almost all MPC members declared lack of motivation for further rate cuts. It will be interesting to see whether they will confirm such view, after CPI data for March showed another, deeper than expected, fall in inflation.

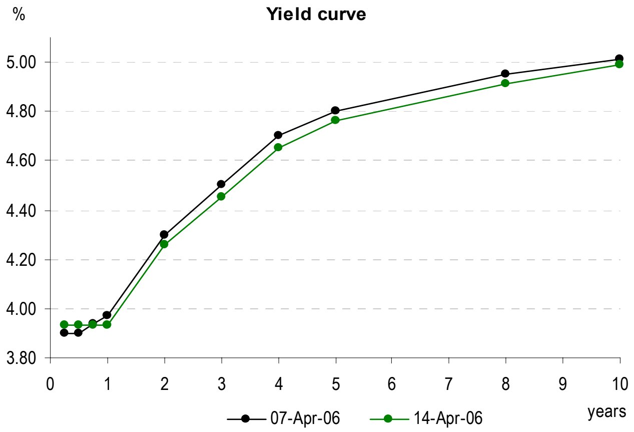
Market monitor



Correction in the weakening trend

▪ In the previous week investors felt the atmosphere of incoming Easter holiday and with low volatility and activity a correction started and zloty gradually appreciated, which went in line with new records on the Warsaw bourse. On Thursday there was a slight depreciation of the zloty, though it appeared to be temporary. The market virtually did not react to actions taken toward coalition agreement between PiS and Samoobrona. During the week EURPLN rate fell by 0,7% and USDPLN rate by 0,3%.

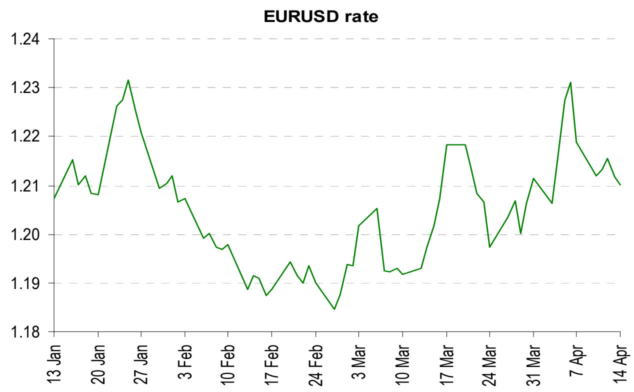
▪ After last weeks strengthening we assume, that zloty will return to depreciation trend. Politics may still have limited influence on Polish political stage, instead core yields will be more essential. In our opinion EURPLN rate will stay in 3.9-4.0 range, and USDPLN rate between 3.21 and 3.31.



Yields marginally lower; low CPI vs. higher core yields

▪ Bonds strengthened since the start of the week following mainly the Bund yields' drop and were driven by expectations of low CPI figure. As situation on the core bond markets reversed and yields rose substantially Polish market was negatively affected as well though eventually yields of Polish bonds at the end of the week were ca. 2-5 bp lower than on previous Friday supported by low CPI.

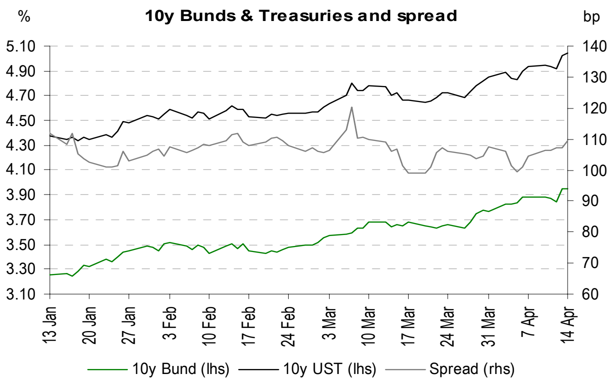
▪ At the beginning of the week market may experience full reaction to CPI data. Positive wages and employment data may contribute to a slight weakening, however the market may be supported by expectations of low PPI due next Friday. Taking into consideration the fact the small number of analysts expect further rat cuts, the core yields will still be important and may negatively affect the Polish market.



Stable EURUSD rate

▪ EURUSD rate was quite stable throughout the week and fluctuated in a quite tight range. The dollar strengthened after release of ZEW index and U.S. trade deficit data, although after some time the euro recovered the incurred losses. The end of the week was quite calm amid market holidays on many international markets. Last week relation of euro to the dollar remained flat near 1.21.

▪ In the next few days net capital flows data may be negative for the dollar, as they may show falling inflows and show another not covering the trade deficit. FOMC minutes, inflation data as well as Fed and ECB members, which determine the expectations toward target level of official interest rates in U.S. and the euro zone will be also important



Yields of 10Y Treasuries above 5%

▪ Core bonds strengthened at the beginning of the week after statements of Fed's central bankers. However after GDP positive trade deficit and retail sales data a strong weakening occurred. Since the pervious Friday 10Y yields rose from 4.98% above the psychological level 5% (to 5.05%), the highest level in more than four years, while 10Y Bund yields from 3.89% to 3.95%.

▪ Next week FOMC minutes, inflation CPI and PPI in U.S. as well as HICP in the euro zone will be crucial for the core bonds markets. Moreover data showing worsening situation on the housing market and in effect negatively affecting U.S. economic growth may be essential as well and may be supportive for U.S. government bonds.

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