

Weekly economic update

12 – 18 June 2006

Last week there were important news in Poland for the domestic financial market. On Tuesday, the government finally approved proposals of tax changes presented by finance minister Zyta Gilowska a few months ago, but it has no impact on the market. First, the proposals are not revolutionary and they were known earlier. Second, nothing has changed as regards uncertainty whether the planned changes will actually be implemented. As some of the planned changes would be unpopular, this may be too much for Gilowska to pass them through the parliament. On Friday, rumours appeared that Gilowska was going to step down from finance minister's post, but they were immediately denied. However, one has to take into account the risk that along with further work on changes in public finance and the 2007 budget current finance minister will lose her temper.

The nearest week in Poland will be one working day shorter, but it will abound with major data releases. The key focus of attention will be on inflation figures. Market consensus (consistent with our forecast) points to slight increase in the inflation rate. This would confirm expectations of gradual inflation acceleration in subsequent months, but not strong enough so that induce the MPC to deliver a rate hike in a foreseeable future. The other data should also be consistent with a scenario of fast economic growth with moderate inflation acceleration.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (12 May)							
18:00	US	Fed budget (M)	Apr	\$ bn	-35.0	-	-35.42
TUESDAY (13 May)							
9:00	GER	ZEW (H)	Jun	pts	47.0	-	50.0
12:30	US	PPI (H)	May	%MoM	0.5	-	0.9
12:30	US	Retail sales (H)	May	%MoM	0.2	-	0.5
WEDNESDAY (14 May)							
9:00	POL	Auction of PLN1.5-2.5bn of 7Y floating rate notes and PLN500m of 12Y CPI linked bonds (H)					
12:00	POL	CPI (H)	May	%YoY	0.8	0.8	0.7
12:00	POL	Balance of payment (M)	May	€ bn	-247	-50	-458
12:00	POL	Money supply (M)	May	%YoY	8.8	8.2	9.6
12:30	US	CPI (H)	May	%MoM	0.3	-	0.6
THURSDAY (15 June)							
	POL	Public holiday					
9:00	EMU	Final HICP (H)	May	%YoY	2.5	-	2.4
13:00	US	Capital net flows (H)	Apr	\$ bn	72.5	-	69.8
13:15	US	Capacity utilization (H)	May	%	82.0	-	81.9
13:15	US	Industrial production (H)	May	%MoM	0.3	-	0.8
16:00	US	Philadelphia Fed index (H)	Jun	pts	12.0	-	14.4
12:30	US	New jobless claims (H)					
FRIDAY (16 June)							
9:00	US	Industrial production (H)	May	%MoM	3.2	-	3.8
13:45	US	Preliminary Michigan (H)	Jun	pts	79.5	-	79.2

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

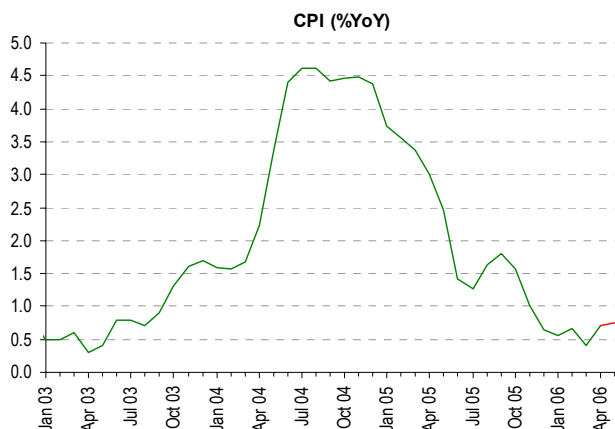
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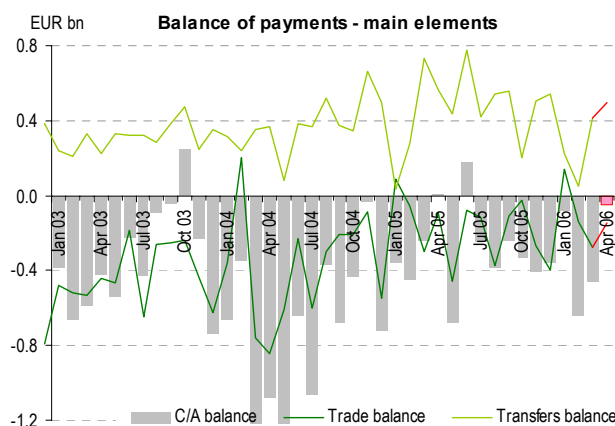
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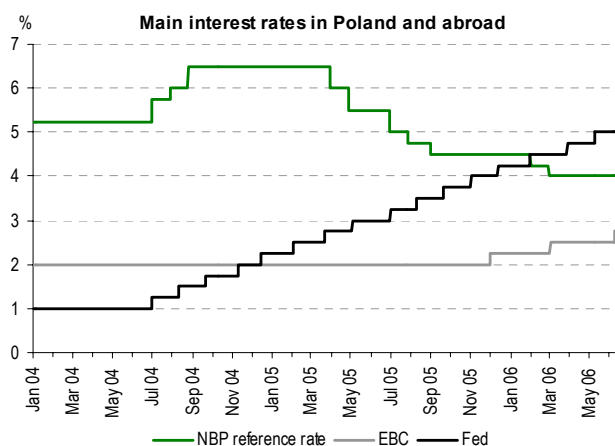
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What's hot this week – Shorter, but busy week

- The nearest week in Poland will be one working day shorter due to holiday on Thursday. As many market participants is likely to go away for the long week, one may expect that market activity on Friday will be limited.
- The Central Statistical Office will be working shortly before the long weekend and on Wednesday at 14:00 local time it will release inflation data. At the same time, the National Bank of Poland will publish monetary statistics for May and balance of payments figures for April.
- We predict inflation slightly increased to 0.8%YoY in May, while FinMin - which had very accurate inflation estimates for previous months - predicts a rise to 0.9%YoY. Anyway, the data should confirm there is no more room for interest rate cuts, as inflation started to accelerate moderately.



- Monetary statistics will not be impressive at first glance, but money growth on a scale predicted by us would be consistent with continuation of strong economic expansion on the one hand and lack of concerns about monetary pressure on prices on the other hand.
- According to our forecasts, balance of payments statistics for April should confirm very good external position of the Polish economy, including continuation of robust exports growth. Persistently good balance of payments position and strong exports is a factor supporting the domestic currency. However, we forecast that imports growth was also strong. This would confirm that domestic demand is gaining strength, but at the same time it would indicate that net exports' contribution to GDP growth will be less favourable in the remainder of this year.

Economy last week – Markets under strong influence of interest rate expectations

- Last week there were no data releases in Poland. As regards other news, one should note that the government finally approved proposals of changes in tax system proposed a few months ago by finance ministry. However, market participants wait whether the changes (and it what shape) will be accepted by the parliament.
- There are already first signals that approval of all the proposed measures by MPs may be difficult. This reminds of the risk connected with possible resignation of Zyta Gilowska from finance minister's post.
- With lack of important domestic events, participants of the Polish market closely watched developments on international markets. Major FX markets and core bond markets abroad were under influence of hawkish comments from Fed officials and ECB decision to raise interest rate "only" by 25 bp while some expected 50 bp.

Quote of the week – No need for the MPC to react

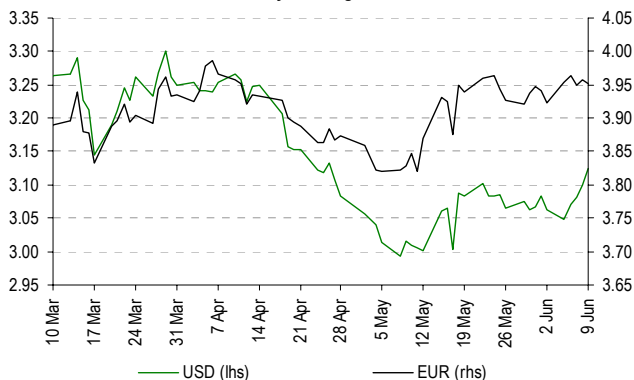
Jan Czekaj, MPC member; Reuters, 6 June

Generally, the Polish economy is outstandingly balanced, both internally and externally. We have very good balance of payments position and good budget performance. The fundamentals are good. (...) Today there are no threats to the economy that would require a reaction from monetary policy. It is too early to talk about rate increases this year, although it must be remembered that the MPC tries to look into the future.

Jan Czekaj is another MPC member who suggested that there is no need to change monetary policy parameters in Poland in a foreseeable time. Czekaj's comments confirm our opinion that there is wide consensus within the MPC that interest rate are at adequate level, given predicted economic situation and medium-term inflation outlook. It seems that according to vast majority of rate-setters there are no strong arguments so that expect swift beginning of monetary policy tightening cycle in Poland.

Market monitor

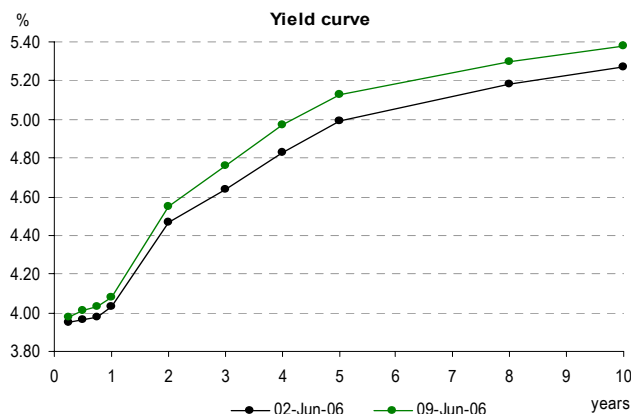
Zloty exchange rate



Zloty trades in a narrow range

- In the past week zloty traded in a quite tight range. Initially it depreciated on the fall of Turkish lira and a stalemate results of elections in Czech Republic. Later on the activity and moves were limited ahead of ECB's meeting, however eventually it had no special impact on the value of Polish currency against the euro. During the week zloty depreciated against the euro by ca. 0.7%, and by ca. 3.1% against the dollar.
- As well as in the past period Polish currency is going to be under strong influence of the abroad, most of all inflation data and rate hikes expectations in U.S., which may deteriorate the sentiment toward the emerging markets. In our view the zloty may fluctuate against the euro in range 3.9-4.0 and versus the dollar between 3.07 and 3.17.

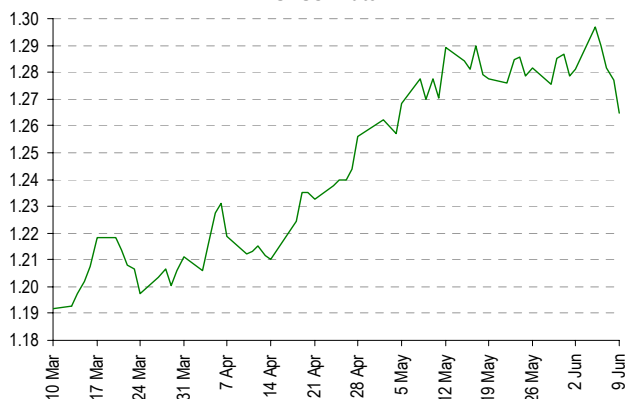
Yield curve



Slight bonds slide

- On the domestic fixed income market there was a slight weakening and yield curve steepened, as yields rose since previous Friday by ca. 8-14 bp. The weakening on the emerging markets had some negative effect on the Polish market, though it was balanced by the yields drop on the core markets.
- Confirmation of the increased inflation pressure in the United States may contribute to a weakening in the Polish market, which is going to be determined by several key domestic economic data releases, especially CPI inflation. Data including signs on the dynamic of U.S. economy i.e. retail sales and industrial production as well as Philadelphia Fed index may be important.

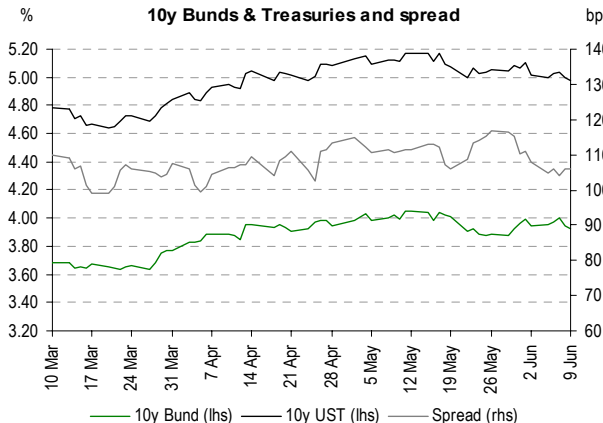
EURUSD rate



EURUSD falls on ECB and Bernanke

- In the first part of the week the dollar was supported by the Fed central bankers statements on inflation, while investors expected the ECB's meeting. Central bank raised main interest rate by 25 bp, though the tone of its communiqué was a bit more dovish as it did not include suggestions on further steps in euro zone's monetary policy. This caused euro drop to the nearest level for over a month. In the past week the euro fell by ca. 2.2%.
- After the ECB's meeting, the expectations on further rate hikes by Fed, which determine the core PPI and CPI in U.S., may be the key data for the EURUSD rate. Net capital flows data may be also important as well as other data confirming the U.S. economic slowdown. ZEW index is going to be important for the euro zone as well.

10y Bunds & Treasuries and spread



EBC and Bernanke – key factors

- Bonds on the core markets were negatively influenced by Ben Bernanke and William Poole on inflation. After the ECB's decision and the communiqué there was a correction on the German market, while U.S. bonds were supported by the funds flows from the falling stocks to "safe haven" bonds. Yields of 10Y Treasuries declined from 5.03% to 5.0% (reaching the minimum at 4.97%) while 10Y German Bunds stayed near ca. 3.95%.
- Core CPI and PPI indices, excluding most volatile food and energy prices, will be decisive factors for the yields of Treasuries and expectations toward next Fed's step in the monetary policy tightening cycle. Bunds yields may be influenced by the ZEW index, which experienced significant fall in the previous month.

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