Bank Zachodni WBK

Weekly economic update

22 – 28 May 2006

Last week, several MPC members, representing almost the whole spectrum of views within the rate-setting panel, suggested that current level of interest rates is adequate to prospects of the economy and should not be changed for considerable period. This shows there is wide consensus on the Council about no need for further monetary easing. On the other hand, apart from Halina Wasilewska-Trenkner no MPC member mentions a possibility of rate hikes in a foreseeable future. Such stance is not surprising given that inflation outlook remains favourable. These opinion is not altered by the fact that the headline inflation rate for April turned out to be higher than expected, as there are still no sign of significant underlying pressure on prices. PPI was also higher than predicted, but it showed no considerable price hikes in other goods than fuel and commodities. Meanwhile, output figures, although slightly weaker than market forecasts, showed that positive tendencies in real economy have been maintained. Upbeat picture of economic situation was also confirmed by balance of payments statistics which indicated continuation of rapid growth in exports with slightly lower, yet still decent rise in imports.

In the nearest week we will see another data on economic activity and price development in the Polish economy. Retail sales figures (high growth is forecasted) and data on unemployment (expectations of another fall) should confirm that the economy gains strength. Core inflation measures for April are anticipated to show some increase. All in all, the next week's set of data will not be supportive for the debt market and may bring mixed impact on the zloty. However, in face of in face of recent events in the international markets, it is very likely that developments on the Polish financial markets next week will be stronger affected by releases of key macro data in the US than by domestic data publications.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 May)					
9:00	**POL**	**Auction of PLN1.0bn 52-week T-bills (M)**					
		TUESDAY (23 May)					
12:00	**POL**	**Core inflation (H)**	**Apr**	**%YoY**	**1.0**	**1.0**	**0.7**
	POL	**Business climate (M)**	**Apr**				
		WEDNESDAY (24 May)					
8:00	**POL**	**Retail sales (H)**	**Apr**	**%YoY**	**14.5**	**14.4**	**10.1**
8:00	**POL**	**Unemployment rate (H)**	**Apr**	**%**	**17.2**	**17.2**	**17.8**
9:00	**POL**	**Switch tender (M)**					
8:00	GER	Ifo index (H)	May	pts	105.1	-	105.9
12:30	US	Factory orders (H)	Apr	%	-0.7	-	6.5
14:00	US	New home sales (H)	Apr	m	1.165	-	1.213
		THURSDAY (25 May)					
12:30	US	Preliminary GDP (H)	Q1	%	3.3	-	3.3
12:30	US	GDP deflator (H)	Q1	%	5.3	-	4.8
14:00	US	Home sales (H)	Apr	m	6.8	-	6.92
		FRIDAY (26 May)					
13:45	US	Final Michigan (H)	May	pts	84.5	-	87.4

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

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

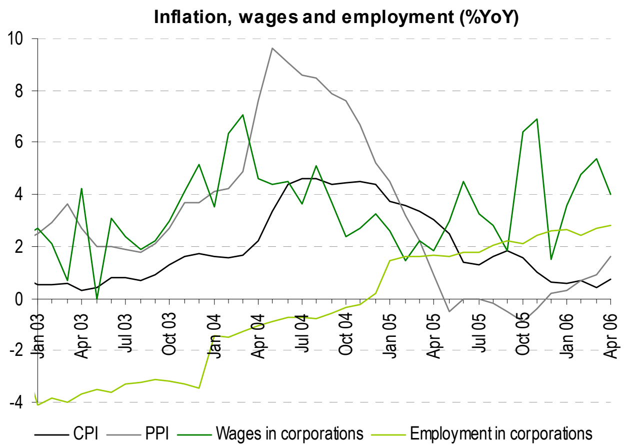
What's hot this week – Key figures abroad

▪ The nearest week will see the last set of macro data before the May meeting of the MPC that is scheduled on the last two days of the month.

▪ Retail sales figures should show a solid increase, and the unemployment probably again declined, which would confirm that the economy gains strength. Business climate indicators should also be quite optimistic. Meanwhile, according to our estimates, net inflation increased in April. All in all, the data set due in the nearest week will not be supportive for the debt market.

▪ However, in face of recent events in the international markets, it is very likely that developments on the Polish financial markets next week will be stronger affected by releases of key macro data in the US than by domestic data publications.

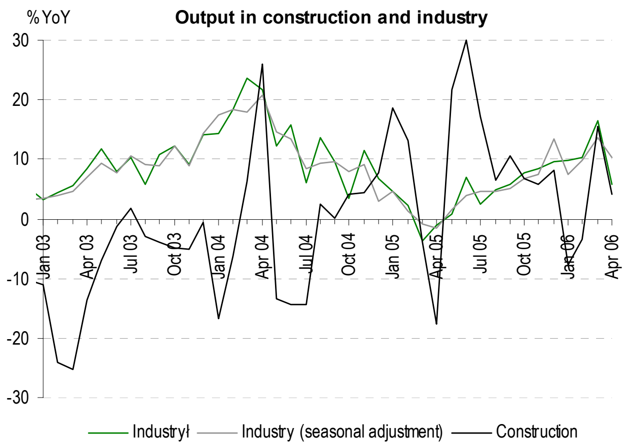
Economy last week – Higher economic activity and slightly higher inflation



▪ CPI data for April surprised on the upside, showing acceleration of the headline inflation rate to 0.7%YoY. However, this does not mean that fundamental inflationary pressure began to strengthen, because inflation in April was elevated by exogenous factors, i.e. high food and fuel prices and high energy costs Meanwhile, tendencies in other categories of prices were still favourable.

▪ Labour market statistics (weaker-than-expected wage growth of 4%YoY and record high employment rise of 2.8%YoY) suggest that pressure from labour market on prices is still not excessive, and at the same time allow to predict gradual acceleration in consumption growth.

▪ PPI growth in April accelerated to 1.6%YoY from 0.9%YoY in March, while stabilisation was expected, but it did not show signs of demand-side pressure on prices.



▪ Industrial output growth in April was 5.8%YoY and was close to our forecast of 4% that was the lowest on the market (market consensus was 9%). However, deceleration of output growth in April is not a signal of weakening in economic activity, yet only an effect of lower number of working days as compared to analogous period of last year. Seasonally adjusted growth in industrial output reach a healthy 10.2%YoY (the third best result since accession boom) shows that underlying trend remains strong.

▪ Balance of payments statistics for March showed continuation of positive trends in foreign trade (23%YoY surge in exports, 21.6%YoY rise in imports) and confirmed external position of the Polish economy is very good. 12-month cumulated C/A gap remained at 1.5% of GDP.

Quote of the week – No arguments for further rate cuts

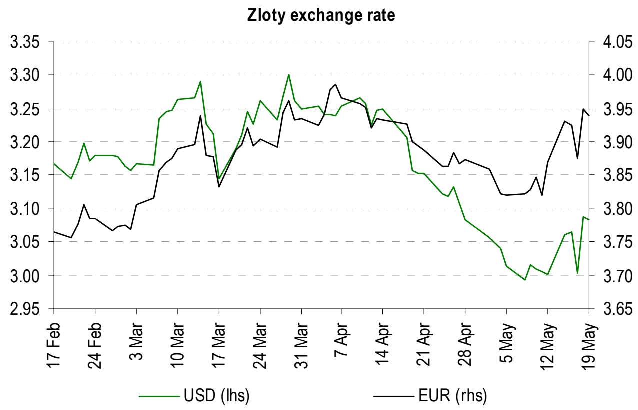
Andrzej Wojtyna, MPC member

PAP, 17 May

The lower inflation, or even deflation is necessarily an argument for rate cut. (…) Since the central bank should not react to short-term supply shocks on inflationary side, on deflationary side it should act only if there is risk that second-round effect will occur. (…) One should not use its ammunition, because what would happen, if GDP growth and inflation decreased suddenly?

In Andrzej Wojtyna's opinion, likewise in case of upward inflation disturbances, monetary policy should not react automatically to supply-side deflationary shocks, and adjustment in policy would be necessary only if there is a risk of negative second-round effects. Wojtyna's strong declaration that interest rates are likely to remain unchanged this year are a significant guide, suggesting that only clear deceleration in economic growth could make the MPC think about monetary easing again. This is consistent with our view on monetary policy prospects.

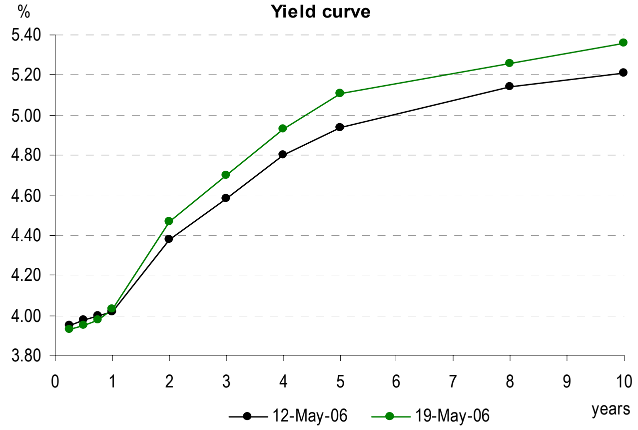
Market monitor



Retreat from emerging markets

▪ Since the start of the week zloty heavily depreciated with regards to the sell-off on the emerging markets, which was connected with high level of yields on the core markets and negative influence of the situation in Turkey. A correction and further weakening was connected with inflation data in U.S. and as compared to the previous Friday EURPLN rose by ca. 1.5% and USDPLN by 2.2%.

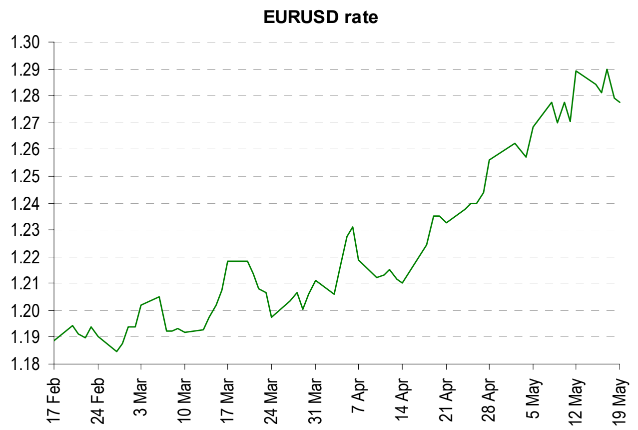
▪ Zloty will remain under influence of the abroad and together with other emerging currencies may react on the data released on the international markets influencing inflation fears and expectations on next rate decisions. On the domestic markets we do not notice factors, which could significantly affect the zloty rate. We assume that zloty is going to trade in range of 3.88-3.98 Against the euro and 3.03-3.13 against the dollar.



The foreign markets weaken Polish debt

▪ The sell-off on the emerging markets did not omit Polish money and fixed income market, which was supported by higher inflation fears (U.S. CPI) and increased expectations on monetary policy tightening in U.S. Another negative factor was higher than expected CPI and PPI, though at the end of the week lower yields on the core markets and output data supported Polish debt. During last week yields rose by 9-17 bp.

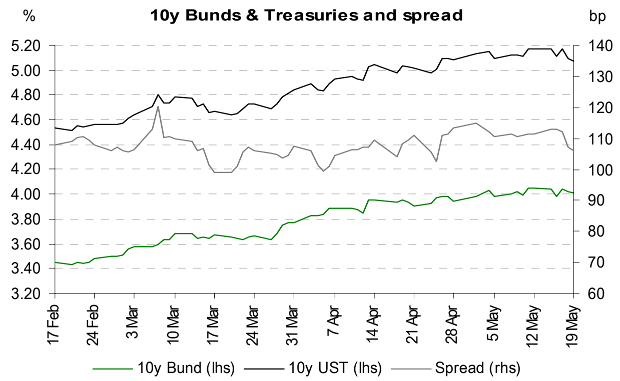
▪ In the coming week data released on the international markets and their influence on the yields on the core markets are going be the most important for the Polish market. Amid comments of the MPC members suggesting that interest rates are at the appropriate level, the retail sales data may be of slightly less importance, though after their release the market may slightly weaken.



Inflation pressures strengthen the dollar

▪ At the start of the week the dollar was strengthening against the euro and other emerging currencies due to profit taking and covering short positions in the dollar, which was supported by soft ZEW index. A correction came in after U.S. PPI and housing market data and the dollar gained again after higher than expected U.S. core CPI. Slight weakening resulted after labour market data. In the last week the EURUSD rate fell by ca. 1%.

▪ With regards to worsening sentiment to the dollar and expected pause in rate hikes in U.S. in our view the dollar may fell further against the euro, and any appreciation may be rather temporary. This week Ifo index, home sales and Q1 GDP data in United States will be the most essential figures and may show slight weakening as compared to the previous period.



High volatility and strengthening on the core markets

▪ U.S. Treasuries strengthened after lower than forecasted ZEW index, softer core PPI and housing market data, while a weakening came in after higher core CPI, though labour market data and Philadelphia Fed index including sign of economic activity worsening resulted in another strengthening. Yields of 10Y Treasuries fell from 5.16% to 5.06%, while Bunds from 4.05% to 3.99%.

▪ Ifo index is going to be essential after its main heralding index ZEW experienced a substantial fall. Data on new and existing home sales may support the signal on U.S. economy slowing down, while GDP for the first will be also important, with the main focus on the inflation components.

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